
Municipal Securities
Rulemaking Board

**January 1, 2004**

The rules contained in this Rule Book were in effect as of the above date.
The most up-to-date version of the Board's rules is posted on the Board's web site at www.msrb.org.

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# HISTORY AND ORGANIZATION OF THE MSRB

## Creation of the Board

Prior to the enactment of the Securities Act Amendments of 1975, the activities of brokers and dealers in municipal securities were substantially unregulated. Dealers engaged solely in the municipal securities business were not required to be registered with the Securities and Exchange Commission ("SEC"). While the general anti-fraud provisions of the federal securities laws applied to transactions in municipal securities, the municipal securities activities of dealers were not subject to a system of regulation focusing specifically on the municipal market.

Historically, investment in municipal securities was concentrated in institutions deemed capable of protecting their own interests. However, by the 1970's, with increased personal income pushing more people into higher income tax brackets, many individual investors, lacking the financial sophistication of institutional investors, were (and still are) participating in the municipal markets. In the early 1970's, several fraud actions were brought by the SEC against municipal securities professionals alleging improper and unethical trading and selling practices.[1] These factors led Congress to conclude that there was an increased need for investor protection through a system of preventative regulation.

These developments were of concern to the overwhelming majority of reputable securities firms and banks in the municipal securities industry; as much as to the Congress and the SEC. Industry representatives worked closely with the Congress and the SEC to develop appropriate legislation that would take into account the unique needs of the municipal markets and the market participants — banks, securities firms and the general public. As a product of the 1975 Amendments to the Securities Exchange Act, Congress required dealers engaging in municipal securities transactions to be registered with the SEC and established the Board as the self-regulatory organization charged with the primary rulemaking authority for the municipal securities activities of dealers.[2]

The Board was formally established on September 5, 1975, by the SEC's appointment of the 15 member board. Board members are equally divided among securities firm representatives, bank representatives and public representatives. Of the five public representatives, at least one must represent municipal securities issuers (*i.e.*, state and local governments) and one must represent municipal securities investors. New Board members are chosen by the Board pursuant to procedures set forth in Board rules. Board members serve staggered three-year terms. Five new Board members are elected each year. Strict rules require that no Board member may succeed him or herself in office, nor may a broker-dealer or bank representative be succeeded by a person associated with that person's firm. The public representatives are subject to prior SEC approval.

## Operating Procedures and Finances

The Board's administrative rules provide for a chairman and a vice chairman, elected by the members for a one-year term. The Board has established standing committees on administration and nominations. Ad hoc committees have focused on such areas as syndicate practices and uniform practice matters.

The Board is assisted by a full-time staff. In addition, groups of industry representatives meet regularly to evaluate and modify the Board's professional qualifications examinations for municipal securities personnel.

As a self-regulatory organization, the Board is not financed by the federal government, but solely by the municipal securities industry. The Board's operations are supported by fees and assessments paid by securities firms and bank dealers engaged in the municipal securities business, including an initial and annual fee for all municipal securities dealers registered with the SEC, an assessment based on the volume of new issue underwriting in which a securities firm or bank dealer participates and an assessment based on municipal securities transactions.

## Rulemaking Authority Process

The Securities Exchange Act sets forth certain areas appropriate for the Board's rulemaking. These enumerated areas include rules to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect investors and the public interest. Under the Securities Exchange Act, the Board is specifically prohibited from requiring issuers of municipal securities directly or indirectly to furnish information to the Board or investors; provided, however, that the Board may require dealers to furnish the Board or investors documents with respect to the issuer which generally are available from a source other than the issuer (*e.g.*, official statements).

The Board's rulemaking procedures involve several steps. In order to provide the maximum opportunity for industry participation, the Board generally issues rulemaking proposals in exposure draft form and provides for a public comment period. Substantive comments on rule proposals received as a result of these procedures have had an important impact on the Board's deliberations and frequently result in modifications in the rules as originally drafted.

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[1] In the report on the Securities and Exchange Act amendments, the Senate Committee on Banking, Housing and Urban Affairs described the practices as involving "all of the characteristics of the classic 'boiler room' operation."

[2] *See* Securities and Exchange Act, 15 U.S.C. Section 78a, et seq. and S. Rept. No. 94-75 74th Cong., 1st Sess. 46-49.

Upon adoption by the Board in final form, rule proposals are filed with the SEC, with copies provided to the federal bank regulatory agencies for their official review. Among matters the Board is required to address in rule filings are the terms and the purpose of the proposed rules, the statutory basis for their adoption, an analysis of the comments received, and the statutory justification for any anticipated burden on competition the rule proposals might impose.

The Securities Exchange Act generally requires SEC publication of the proposal in the *Federal Register* and a public comment period. Upon SEC approval, Board rules have the force and effect of federal law.[3]

The Board's rules are enforced by the National Association of Securities Dealers, Inc. (for securities firms), bank regulatory agencies (the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation) for bank dealers, and the SEC for all brokers, dealers and municipal securities dealers. Although the Board does not have inspection or enforcement powers, an important aspect of its rulemaking activities involves the on-going interpretation of its rules. This is done by means of interpretive letters and notices. The Board also closely coordinates with the organizations charged with enforcement of the Board's rules concerning the meaning and proper application of the rules.

[3] The Board's rules ordinarily are subject to approval by the SEC prior to becoming effective. Exceptions include rules relating solely to the administration of the Board and assessments. These become effective upon filing with the SEC but may thereafter be rescinded by the SEC within 60 days if the SEC finds cause to do so.

# MUNICIPAL SECURITIES RULEMAKING BOARD

## *Officers*

2003-2004

WILLIAM J. JESTER, JR.
*Chairman*

J. BEN WATKINS, III
*Vice Chairman*

## *Members*

### Bank Representatives

| | |
|---|---|
| PATRICE DeCORREVONT, *Institutional Sales Manager*<br>Banc One Capital Markets, Inc. | Chicago, Illinois |
| WILLIAM J. JESTER, JR., *Managing Director, Manager, Municipal Bond Department*<br>UBS Financial Services Inc. | New York, New York |
| MICHAEL SMALE, *Senior Vice President*<br>ABN AMRO Financial Services Inc. | Chicago, Illinois |
| PHILLIP D. SMITH, *Managing Director*<br>Bank of America Securities LLC | Charlotte, North Carolina |
| MICHAEL J. WILK, *Senior Managing Director, Capital Markets*<br>Comercia Securities | Detroit, Michigan |

### Public Representatives

| | |
|---|---|
| JANICE D. DAVIS, *Secretary of Financial Oversight, Director of Finance*<br>City of Philadelphia | Philadelphia, Pennsylvania |
| THOMAS G. DOE, *President*<br>Municipal Market Advisors/Cutler Investment Corp. | Concord, Massachusetts |
| THOMAS J. FETTER, *Vice President/Director of Municipal Investments*<br>Eaton Vance Management | Boston, Massachusetts |
| IAN A. MACKINNON, *Retired as Managing Director of the Fixed Income Group*<br>*The Vanguard Group of Investment Companies* | Coatesville, Pennsylvania |
| J. BEN WATKINS, III, *Director*<br>State of Florida, Division of Bond Finance | Tallahassee, Florida |

### Securities Firm Representatives

| | |
|---|---|
| AMELIA A.J. BOND, *Senior Vice President, Director of Public Finance Department*<br>A.G. Edwards & Sons, Inc. | Dallas, Texas |
| KENNETH D. GIBBS, *Senior Vice Pesident and Director of Public Finance*<br>First Albany Corporation | New York, New York |
| FRANCIS J. INGRASSIA, *Managing Director*<br>Goldman, Sachs & Co. | New York, New York |
| STEVEN MILANO, *Managing Director and Manger Syndicate Desk*<br>Lehman Brothers | New York, New York |
| KENNETH E. WILLIAMS, *President and Chief Executive Officer*<br>Stone & Youngberg | San Francisco, California |

## PROFESSIONAL STAFF

CHRISTOPHER A. TAYLOR
*Executive Director*

**Rulemaking/Policy Development**
DIANE G. KLINKE, *General Counsel*
HAROLD L. JOHNSON, *Deputy General Counsel*
P. JOHN BAUGHMAN, *Senior Data Analyst and Supervisor*
JILL C. FINDER, *Assistant General Counsel*
ERNESTO A. LANZA, *Senior Associate General Counsel*
LARRY M. LAWRENCE, *Policy and Technology Advisor*
JUSTIN R. PICA, *Uniform Practice Specialist*
RONALD W. SMITH, *Senior Legal Associate*
CAROLYN WALSH, *Associate General Counsel*

**Municipal Securities Information Library System**
THOMAS A. HUTTON, *Director*
LYDIA HODGSON, *Manager*
FRANCES BERRY, *Supervisor*
TRACEY TROTTER, *Supervisor*

**Professional Qualifications**
LORETTA JONES, *Director*
ANDREW STRAIT, *Professional Qualifications Administrator*

**Accounting**
MELANIE S. RICHARDSON, *Comptroller*

## ORGANIZATIONS WITH INSPECTION AND ENFORCEMENT AUTHORITY FOR BOARD RULES

Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549
*www.sec.gov*

NASD
1735 K Street N.W.
Washington, D.C. 20006
Attn: Member Regulation
Fixed Income Securities Group
*www.nasd.com*

Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429
Attn: Securities, Capital Markets and Trusts
*www.fdic.gov*

Federal Reserve System
20th and C Streets N.W.
Washington, D.C. 20551
Attn: Market and Liquidity Risks
Division of Banking Supervision and Regulation
*www.bog.frb.fed.us*

Office of the Comptroller of the Currency
250 E Street S.W.
Washington, D.C. 20219
Attn: Treasury and Market Risk
*www.occ.treas.gov*

## ADMINISTRATIVE RULES

### Rule A-1: Rules of the Board

The rules of the Board shall be classified as administrative rules, definitional rules and general rules, respectively. Administrative rules shall pertain to the operation and administration of the Board and shall be identified by the prefix "A". Definitional rules shall define terms used in the rules of the Board and shall be identified by the prefix "D". General rules shall pertain to all other matters within the scope of the Board's authority and shall be identified by the prefix "G".

### Rule A-2: Powers of the Board

Subject to the provisions of the Act and the rules and regulations of the Commission thereunder, the Board shall have the power to determine all matters relating to the operation and administration of the Board and to exercise all other rights and powers granted by the Act to the Board.

### Rule A-3: Membership on the Board

(a) *Number and Representation.* The Board shall consist of 15 members, at all times equally divided among the following groups:

(i) *Public Representatives.* Individuals who are not associated with any broker, dealer, or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling, any broker or dealer which is not a broker, dealer or municipal securities dealer that effects municipal securities transactions), at least one of whom shall be representative of investors in municipal securities, and at least one of whom shall be representative of issuers of municipal securities;

(ii) *Broker-Dealer Representatives.* Individuals who are associated with and representative of brokers, dealers and municipal securities dealers which are not banks or subsidiaries or departments or divisions of banks;

(iii) *Bank Representatives.* Individuals who are associated with and representative of municipal securities dealers which are banks or subsidiaries or departments or divisions of banks.

(b) *Increase or Decrease in Number.* The total number of members of the Board may be increased or decreased from time to time by rule of the Board, but in no event shall the total number of members of the Board be less than 15. Any such increase or decrease shall be in multiples of six so that the total number of members of the Board shall always be an odd number, equally divided among the three groups of representatives enumerated in section (a) of this rule.

(c) *Nomination and Election of Members.*

(i) Members shall be nominated and elected in accordance with the procedures specified by this rule. All members of the Board shall be elected for terms of three years, so that the terms of office of one-third of the whole Board shall expire each year. The terms of office of all members of the Board shall commence on October 1 of the year in which elected and shall terminate on September 30 of the year in which their terms expire. No member of the Board may succeed himself or herself in office and no broker-dealer representative or bank representative may be succeeded in office by any person associated with the broker, dealer or municipal securities dealer with which such member was associated at the expiration of such member's term.

(ii) The Board will appoint a Nominating Committee composed of nine members. The membership of the Nominating Committee shall consist of six Board members and three persons who are not members of the Board. Of the six Board members, two shall be bank representatives, two shall be broker-dealer representatives, and two shall be public representatives. Of the three non-Board members, one shall be associated with and representative of bank dealers, one shall be associated with and representative of brokers, dealers, and municipal securities dealers other than bank dealers, and one shall not be associated with any broker, dealer, or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling any broker or dealer which is not a broker, dealer or municipal securities dealer that effects municipal securities transactions). In appointing persons to serve on the Nominating Committee, factors to be considered include the need to achieve broad geographic representation on such Committee, as well as diversity in the size and type of brokers, dealers and municipal securities dealers represented on such Committee.

(iii) The Nominating Committee shall publish a notice in a financial journal having general national circulation among members of the municipal securities industry soliciting nominations for the positions on the Board to be filled in such year. The notice shall require that recommendations be accompanied by a statement of the position for which the person is recommended, the background and qualifications for membership on the Board of the person recommended and information concerning such person's association with any broker, dealer, or municipal securities dealer. The Nominating Committee shall accept recommendations pursuant to such notice for a period of at least 30 days. Any interested member of the public, whether or not associated with a broker, dealer, or municipal securities dealer, may submit recommendations to the Nominating Committee. The names of all persons recommended to the Nominating Com-

mittee shall be made available to the public upon request.

(iv) The Nominating Committee shall nominate one person for each of the Board positions to be filled and shall submit the nominees to the Board for approval. In making such nominations, the Nominating Committee shall take into consideration such factors as the need to maintain broad geographic representation on the Board, as well as diversity in the size and type of brokers, dealers, and municipal securities dealers represented. Each nomination shall be accompanied by a statement indicating the position for which such person is nominated, the nominee's qualifications to serve as a member of the Board, and information concerning the nominee's association with any broker, dealer, or municipal securities dealer. The names of the nominees will be confidential.

(v) The Board shall accept or reject each nominee submitted by the Nominating Committee. In the event that the Board rejects a nominee, the Nominating Committee will propose another nominee for Board consideration.

(vi) The public representatives on the Board will, prior to their assumption of office, be subject to approval by the Commission to assure that no one of them is associated with any broker, dealer or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling, any broker or dealer which is not a broker, dealer or municipal securities dealer that effects municipal securities transactions) and that at least one of the public representatives of the Board is representative of investors in municipal securities and at least one is representative of issuers of municipal securities.

(vii) Upon completion of the procedures for nomination and election of new Board members, the Board will announce the names of the new members not later than October 1 of each year.

(d) *Resignation and Removal of Members*. A member may resign from the Board by submitting a written notice of resignation to the Chairman of the Board which shall specify the effective date of such member's resignation. In no event shall such date be more than 30 days from the date of delivery of such notice to the Chairman. If no date is specified, the resignation shall become effective immediately upon its delivery to the Chairman. In the event the Board shall find that any member has willfully violated any provision of the Act, any rule or regulation of the Commission thereunder, or any rule of the Board or has abused his or her authority or has otherwise acted, or failed to act, so as to affect adversely the public interest or the best interests of the Board, the Board may, upon the affirmative vote of two-thirds of the whole Board (which shall include the affirmative vote of at least one public representative, one broker-dealer representative and one bank representative), remove such member from office.

(e) *Vacancies*. Vacancies on the Board shall be filled by vote of the members of the Board, subject to the Commission's power of approval referred to in section (c) of this rule with respect to public representatives. Any person so elected to fill a vacancy shall serve for the term, or any unexpired portion of the term, for which such person's predecessor was elected. For purposes of this rule, the term "vacancies on the Board" shall include any vacancy resulting from the resignation of any person duly elected to the Board prior to the commencement of his or her term.

(f) *Compensation and Expenses*. Members shall be entitled to an allowance for transportation expenses, to the extent provided by resolution of the Board, from their home to the site of a meeting of the Board and from the site of such meeting to their home, together with a per diem to be set by the Board for those days or fraction thereof on which they attend Board meetings or participate in other designated activities. Members of the Board shall also be entitled to reimbursement for actual and necessary expenses incurred by them in connection with any other official business of the Board. Except as provided in section (c) of rule A-6, no member of the Board shall be entitled to receive any other compensation from the Board.

***BACKGROUND***

Rule A-3 relates to the nomination and election of new Board members. Of the 15 initial members of the Board appointed by the Commission, five members left office in September 1977, five in 1978 and the remaining five in 1979. The Board annually appoints a Nominating Committee composed of six Board members and three persons from the municipal securities industry and the public who are not Board members, to assist in the selection of the new Board members to take office in October. The Nominating Committee solicits recommendations for nominees to the Board and nominates one person for each position to be filled. The Board then accepts or rejects the nominees from the slate submitted by the Nominating Committee. In the event a nominee is rejected, the Nominating Committee must hold a meeting to choose another nominee.

## Rule A-4: Meetings of the Board

(a) *Meetings*. Regular meetings of the Board shall be held at least quarterly and at such time and place as from time to time determined by resolution of the Board or provided by rule of the Board. Special meetings of the Board shall be called by the Secretary to the Board at the request of the Chairman of the Board or at the written request of not less than three members, which request shall in each case specify the purpose or purposes of the meeting. At special meetings, the Board shall consider only those specific matters for which the meeting was called, unless all members consent either at the meet-

ing or in writing before or after the meeting to the consideration of other matters.

(b) *Notice of Meetings.* Notice of the time and place of special meetings of the Board shall be mailed to each member, at such member's address appearing in the records of the Board, not later than the seventh calendar day preceding the date on which the meeting is to be held, or by telephone, e-mail or personal delivery not later than the third calendar day preceding the date on which the meeting is to be held. Written notice of special meetings of the Board shall be signed by the Secretary to the Board. Notice of a special meeting shall also set forth the purpose or purposes of the meeting and the name or names of the person or persons at whose request the meeting is being called. Notice of a special meeting need not be given to any member who submits a signed waiver of notice before or after the meeting, or who attends the meeting without protesting, prior thereto or at the commencement thereof, the lack of notice to such member. No notice of regular meetings of the Board shall be required.

(c) *Quorum and Voting Requirements.* A quorum of the Board shall consist of two-thirds of the whole Board (at least one of whom shall be a public representative, one a broker-dealer representative and one a bank representative), and any action taken by the affirmative vote of a majority of the whole Board at any meeting at which a quorum is present shall, except as otherwise provided by rule of the Board, constitute the action of the Board. Unless otherwise specified by the Act or by rule of the Board, action by the Board may be by resolution. Resolutions of the Board shall take effect immediately, unless a different effective date shall be specified therein.

(d) *Action Without a Meeting.* Action by the Board may be taken without a meeting by written consent of the Board setting forth the action so taken or by telephone or e-mail poll of all members of the Board, provided that, in the case of action taken by telephone or e-mail poll, the Board, at a meeting, or the chairman of the Board authorizes the action to be taken by such means. The Executive Director shall transmit to each Board member, as soon as practicable after a telephone or e-mail poll is taken, a written statement setting forth the question or questions with respect to which the telephone or e-mail poll was taken and the results of the telephone or e-mail poll. Such statement shall also be entered in the minutes of the next Board meeting. In the case of action taken without a meeting by written consent, telephone or e-mail poll, an affirmative vote of a majority of the whole Board is required.

## Rule A-5: Officers and Employees of the Board

(a) *Officers of the Board.* The officers of the Board shall consist of a Chairman and a Vice Chairman, and such other officers as the Board may deem necessary or appropriate. The Chairman shall preside at meetings of the Board. During the absence or inability to act of the Chairman, or while the office of Chairman is vacant, the Vice Chairman shall be vested with all of the powers and shall perform all of the duties of the Chairman. In the event of the absence of both the Chairman and Vice Chairman at any meeting of the Board, the Board may designate one of the members present as acting Chairman for the purpose of presiding at such meeting. The officers of the Board shall have such other powers and perform such other duties as the Board may determine by resolution.

(b) *Election of Officers of the Board.* Officers of the Board shall be elected annually from among the members, by secret, written ballot of the members, at a meeting of the Board held prior to October 1 of each year according to procedures adopted by the Board. Officers shall serve for a term commencing on the October 1 next following their election and ending with the succeeding September 30; *provided, however,* that any officer may resign his or her office prior to the expiration of his or her term by filing a written notice of resignation with the Secretary to the Board which shall specify the effective date of such resignation. In no event shall such date be less than 10 days or more than 30 days from the date of filing of such notice. If no date is specified, the resignation shall become effective 10 days from the date of filing. The Board may remove any officer at any time by two-thirds vote of the whole Board. Vacancies in office shall be filled as soon as practicable by vote of the members and any person elected to fill a vacancy shall serve only for the remainder of his or her predecessor's term.

(c) *Executive and Administrative Staff.* The staff of the Board shall consist of an Executive Director, a General Counsel, a Secretary to the Board, a Treasurer to the Board, and such other personnel as the Board shall deem necessary or appropriate. The duties and responsibilities of the Executive Director shall be as prescribed by the Board. The duties and responsibilities of all other staff shall be as prescribed by the Executive Director.

(d) *Attorneys, Consultants and Others.* The Board may retain such attorneys, consultants and other independent contractors as the Board may deem necessary or appropriate.

## Rule A-6: Committees of the Board

(a) *Establishment.* The Board may establish one or more standing or special committees, each to have and exercise such powers and authority as may be provided by the Board in the resolution establishing such committee; *provided, however,* that no such committee shall have the authority to exercise any of the powers and authority specifically conferred upon the Board by the Act or by rule of the Board. In all such matters, the role of any such committee shall be solely advisory. The Chairman of the Board shall be an *ex officio* member of each such committee.

(b) *Procedure.* The Board shall, by resolution, establish rules of procedure for each committee appointed by the Board, to the extent deemed necessary or appropriate by the Board. To the extent not so provided by the Board, each committee may determine its own rules of procedure.

(c) Members of a standing or special committee of the Board shall be entitled to a per diem allowance to be set by the Board for those days or fraction thereof on which such committee meets, subject, however, to the approval of the Chairman of the Board with respect to each such meeting.

## Rule A-7: Assessments

The Board shall, by rule, provide for the costs and expenses of its operation and administration by levying such fees and charges on brokers, dealers and municipal securities dealers as may be determined necessary or appropriate by the Board.

## Rule A-8: Rulemaking Procedures

(a) *Adoption of Proposed Rules and Submission to Commission.* The Board shall adopt such proposed rules as the Board shall deem necessary or appropriate to effect the purposes of the Act with respect to transactions in municipal securities effected by brokers, dealers and municipal securities dealers, including, as a minimum, proposed rules relating to those matters prescribed in section 15B(b)(2)(A) through (K) of the Act. Upon their adoption by the Board, the Board shall submit proposed rules to the Commission in accordance with the procedures set forth in section 19(b) of the Act and shall file such proposed rules with the appropriate regulatory agencies in accordance with the provisions of section 17(c) of the Act. A proposed rule of the Board shall become a rule of the Board upon its approval by the Commission, pursuant to section 19(b)(2) of the Act, or upon filing with the Commission in accordance with the provisions of section 19(b)(3)(A) of the Act, or upon the determination of the Commission in accordance with the provisions of section 19(b)(3)(B) of the Act. Documents required to be submitted to the Commission in connection with the proposed rules of the Board shall be signed on behalf of the Board by the Chairman or Secretary of the Board, or by any person designated by the Board for that purpose by resolution.

(b) *Advisory Opinions and Interpretations.* The Board may from time to time render or cause to be rendered advisory opinions and interpretations of rules of the Board at the request of any interested person. Such opinions and interpretations shall represent the Board's intent in adopting the rules which are the subject of such opinions and interpretations.

(c) *Procedures.* The Board may from time to time prescribe and amend procedures relating to the administration of Board rules. Such procedures and amendments may be approved by the Board pursuant to rule A-4(d).

Each broker, dealer and municipal securities dealer shall be subject to such procedures and amendments thereto in the same manner as the broker, dealer and municipal securities dealer is subject to the rules of the Board.

Procedures and amendments thereto shall become effective no earlier than 10 business days after publication of such procedures and amendments.

(d) *Access to Board Rules and Other Action.* The Board shall establish procedures designed to provide access by all interested persons to rules of the Board and other official Board action, and otherwise to keep all interested persons informed and advised of all such rules and action.

## Rule A-9: Fiscal Year

The fiscal year of the Board shall commence on October 1 of each year and end on September 30 of the following year.

## Rule A-10: Independent Audit

The books and records of the Board shall be audited annually by independent certified public accountants selected by the Board, who shall certify the results of their audit to the Board not later than 90 days following the close of each fiscal year of the Board.

## Rule A-11: Indemnification of Members, Employees and Arbitrators

Each member and employee of the Board and each arbitrator selected by the Board under Rule G-35 shall be indemnified and held harmless against all liabilities and related expenses incurred in connection with the performance of his or her official duties, provided that such member, employee or arbitrator has acted, or omitted to act, in good faith and within the scope of his or her authority.

## Rule A-12: Initial Fee

Prior to effecting any transaction in or inducing or attempting to induce the purchase or sale of any municipal security, a broker, dealer, or municipal securities dealer shall pay to the Board an initial fee of $100, accompanied by a written statement setting forth the name, address and Securities and Exchange Commission registration number of the broker, dealer, or municipal securities dealer on whose behalf such fee is paid. The Commission registration number shall also be set forth on

the face of the remittance. Such fee shall be payable at the offices of the Board. In the event any person subject to this rule shall fail to pay the required fee, the Board may recommend to the Commission that the registration of such person with the Commission be suspended or revoked.

## *Interpretive Letters*

**Extent of municipal securities activities.** You inquire whether your firm is subject to the initial fee imposed by rule A-12 of the Municipal Securities Rulemaking Board ("MSRB"). In that letter, you argue that the fee would constitute a substantial portion of the income of the [company name omitted.] from the sale of a municipal securities and that firms with a low volume of business should not be required to pay this fee.

The MSRB was established by the Securities Acts Amendments of 1975 as the primary rulemaking authority with respect to the activities of municipal securities brokers and dealers and transactions in municipal securities. All municipal securities brokers and dealers, regardless of the volume of their municipal securities business, are subject to the rules promulgated by the MSRB.

MSRB rule A-12 provides for an initial assessment upon all municipal securities brokers and dealers to defray a portion of the MSRB's costs and expenses. In approving this rule, the Commission determined that such an assessment does not impose an undue burden and is consistent with the statutory requirement that the MSRB be self-funding. Thus, we can find no reason to recommend that the Commission exempt the Company from the provisions of MSRB rule A-12. *SEC interpretation of January 6, 1977.*

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**Extent of municipal securities activities.** We have received a copy of your letter of December 17, 1976, addressed to the Municipal Securities Rulemaking Board ("MSRB"), in which you question the applicability of MSRB Rule A-12 to [name of company omitted], a registered broker-dealer which, in 1976, engaged in occasional municipal securities transactions involving securities which totaled under $12,000 in face amount.

The MSRB was established by the Securities Acts Amendments of 1975 (the "Amendments") as the primary rulemaking authority with respect to the activities of municipal securities brokers and dealers and with respect to transactions in municipal securities. All municipal securities brokers and dealers, regardless of whether they were registered broker-dealers prior to the Amendments and regardless of the volume of their municipal securities business, are subject to the rules promulgated by the MSRB.

MSRB Rule A-12 provides for a single, initial assessment of $100 upon all municipal securities brokers and dealers to defray a portion of the MSRB's costs and expenses in carrying out its Congressionally mandated function of devising a system of rules and regulations applicable to all municipal securities professionals. The bulk of those costs and expenses are currently defrayed by revenues from fees assessed pursuant to Rule A-13 which applies to underwriters of municipal securities.

In approving MSRB Rule A-12, the Commission determined that such an assessment does not impose an undue burden and is consistent with the statutory requirement that the MSRB be self-funding. Therefore, we would not recommend that the Commission consider exempting [name of company omitted] from the provisions of MSRB Rule A-12. *SEC interpretation of January 4, 1977.*

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**Previously registered entities.** Thank you for your letter [name and date deleted] which has been referred to me for response. The letter relates to the Municipal Securities Rulemaking Board's rule A-12, which imposes an initial fee of $100 on municipal securities brokers and municipal securities dealers.

We note that the terms "municipal securities broker" and "municipal securities dealer" are not restricted under the Securities Acts Amendments of 1975 (the "1975 Amendments") to securities firms and banks effecting transactions exclusively in municipal securities. Many municipal securities brokers and municipal securities dealers (other than bank dealers) were registered with the Securities and Exchange Commission (the "Commission") as brokers or dealers prior to the 1975 Amendments. Municipal securities brokers and municipal securities dealers already registered with the Commission were not required to re-register with respect to their municipal securities activities, but nevertheless are subject to payment of the Board's initial fee. In addition, many municipal securities brokers and municipal securities dealers have been and are members of the national securities exchanges and the National Association of Securities Dealers, Inc.

We are unable to conclude from the information set forth in your letter that the initial fee imposed by the Board's rule A-12 is inapplicable to your firm. *MSRB interpretation of June 16, 1976.*

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**Introducing broker.** We are in receipt of your letter dated March 23, 1976, concerning the Municipal Securities Rulemaking Board's initial fee of $100 payable by municipal securities brokers and municipal securities dealers.

We note that the term "broker" as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (the "Act") is not restricted to securities firms that directly effect transactions for the account of others. Rule 15c3-1(a)(2) of the Securities and Exchange Commission, which establishes the ... minimum net capital requirement applicable to brokers that generally do not carry customer accounts, necessarily assumes that the introduction and forwarding of transactions and accounts "to another broker or dealer" is itself the performance of a brokerage function. The definition of the term "municipal securities broker" set forth in section 3(a)(31) of the Act incorporates the statutory definition of "broker" and therefore appears similarly not restricted to firms directly effecting transactions in municipal securities for the account of others.

Pursuant to rule D-1 of the Board, which incorporates the definitions of terms used in the Act for purposes of the Board's rules, the term "municipal securities broker" as used in rule A-12 has the same meaning as set forth in section 3(a)(31) of the Act. Accordingly, we are unable to conclude from the information set forth in your letter that the fee imposed by rule A-12 is inapplicable to your firm. *MSRB interpretation of April 2, 1976.*

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**Introducing broker.** Thank you for your letter [name and date deleted] which has been referred to me for response. Your letter relates to the Municipal Securities Rulemaking Board's rule A-12, which imposes an initial fee of $100 on municipal securities brokers and municipal securities dealers. More particularly, you question whether an introducing broker with respect to municipal securities transactions is a "municipal securities broker" subject to the Board's rule A-12.

We note that the term "broker" as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (the "Act") is not restricted to securities firms that directly effect transactions in securities for the account of others. We call your attention to various rules of the Securities and Exchange Commission governing the activities of "brokers" and "dealers" that recognize introducing brokers as "brokers" under the Act. *See, e.g.*, rules 15c3-1(a)(2), 15c3-3(k)(2). The definition of the term "municipal securities broker" set forth in section 3(a)(31) of the Act incorporates the statutory definition of "broker" and therefore appears similarly not limited to firms

directly effecting transactions in municipal securities for the account of others.

With respect to the portion of your business that relates to transactions in municipal securities, we note that the term "municipal securities broker" is not limited under the Act to brokers effecting transactions exclusively in municipal securities. Such transactions need not constitute a principal part of a municipal securities broker's business. Pursuant to rule D-1 of the Board, which incorporates the definition of terms used in the Act for purposes of the Board's rules, the term "municipal securities broker" as used in rule A-12 has the same meaning as set forth in section 3(a)(31) of the Act. Accordingly, we are unable to conclude from the information set forth in your letter that the fee imposed by rule A-12 is inapplicable to your situation.

You may wish, however, to consult the staff of the Securities and Exchange Commission with respect to your status. If we may be of any further assistance to you, please do not hesitate to contact us. *MSRB interpretation of June 11, 1976.*

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**Affiliated entities.** Thank you for your letter [name and date deleted] which has been referred to me for response. The letter relates to the Municipal Securities Rulemaking Board's rule A-12, which imposes an initial fee of $100 on municipal securities brokers and municipal securities dealers.

Your letter indicates that you acquired the firm of [firm's name deleted.] which is registered with the Securities and Exchange Commission as a broker-dealer, as of April 1, 1976. The acquired firm, which is now called [firm's name deleted] is a wholly-owned subsidiary of your firm.

We note that the Securities Exchange Act of 1934 (the "Act") defines the terms "municipal securities broker" and "municipal securities dealer" by reference to the types of activities engaged in by a "person," rather than by reference to the affiliation or ownership of the "person." Under section 3(a)(9) of the Act, parent and subsidiary corporations are considered to be separate "persons." Accordingly, we are unable to conclude from the information set forth in your letter that the initial fee imposed by the Board's rule A-12 is inapplicable to [the acquired firm] because of your ownership of that firm.

We should point out, however, that the applicability of the initial fee depends upon the nature of [the acquired firm's] activities. If [the acquired firm] was a municipal securities broker or municipal securities dealer prior to its acquisition by you, the initial fee would be payable in accordance with rule A-12 regardless of the nature of [the acquired firm's] present securities activities. Of course, the initial fee would also be payable if [the acquired firm] is presently acting as a municipal securities broker or municipal securities dealer. As your letter does not discuss the activities of [the acquired firm] prior to or after its acquisition by you, we are unable to conclude that the Board's initial fee is inapplicable. *MSRB interpretation of June 11, 1976.*

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See also:

**Rule A-14 Interpretive Letters – Fully disclosed broker,** *MSRB interpretation of April 4, 1978.*

**– Extent and type of municipal securities activities,** *MSRB interpretation of May 3, 1978.*

**– Registered municipal securities dealer,** *MSRB interpretation of June 11, 1981.*

**Rule G-3 Interpretive Letter – Municipal securities principal: MSRB registered dealer,** *MSRB interpretation of March 30, 1994.*

## Rule A-13: Underwriting and Transaction Assessments for Brokers, Dealers and Municipal Securities Dealers

(a) *Underwriting Assessments–Scope.* Each broker, dealer and municipal securities dealer shall pay to the Board an underwriting fee as set forth in section (b) for all municipal securities purchased from an issuer by or through such broker, dealer or municipal securities dealer, whether acting as principal or agent, as part of a primary offering, provided that section (b) of this rule shall not apply to a primary offering of securities if all such securities in the primary offering:

(i) have an aggregate par value less than $1,000,000;

(ii) have a final stated maturity of nine months or less;

(iii) at the option of the holder thereof, may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent;

(iv) have authorized denominations of $100,000 or more and are sold to no more than thirty-five persons each of whom the broker, dealer or municipal securities dealer reasonably believes: (A) has the knowledge and experience necessary to evaluate the merits and risks of the investment; and (B) is not purchasing for more than one account, with a view toward distributing the securities; or

(v) constitute municipal fund securities.

If a syndicate or similar account has been formed for the purchase of the securities, the underwriting fee shall be paid by the managing underwriter on behalf of each participant in the syndicate or similar account.

(b) *Underwriting Assessments–Amount.* For those primary offerings subject to assessment under section (a) above, the amount of the underwriting fee is:

(i) for primary offerings in which all securities offered have a final stated maturity less than two years, .001% ($.01 per $1,000) of the par value;

(ii) for primary offerings in which all securities offered, at the option of the holder thereof, may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every two years until maturity earlier redemption, or purchase by an issuer or its designated agent, .001% ($.01 per $1,000) of the par value; and

(iii) for all other primary offerings subject to this rule, .003% ($.03 per $1,000) of the par value.

(c) *Transaction Assessments.*

(i) Inter-Dealer Sales. Each broker, dealer and municipal securities dealer shall pay to the Board a fee equal to .0005% ($.005 per $1,000) of the total par value of inter-dealer municipal securities sales that it reports to the Board under rule G-14(b), except as provided in section (iii) of this paragraph (c). For those inter-dealer transactions reported to the Board by a broker, dealer or municipal securities dealer on behalf of another broker, dealer or municipal securities dealer, the inter-dealer transaction fee shall be paid by the broker, dealer or municipal securities dealer that reported the transaction to the Board. Such broker, dealer, or municipal securities dealer may then collect the inter-dealer transaction fee from the broker, dealer or municipal securities dealer on whose behalf the transaction was reported.

(ii) Customer Sales. Each broker, dealer and municipal securities dealer shall pay to the Board a fee equal to .0005% ($.005 per $1,000) of the total par value of sales to customers that it reports to the Board under rule G-14(b), except as provided in section (iii) of this paragraph (c). The customer transaction fee shall be paid by the broker, dealer or municipal securities dealer that effected the sale to the customer.

(iii) Transactions Not Subject to Fee. Transaction fees are not assessed on transactions in municipal securities that:

(a) have a final stated maturity of nine months or less; or

(b) at the time of trade, may be tendered at the option of the holder to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent.

(d) *Billing Procedure.* The Board periodically will invoice brokers, dealers and municipal securities dealers for payment of underwriting and transaction fees. The underwriting and transaction fees must be paid within 30 days of the sending of the invoice by the Board.

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

(f) *Definitions.* For purposes of this rule, the term "primary offering" shall mean an offering of municipal securities directly or indirectly by or on behalf of the issuer of such securities, including any remarketing of such securities directly by or on behalf of the issuer of such securities.

## MSRB INTERPRETATIONS

### INTERPRETIVE NOTICE ON UNDERWRITING ASSESSMENT

April 7, 1976

The Municipal Securities Rulemaking Board (the "Board") has received several requests for interpretation of rule A-13, which requires each municipal securities broker and municipal securities dealer to pay the Board a fee [on] ... the face amount of municipal securities purchased from an issuer as part of a new issue. These requests concern the applicability of the fee to securities which have a stated maturity of [nine months or less] ..., but are part of a new issue having a final stated maturity of [more than nine months].

Rule A-13 is intended to impose the ... underwriting assessment on the face amount of all securities purchased from an issuer that are part of a new issue of municipal securities if any part of the issue has a final stated maturity of [more than nine months] ... from the date of the securities. Thus, calculation of the fee should be based upon all municipal securities which are part of such new issue, including securities having a stated maturity of [nine months or less] .... The assessment is not intended to apply, however, to short-term issues having a final maturity of [nine months or less].

**NOTE: Revised to reflect subsequent amendments.**

### *Interpretive Letters*

**Underwriting assessment: intrastate underwriting.** This will acknowledge receipt of your letter dated March 3, 1978 requesting that [Company name deleted.] be granted an exemption from rule A-13 of the Municipal Securities Rulemaking Board (the "Board"). Rule A-13 requires municipal securities brokers and municipal securities dealers to pay a fee to the Board based on their municipal securities underwriting activity. In your letter, you suggest that "the Company" should not be subject to the underwriting assessment imposed by the rule because it engages only in intrastate sales of municipal securities "to registered broker-dealers or institutional investors."

As a technical matter, although the Board has the authority to interpret its rules and to amend them through prescribed statutory procedures, the Board does not have the authority to grant exemptions from the rules. The authority to grant exemptions is vested in the Securities and Exchange Commission by section 15B(a)(4) of the Securities Exchange Act of 1934, as amended (the "Act").

In considering whether "the Company" should request an exemption from the Commission, the following information concerning rule A-13 may be helpful. The purpose of rule A-13 is to provide a reasonable and equitable means of defraying the costs and expenses of operating and administering the Board, as contemplated by section 15B(b)(2)(J) of the Act. The rule applies to all municipal securities dealers, with respect to their municipal securities underwriting activities, and covers situations in which new issue municipal securities are sold by or through a municipal securities professional to other securities professionals and institutional customers, as well as to individuals.

With respect to the intrastate character of "the Company's" underwriting activity, we note that certain provisions of the Securities Acts Amendments of 1975 (Pub. L. 94-29) had the effect of including within the scope of municipal securities dealer regulation the intrastate activities of municipal securities dealers. (*See* sections 3(a)(17), 15(a)(1) and 15B(a)(1) of the Act.) Rule A-13 makes no distinction between interstate and intrastate offerings. *MSRB interpretation of March 27, 1978.*

**Underwriting assessment: application to private placements.** This is in response to your request for a clarification of the application of Board rule A-13, concerning the underwriting assessment for municipal securities brokers and municipal securities dealers, to private placements of municipal securities.

Rule A-13 imposes an assessment fee on the underwriting of new issue municipal securities as an equitable means of defraying the costs and expenses of operating the Board. The assessment fee applies to new issue municipal securities which are "... purchased from an issuer by or through [a] municipal securities broker, or municipal securities dealer, whether acting as principal or agent." The Board has consistently interpreted the rule as requiring payment of the assessment fee where a municipal securities dealer acting as agent for the issuer arranges the direct placement of new issue municipal securities with institutional customers or individuals. In such cases it can be said that the securities are purchased from an issuer "through" the municipal securities dealer.

Of course, a municipal securities dealer who serves in an advisory role to an issuer on such matters as the structure or timing of a new issue, but who plays no part in arranging a private placement of the securities, would not be required to pay the assessment fee prescribed by rule A-13. *MSRB interpretation of February 22, 1982.*

## Rule A-14: Annual Fee

In addition to any other fees prescribed by the rules of the Board, each broker, dealer and municipal securities dealer shall pay an annual fee to the Board of $300, with respect to each fiscal year of the Board in which the broker, dealer or municipal securities dealer conducts municipal securities activities. Such fee must be received at the office of the Board no later than October 31 of the fiscal year for which the fee is paid, accompanied by the invoice sent to the broker, dealer or municipal securities dealer by the Board, or a written statement setting forth the name, address and Commission registration number of the broker, dealer or municipal securities dealer on whose behalf the fee is paid.

### *Interpretive Letters*

**Registered municipal securities dealer.** Your letter dated February 11, 1981 has been referred to me for response.

In your letter you state that [the firm] "has had no transactions in municipal securities since a trade on September 13, 1979." You note that according to rule A-14 of the Board relating to annual fees, a fee ... is payable for each fiscal year in which the municipal securities broker or municipal securities dealer conducts business. You conclude that "[s]ince we did not conduct any business during the last fiscal year (10/1/79-9/30/80) it would appear that [the firm] should be entitled to a refund" for the fiscal year ending October, 1980, and should not be liable for payment of the annual fee for the fiscal year ending October, 1981.

The purpose of the annual fee imposed by rule A-14 is to defray the costs of the Board's communications with those firms which are qualified to do a municipal securities business. There is no threshold level of municipal securities business which triggers liability for payment of the annual fee. Rather, the fee is imposed on all brokers and dealers who are registered as municipal securities brokers with the S.E.C. Since [the firm] is registered as a municipal securities dealer, it is liable for payment of the annual fee imposed by rule A-14 for the fiscal year ending October 1981.

If your firm no longer intends to do a municipal securities business, rule A-15 of the Board provides a procedure for withdrawal from registration as a municipal securities dealer. Withdrawal from registration would, of course, enable your firm to avoid paying annual fees to the Board. However, at such time as your firm resumes any municipal securities business, it would be required to pay the initial and annual fees imposed by rules A-12 and A-14, respectively. *MSRB interpretation of June 11, 1981.*

**Fully disclosed broker.** I refer to your letter of March 24, 1978 in which you request a determination concerning whether as a broker who passes all of his business through a dealer on a fully disclosed basis you are subject to the Municipal Securities Rulemaking Board's rules A-12 and A-14 which impose an initial and annual fee on municipal securities brokers and municipal securities dealer.

I note that the term "broker" as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (the "Act") is not restricted to securities firms that directly effect transactions in securities for the account of others. I call your attention to various rules of the Securities and Exchange Commission governing the activities of "brokers" and "dealers" that recognize introducing brokers as "brokers" under the Act. *See e.g.*, rules 15c3-1(a)(2) and 15c3-3(k)(2). The definition of the term "municipal securities broker" set forth in section 3(a)(31) of the Act incorporates the statutory definition of "broker" and therefore appears similarly not limited to firms directly effecting transactions in municipal securities for the account of others.

Pursuant to rule D-1 of the Board, which incorporates the definition of terms used in the Act for purposes of the Board's rules, the term "municipal securities broker" as used in rules A-12 and A-14 has the same meaning as set forth in section 3(a)(31) of the Act.

Accordingly, we are unable to conclude that the fees imposed by the Board are inapplicable to your situation. *MSRB interpretation of April 4, 1978.*

**Extent and type of municipal securities activities.** Your letter dated March 23, 1978 concerning compliance with the Municipal Securities Rulemaking Board's requirements has been referred to me for response.

The Municipal Securities Rulemaking Board was established by the Securities Acts Amendments of 1975 as the primary rulemaking authority with respect to the activities of municipal securities brokers and dealers and with respect to transactions in municipal securities. The Board's rules apply to each municipal securities broker and municipal securities dealer within the meaning of sections 3(a)(31) and 3(a)(30), respectively, of the Securities Exchange Act of 1934, as amended (the "Act"), and all municipal securities brokers and dealers regardless of the volume of their municipal securities business, are subject to the rules promulgated by the Board insofar as transactions in municipal securities are concerned, whether such transactions are solicited or unsolicited.

Under section 15B(b)(2)(J) of the Act, the Board is directed to prescribe fees and charges payable by each municipal securities dealer and municipal securities broker to defray the costs and expenses of operating the Board. Pursuant to this authority, the Board adopted rules A-12 and A-14 which impose an

initial fee and an annual fee on each municipal securities broker and municipal securities dealer. A copy of these rules are enclosed.

In approving MSRB rules A-12 and A-14, the Securities and Exchange Commission determined that these assessments are consistent with the statutory requirement that the MSRB be self-funding. We therefore request that you comply with these rules and forward your checks to us promptly. *MSRB interpretation of May 3, 1978.*

See also:

**Rule G-3 Interpretive Letter – Municipal securities principal: MSRB registered dealer,** *MSRB interpretation of March 30, 1994.*

## Rule A-15: Notification to Board of Termination of Municipal Securities Activities and Change of Name or Address

(a) *Procedure for Notifying Board of Termination.* A broker, dealer, or municipal securities dealer that ceases to be engaged in municipal securities activities must promptly notify the Board of such broker's, dealer's or municipal securities dealer's change of status by filing with the Board a written statement setting forth such broker's, dealer's or municipal securities dealer's name, address and Commission registration number and the fact that such broker, dealer or municipal securities dealer is no longer engaging in municipal securities activities.

(b) *Obligation to Pay Fees.* A broker, dealer, or municipal securities dealer that files notification with the Board pursuant to section (a) of this rule shall be obligated to pay the fees owed to the Board at the time of filing of such notification.

(c) *Notification of Name or Address Change.* Each broker, dealer or municipal securities dealer which has followed the procedure set forth in Board rule A-12 shall notify the Board promptly of any changes to the information required by rule A-12.

### *Interpretive Letter*

See:

**Rule G-3 Interpretive Letter – Municipal securities principal: MSRB registered dealer,** *MSRB interpretation of March 30, 1994.*

## Rule A-16: **Reserved**

## Rule A-17: Confidentiality of Examination Reports

Any report of an examination or of information extracted from a report of an examination ("examination report") of a broker, dealer and municipal securities dealer furnished to the Board by the Securities and Exchange Commission pursuant to section 15(B)(c)(7)(B) of the Act and rule 15Bc7-1 thereunder shall be maintained and utilized in accordance with the following terms and conditions, in order to ensure the confidentiality of any information contained in such reports:

(1) Any such examination report shall be reviewed only by authorized members of the Board's staff; no member of the Board shall have access, directly or indirectly, to an examination report. Anything herein to the contrary notwithstanding, the staff of the Board may furnish to the Board or any appropriate committee thereof summaries or other communications relating to the examination reports, provided that such summaries or other communications shall not contain information which might make it possible to identify the brokers, dealers or municipal securities dealers or associated persons which are the subject of the examination reports to which any such summary or other communication relates.

(2) The Executive Director and General Counsel shall designate jointly the members of the staff of the Board who shall have access to the examination reports.

(3) Each member of the staff of the Board who is authorized pursuant to section (2) of this rule to have access to the examination reports shall execute a written undertaking that he or she will not copy or use for personal purposes any part of such reports, nor reveal the contents thereof to any unauthorized person.

(4) The examination reports shall be maintained on the premises of the Board in locked cabinets with access thereto limited to authorized members of the staff of the Board.

## DEFINITIONAL RULES

### Rule D-1: General

Unless the context otherwise specifically requires, the terms used in the rules of the Municipal Securities Rulemaking Board shall have the respective meanings set forth in the Securities Exchange Act of 1934 (15 U.S.C. § 78a *et seq.*) and the rules and regulations of the Securities and Exchange Commission thereunder.

### Rule D-2: "Act"

The term "Act" shall mean the Securities Exchange Act of 1934, as from time to time amended.

### Rule D-3: "Commission"

The term "Commission" shall mean the Securities and Exchange Commission.

### Rule D-4: "Board"

The term "Board" shall mean the Municipal Securities Rulemaking Board.

### Rule D-5: "Member"

The term "member" shall mean a member of the Board.

### Rule D-6. "Whole Board"

The term "whole Board" shall mean the total number of members of the Board provided for in the administrative rules of the Board without regard to vacancies.

### Rule D-7: "Proposed Rules and Rules of the Board"

The term "rule" shall mean a rule which the Board shall have adopted within the scope of its authority under section 15B of the Act, which shall have become effective in accordance with section 19(b) of the Act or which shall have been amended by the Commission pursuant to section 19(c) of the Act. The term "proposed rule" shall mean a rule of the Board prior to the time when the same shall have become effective in accordance with section 19(b) of the Act.

### Rule D-8: "Bank Dealer"

The term "bank dealer" shall mean a municipal securities dealer which is a bank or a separately identifiable department or division of a bank as defined in rule G-1 of the Board.

### Rule D-9: "Customer"

Except as otherwise specifically provided by rule of the Board, the term "customer" shall mean any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its securities.

#### *MSRB INTERPRETATION*

EXCERPT FROM NOTICE OF APPROVAL OF FAIR PRACTICE RULES

October 24, 1978

Rule D-9 codifies, as a definitional rule of general application, the definition of the term "customer" presently set forth in various Board rules. Employees and other associated persons of brokers, dealers and municipal securities dealers would, under this definition, be "customers" with respect to transactions effected for their personal accounts. An issuer would be a "customer" within the meaning of the rule except in the case of a sale by it of a new issue of its securities.

### Rule D-10: "Discretionary Account"

The term "discretionary account" shall mean the account of a customer carried or introduced by a broker, dealer, or municipal securities dealer with respect to which such broker, dealer, or municipal securities dealer is authorized to determine what municipal securities will be purchased, sold or exchanged by or for the account.

#### *MSRB INTERPRETATION*

EXCERPT FROM NOTICE OF APPROVAL OF FAIR PRACTICE RULES

October 24, 1978

Rule D-10 defines a discretionary account as an account for which a municipal securities professional has been authorized to determine what municipal securities will be purchased, sold or exchanged by or for the account. The definition covers accounts for which a municipal securities professional exercises discretionary authority from time to time, as well as accounts in which the customer sometimes, but not always, makes investment decisions. Under rule D-10, a discretionary account will not be

deemed to exist if the professional's discretion is limited to the price at which, or the time at which, an order given by a customer for a definite amount of a specified security is executed. The definition relates to discretion concerning what municipal securities will be purchased, sold or exchanged, rather than when or at what price such transactions may occur.

## Rule D-11: "Associated Persons"

Unless the context otherwise requires or a rule of the Board otherwise specifically provides, the terms "broker," "dealer," "municipal securities broker," "municipal securities dealer," and "bank dealer" shall refer to and include their respective associated persons. Unless otherwise specified, persons whose functions are solely clerical or ministerial shall not be considered associated persons for purposes of the Board's rules.

### *MSRB INTERPRETATION*

EXCERPT FROM NOTICE OF APPROVAL OF FAIR PRACTICE RULES

October 24, 1978

Rule D-11 is designed to eliminate the need to make specific reference to personnel of securities firms and bank dealers in each Board rule that applies both to the organization and its personnel.

The term "associated person" in rule D-11 has the same meaning as set forth in sections 3(a)(18) and 3(a)(32) of the Act, except that clerical and ministerial personnel are excluded from the definition for purposes of the Board's rules, unless otherwise specified. Although the statutory definitions of associated persons include individuals and organizations in a control relationship with the securities professional, the context of the fair practice rules indicates that such rules will ordinarily not apply to persons who are associated with securities firms and bank dealers solely by reason of a control relationship.

## Rule D-12: "Municipal Fund Security"

The term "municipal fund security" shall mean a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, would constitute an investment company within the meaning of Section 3 of the Investment Company Act of 1940.

### *MSRB INTERPRETATION*

INTERPRETATION RELATING TO SALES OF MUNICIPAL FUND SECURITIES IN THE PRIMARY MARKET

January 18, 2001

The Municipal Securities Rulemaking Board (the "Board") has learned that sales of certain interests in trust funds held by state or local governmental entities may be effected by or through brokers, dealers or municipal securities dealers ("dealers"). In particular, the Board has reviewed two types of state or local governmental programs in which dealers may effect transactions in such interests: pooled investment funds under trusts established by state or local governmental entities ("local government pools")[1] and higher education savings plan trusts established by states ("higher education trusts").[2] In response to a request of the Board, staff of the Division of Market Regulation of the Securities and Exchange Commission (the "SEC") has stated that "at least some interests in local government pools and higher education trusts may be, depending on the facts and circumstances, 'municipal securities' for purposes of the [Securities] Exchange Act [of 1934]."[3] Any such interests that may, in fact, constitute municipal securities are referred to herein as "municipal fund securities." To the extent that dealers effect transactions in municipal fund securities, such transactions are subject to the jurisdiction of the Board pursuant to Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act").

With respect to the applicability to municipal fund securities of Exchange Act Rule 15c2-12, relating to municipal securities disclosure, staff of the SEC's Division of Market Regulation has stated:

> [W]e note that Rule 15c2-12(f)(7) under the Exchange Act defines a "primary offering" as including an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities. Based upon an analysis of programs that have been brought to our attention, it appears that interests in local government pools or higher education trusts generally are offered only by direct purchase from the issuer. Accordingly, we would view those interests as having been sold in a "primary offering" as that term is defined in Rule 15c2-12. If a dealer is acting as an "underwriter" (as defined in Rule 15c2-12(f)(8)) in connection with that primary offering, the dealer may be subject to the requirements of Rule 15c2-12.[4]

Rule 15c2-12(f)(8) defines an underwriter as "any person who has purchased from an issuer of municipal securities with a view to, or offers or sells for an issuer of municipal securities in connection with, the offering of any municipal security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking."[5]

Consistent with SEC staff's view regarding the sale in primary offerings of municipal fund securities, dealers acting as underwriters in primary offerings of municipal fund securities generally would be subject to the requirements of rule G-36, on delivery of official statements, advance refunding documents and Forms G-36(OS) and G-36(ARD) to Board or its designee. Thus, unless such primary offering falls within one of the stated exemptions in Rule 15c2-12, the Board expects that the dealer would receive a final official statement from the issuer or its agent under its contractual agreement entered into pursuant to Rule 15c2-12(b)(3).[6] Such final official statement should be received from the issuer in sufficient time for the dealer to send it, together with Form G-36(OS), to the Board within one business day of receipt but no later than 10 business days after any final agreement to purchase, offer, or sell the municipal fund securities, as required under rule G-36(b)(i).[7] "Final official statement," as used in rule G-36(b)(i), has the same meaning as in Rule 15c2-12(f)(3), which states, in relevant part:

> The term *final official statement* means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons materi-

al to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.[8]

The Board understands that issuers of municipal fund securities typically issue and deliver the securities continuously as customers make purchases, rather than issuing and delivering a single issue on a specified date. As used in Board rules, the term "underwriting period" with respect to an offering involving a single dealer (*i.e.*, not involving an underwriting syndicate) is defined as the period (A) commencing with the first submission to the dealer of an order for the purchase of the securities or the purchase of the securities from the issuer, whichever first occurs, and (B) ending at such time as the following two conditions both are met: (1) the issuer delivers the securities to the dealer, and (2) the dealer no longer retains an unsold balance of the securities purchased from the issuer or 21 calendar days elapse after the date of the first submission of an order for the securities, whichever first occurs.[9] Since an offering consisting of securities issued and delivered on a continuous basis would not, by its very nature, ever meet the first condition for the termination of the underwriting period, such offering would continuously remain in its underwriting period.[10] Further, since rule G-36(d) requires a dealer that has previously provided an official statement to the Board to send any amendments to the official statement made by the issuer during the underwriting period, such dealer would remain obligated to send to the Board any amendments made to the official statement during such continuous underwriting period. However, in view of the increased possibility that an issuer may change the dealer that participates in the sale of its securities during such a continuous underwriting period, the Board has determined that rule G-36(d) would require that the dealer that is at the time of an amendment then serving as underwriter for securities that are still in the underwriting period send the amendment to the Board, regardless of whether that dealer or another dealer sent the original official statement to the Board.

In addition, municipal fund securities sold in a primary offering would constitute new issue municipal securities for purposes of rule G-32, on disclosures in connection with new issues, so long as the securities remain in their underwriting period. Rule G-32 generally requires that a dealer selling a new issue municipal security to a customer must deliver the official statement in final form to the customer by settlement of such transaction. Thus, a dealer effecting transactions in municipal fund securities that are sold during a continuous underwriting period would be required to deliver to the customer the official statement by settlement of each such transaction. However, in the case of a customer purchasing such securities who is a repeat purchaser, no new delivery of the official statement would be required so long as the customer has previously received it in connection with a prior purchase and the official statement has not been changed from the one previously delivered to that customer.[11]

Certain other implications arise under Board rules as a result of the status, in the view of SEC staff, of sales of municipal fund securities as primary offerings. For example, dealers are reminded that the definition of "municipal securities business" under rule G-37, on political contributions and prohibitions on municipal securities business, and rule G-38, on consultants, includes the purchase of a primary offering from the issuer on other than a competitive bid basis or the offer or sale of a primary offering on behalf of any issuer. Thus, a dealer's transactions in municipal fund securities may affect such dealer's obligations under rules G-37 and G-38. In addition, rule G-23, on activities of financial advisors, applies to a dealer's financial advisory or consultant services to an issuer with respect to a new issue of municipal securities.

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1 The Board understands that local government pools are established by state or local governmental entities as trusts that serve as vehicles for the pooled investment of public moneys of participating governmental entities. Participants purchase interests in the trust and trust assets are invested in a manner consistent with the trust's stated investment objectives. Investors generally do not have a right to control investment of trust assets. *See generally* National Association of State Treasurers, Special Report: Local Government Investment Pools (July 1995); Standard & Poor's Fund Services, Local Government Investment Pools (May 1999).

2 The Board understands that higher education trusts generally are established by states under section 529(b) of the Internal Revenue Code as "qualified state tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. Individuals purchase interests in the trust and trust assets are invested in a manner consistent with the trust's stated investment objectives. Investors do not have a right to control investment of trust assets. *See generally* College Savings Plans Network, Special Report on State and College Savings Plans (1998).

3 Letter dated February 26, 1999 from Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, to Diane G. Klinke, General Counsel of the Board, in response to letter dated June 2, 1998 from Diane G. Klinke to Catherine McGuire, *published as* Municipal Securities Rulemaking Board, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 032299033 (Feb. 26, 1999) (the "SEC Letter").

4 SEC Letter.

5 The definition of underwriter excludes any person whose interest is limited to a commission, concession, or allowance from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission, concession, or allowance.

6 Section (b)(3) of Rule 15c2-12 requires that a dealer serving as a Participating Underwriter in connection with a primary offering subject to the Rule contract with an issuer of municipal securities or its designated agent to receive copies of a final official statement at the time and in the quantities set forth in the Rule.

7 If a primary offering of municipal fund securities is exempt from Rule 15c2-12 (other than as a result of being a limited offering as described in section (d)(1)(i) of the Rule) and an official statement in final form has been prepared by the issuer, then the dealer would be expected to send the official statement in final form, together with Form G-36(OS), to the Board under rule G-36(c)(i).

8 Dealers seeking guidance as to whether a particular document or set of documents constitutes a final official statement for purposes of rule G-36(b)(i) should consult with SEC staff to determine whether such document or set of documents constitutes a final official statement for purposes of Rule 15c2-12.

9 *See* rule G-32(c)(ii)(B). If approved by the SEC, the proposed rule change will redesignate this section as rule G-32(d)(ii)(B).

10 Similarly, an offering involving an underwriting syndicate and consisting of securities issued and delivered on a continuous basis also would remain in its underwriting period under the definition thereof set forth in rule G-11(a)(ix).

11 This is equally true for other forms of municipal securities for which a customer has already received an official statement in connection with an earlier purchase and who proceeds to make a second purchase of the same securities during the underwriting period. Furthermore, in the case of a repeat purchaser of municipal securities for which no official statement in final form is being prepared, no new delivery of the written notice to that effect or of any official statement in preliminary form would be required so long as the customer has previously received it in connection with a prior purchase. However, if an official statement in final form is subsequently prepared, the customer's next purchase would trigger the delivery requirement with respect to such official statement. Also, if an official statement which has previously been delivered is subsequently amended during the underwriting period, the customer's next purchase would trigger the delivery requirement with respect to such amendment.

## GENERAL RULES

### Rule G-1: Separately Identifiable Department or Division of a Bank

(a) A separately identifiable department or division of a bank, as such term is used in section 3(a)(30) of the Act, is that unit of the bank which conducts all of the activities of the bank relating to the conduct of business as a municipal securities dealer ("municipal securities dealer activities"), as such activities are hereinafter defined, *provided that:*

(1) Such unit is under the direct supervision of an 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, including the supervision of all bank employees engaged in the performance of such activities; and

(2) There are separately maintained in or separately extractable from such unit's own facilities or the facilities of the bank, all of the records relating to the bank's municipal securities dealer activities, and *further provided that* such records are so maintained or otherwise accessible as to permit independent examination thereof and enforcement of applicable provisions of the Act, the rules and regulations thereunder and the rules of the Board.

(b) For purposes of this rule, the activities of the bank which shall constitute municipal securities dealer activities are as follows:

(1) underwriting, trading and sales of municipal securities;

(2) financial advisory and consultant services for issuers in connection with the issuance of municipal securities;

(3) processing and clearance activities with respect to municipal securities;

(4) research and investment advice with respect to municipal securities;

(5) any activities other than those specifically enumerated above which involve communication, directly or indirectly, with public investors in municipal securities; and

(6) maintenance of records pertaining to the activities described in paragraphs (1) through (5) above; *provided, however*, that the activities enumerated in paragraphs (4) and (5) above shall be limited to such activities as they relate to the activities enumerated in paragraphs (1) and (2) above.

(c) The fact that directors and senior officers of the bank may from time to time set broad policy guidelines affecting the bank as a whole and which are not directly related to the day-to-day conduct of the bank's municipal securities dealer activities, shall not disqualify the unit hereinbefore described as a separately identifiable department or division of the bank or require that such directors or officers be considered as part of such unit.

(d) The fact that the bank's municipal securities dealer activities are conducted in more than one geographic organizational or operational unit of the bank shall not preclude a finding that the bank has a separately identifiable department or division for purposes of this rule, *provided, however*, that all such units are identifiable and that the requirements of paragraphs (1) and (2) of section (a) of this rule are met with respect to each such unit. All such geographic, organizational or operational units of the bank shall be considered in the aggregate as the separately identifiable department or division of the bank for purposes of this rule.

### *MSRB INTERPRETATION*

See:

**Rule G-23 Interpretation – Notice on Application of Board Rules to Financial Advisory Services Rendered to Corporate Obligors on Industrial Development Bonds,** May 23, 1983.

#### *Interpretive Letters*

**Separately identifiable department or division of a bank.** This will acknowledge receipt of your letter of November 12, 1975, in which you request, on behalf of the Dealer Bank Association, an interpretative opinion with respect to the rule of the Municipal Securities Rulemaking Board (the "Board") defining the term "separately identifiable department or division of a bank," as used in section 3(a)(30) of the Securities Exchange Act of 1934, as amended (the "Act"). Such rule was originally numbered rule 4 of the Board and became effective on October 15, 1975. The rule is presently numbered rule G-1 of the Board.

In your letter you pose a series of questions concerning rule G-1, as follows:

(1) A bank has an operations department that performs processing and clearance activities, and maintains records, with respect to the bank's underwriting, trading and sales of municipal securities, as well as with respect to certain other bank activities. Can this bank have a "separately identifiable department or division" as defined in rule G-1?

(2) In a bank with numerous branches, an employee or officer in a branch will on occasion accept or solicit an order from a customer for municipal securities. Does this preclude a finding that the bank has a "separately identifiable department or division"?

(3) Mr. X is a senior vice president of a bank. He is not a director. Mr. X's only relationship to the bank's municipal securities dealer activities is that he is a

member of a management committee within the bank that determines the amount of the bank's funds that will be made available for the bank's municipal securities dealer activities, as well as for other bank activities. The bank has a separately identifiable department or division that otherwise meets the requirements of rule G-1. Is Mr. X a person who must be designated by the board of directors of the bank under rule G-1(a)(1)?

(4) A bank has a corporate trust department that, among other things, serves as paying agent for certain municipal securities and performs clearing functions in municipal securities, in addition to the processing and clearance activities performed in connection with the bank's underwriting, trading and sales of municipal securities. Are the persons in the bank's corporate trust department who engage solely in activities that do not relate to the underwriting, trading and sales of municipal securities by the bank performing municipal securities dealer activities?

With respect to question (1) above, paragraph (d) of rule G-1 contemplates that the municipal securities dealer activities of a bank, as such activities are defined in paragraph (b) of the rule, may be conducted in more than one organizational or operational unit of the bank, for example, underwriting, trading and sales activities in the bond department, and processing and clearance activities in the operations department of the bank. Under the rule, all such units can be aggregated to constitute a separately identifiable department or division within the meaning of section 3(a)(30) of the Act, provided that each such unit is identifiable and under the direct supervision of an officer 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. The officer so designated need not be the same for all such units. For example, the senior officer of the bank's bond department may be designated as responsible for the municipal securities dealer activities conducted by that department, while the senior officer of the bank's operations department may be designated as responsible for the municipal securities dealer activities conducted by that department. In addition, the records of each such unit relating to municipal securities dealer activities must be separately maintained or separately extractable so as to permit independent examination of such records and enforcement of applicable provisions of the Act, the rules and regulations of the Commission thereunder and the rules of the Board. Finally, each such unit comprising the separately identifiable department or division may be engaged in activities other than those relating to municipal securities dealer activities. For example, the bond department may also engage in activities relating to United States government obligations, while the operations department may perform processing and clearance functions for departments of the bank other than the bond department.

With respect to question (2) above, paragraph (d) of rule G-1 also contemplates that the municipal securities dealer activities of a bank may be conducted at more than one geographic location. However, in order for such a bank to have a separately identifiable department or division, the branch employees who accept or solicit orders for municipal securities must, with respect to acceptance or solicitation of such orders, be affiliated with one of the identifiable units of the bank comprising such department or division and must, with respect to acceptance or solicitation of such orders, be responsible to an officer 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. Further, the bank's records relating to the transactions effected by such branch employees must meet the criteria of paragraph (a) of rule G-1 with respect to separate maintenance and accessibility.

With respect to question (3) above, paragraph (c) of rule G-1 recognizes that senior officers of a bank may make determinations affecting bank policy as a whole which have an indirect effect on the municipal securities dealer activities of the bank. For example, determinations with respect to the deployment of the bank's funds may affect the size of the bank's inventory of municipal securities or volume of underwriting. Ordinarily such determinations would not directly relate to the day-to-day conduct of the bank's municipal securities dealer activities and senior officers making such determinations need not be designated by the board of directors of the bank as responsible for the conduct of such activities. However, if the determinations of senior officers have a direct and immediate impact on the day-to-day conduct of the bank's municipal securities dealer activities, whether by reason of the scope of such determinations, the frequency with which such determinations are made, or by reason of other factors, such officers may be considered to be directly engaged in the conduct of the bank's municipal securities dealer activities and required to be designated by the board of directors of the bank as responsible for the day-to-day conduct of such activities.

With respect to question (4) above, the regulatory focus of section 15B(b)(2)(H) of the Act is on the dealer activities of a bank. Accordingly, subparagraph (b)(2) of rule G-1 was intended to relate to such dealer activities, and not to describe other activities of the bank which might involve municipal securities. Employees of a bank's corporate trust department who perform clearance and other functions with respect to municipal securities, but which do not relate to the underwriting, trading and sales activities of the bank, do not perform municipal securities dealer activities within the meaning of rule G-1.

This opinion is rendered on behalf of the Board, pursuant to authority delegated by the Board. Copies of this opinion are being sent to the Securities and Exchange Commission, the bank regulatory agencies and the National Association of Securities Dealers, Inc. *MSRB interpretation of November 17, 1975.*

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**Inclusion of IDB-related activities.** This responds to your letter of June 14, 1983 concerning your request for an interpretation of Board rule G-1, which defines a "separately identifiable department or division" of a bank. In particular, you request our advice concerning whether certain activities engaged in by your Corporate Finance Division (the "Division") should be considered "municipal securities dealer activities" for purposes of the rule. Your letter and a subsequent telephone conversation set forth the following facts:

The Division acts as financial advisor to certain corporate customers of the Bank. Some of these customers wish to raise money through the issuance of IDBs. In order to assist these corporations in the placement of the IDBs, the Division contacts from one to ten institutional investors and provides them with information regarding the terms of the proposed financing and basic facts about the corporation. If the investor expresses interest in the financing, a confidential memorandum describing the financing, prepared by the corporation with the assistance of the Division, is sent.

During negotiations between the corporation and the investor, the Division may act as a liaison between the two parties in the communication of comments on the financing documents. According to the bank, the Division is not an agent of the corporation and is not authorized to act on behalf of the corporation in accepting any terms or conditions associated with the proposed financing. For its services, the Division usually receives a percentage of the total dollar amount of securities issued, with a minimum contingent on the successful completion of the deal. While the bank has established a separately identifiable division pursuant to rule G-1, the Division is not part of it.

Your inquiry was discussed by the Board at its July meeting. The Board is of the view that the activities of the Division, as described, con-

stitute the sales of municipal securities for purposes of the definition of municipal securities dealer activities in Board rule G-1. Therefore, these activities should be conducted in the bank's registered separately identifiable department by persons qualified under the Board's professional qualifications rules. *MSRB interpretation of July 26, 1983.*

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**Portfolio credit analyst.** This will acknowledge with thanks receipt of your letter dated May 2, 1978 concerning the status of persons occupying the position of portfolio credit analyst at your bank. Your letter, as well as our telephone conversations prior and subsequent to the letter, raise two questions concerning the status of such persons under Board rules. First, are the functions of a portfolio credit analyst subject to the requirements of rule G-1, which defines a separately identifiable dealer department or division of a bank? Second, must a portfolio credit analyst qualify as a municipal securities representative or municipal securities principal under Board rule G-3?

Although we recognize that the primary purpose of the portfolio credit analyst, as set forth in the material you furnished to me, is to review your bank's investment portfolio, a function not subject to Board regulation, to the extent that the analyst provides research advice and analysis in connection with your bank's underwriting, trading or sales activities, the analyst must be included within the municipal securities dealer department for purposes of rule G-1, and is subject to the qualification requirements of rule G-3.

Under Board rule G-1, a separately identifiable department or division of a bank is that unit of the bank which conducts all of the municipal securities dealer activities of the bank. Section (b) of the rule defines municipal securities dealer activities to include research with respect to municipal securities to the extent such research relates to underwriting, trading, sales or financial advisory and consultant services performed by the bank. Thus, we think it clear that for purposes of rule G-1, persons functioning as portfolio credit analysts who render research in connection with underwriting, trading or sales activities at your bank must be included within the separately identifiable department or division of the bank for purposes of rule G-1. This is consistent with the underlying purpose of rule G-1 to assure that all of the functions performed at the bank relating to the business of the bank as a municipal securities dealer are appropriately identified for purposes of supervision, inspection and enforcement.

Under rule G-3(a)(iii)[*], a municipal securities representative is defined as a person associated with a municipal securities broker or municipal securities dealer who performs certain functions similar to those defined as municipal securities dealer activities in rule G-1. The position of portfolio credit analyst as described in your letter and accompanying material appears to fit the definition of municipal securities representative to the extent that persons occupying such position perform research in connection with the bank's underwriting, trading or sales activities. Under rule G-3(e)[†], municipal securities representatives are required to qualify in accordance with Board rules. A similar result would obtain with respect to qualification as a municipal securities principal, if the portfolio credit analyst functions in a supervisory capacity. *MSRB interpretation of June 8, 1978.*

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[*][Currently codified at rule G-3(a)(i).]
[†][Currently codified at rule G-3(a)(ii).]

## Rule G-2: Standards of Professional Qualification

No broker, dealer or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security unless such broker, dealer or municipal securities dealer and every natural person associated with such broker, dealer or municipal securities dealer is qualified in accordance with the rules of the Board.

### *Interpretive Letters*

**Execution of infrequent unsolicited orders.** This is in response to your letter in which you state that your firm is a discount broker that executes orders on an unsolicited basis and that occasionally a customer will approach your firm to sell a municipal security they own or to purchase a specific issue. You ask that the Board give consideration to allowing a firm like yours to act as a broker/dealer for customers on an unsolicited basis without being required to have an associated person qualified as a municipal securities principal.

Rule G-2, on standards of professional qualification, states that no dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security unless such dealer and every natural person associated with such dealer is qualified in accordance with the rules of the Board. Rule G-3, on professional qualifications, states that a dealer that conducts a general securities business shall have at least one associated person qualified as a municipal securities principal to supervise the dealer's municipal securities activities.

The Board's rules do not provide an exemption from the numerical requirements for municipal securities principals based on the type of transactions in municipal securities in which a dealer engages. There also is no exemption from the Board's rules based on a *de minimis* number of transactions in municipal securities. MSRB *interpretation of October 2, 1998.*

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

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

(a) *Municipal Securities Representative.*

(i) Definition. The term "municipal securities representative" means a natural person associated with a broker, dealer or municipal securities 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) above shall be limited to such activities as they relate to the activities enumerated in subparagraphs (A) and (B) above.

(ii) Qualification Requirements.

(A) Except as otherwise provided in this paragraph (a)(ii), every municipal securities representative shall take and pass the Municipal Securities Representative Qualification Examination prior to being qualified as a municipal securities representative. The passing grade shall be determined by the Board.

(B) The requirements of subparagraph (a)(ii)(A) of this rule shall not apply to any person who is duly qualified as a general securities representative by reason of having taken and passed the General Securities Registered Representative Examination.

(C) The requirements of subparagraph (a)(ii)(A) of this rule shall not apply to any person who is duly qualified as a limited representative–investment company and variable contracts products by reason of having taken and passed the Limited Representative–Investment Company and Variable Contracts Products Examination, but only if such person's activities with respect to municipal securities described in paragraph (a)(i) of this rule are limited solely to municipal fund securities.

(D) Any person who ceases to be associated with a broker, dealer or municipal securities dealer (whether as a municipal securities representative or otherwise) for two or more years at any time after having qualified as a municipal securities representative in accordance with subparagraphs (a)(ii)(A), (B) or (C) shall again meet the requirements of subparagraphs (a)(ii)(A), (B) or (C) prior to being qualified as a municipal securities representative.

(iii) Apprenticeship.

(A) Any person who first becomes associated with a broker, dealer or municipal securities dealer in a representative capacity (whether as a municipal securities representative, general securities representative or limited representative–investment company and variable contracts products) without having previously qualified as a municipal securities representative, general securities representative or limited representative–investment company and variable contracts products shall be permitted to function in a representative capacity without qualifying pursuant to subparagraph (a)(ii)(A), (B) or (C) for a period of at least 90 days following the date such person becomes associated with a broker, dealer or municipal securities dealer, *provided, however,* that such person shall not transact business with any member of the public with respect to, or be compensated for transactions in, municipal securities during such 90 day period, regardless of such person's having qualified in accordance with the examination requirements of this rule. A person subject to the requirements of this paragraph (a)(iii) shall in no event continue to perform any of the functions of a municipal securities representative after 180 days following the commencement of such person's association with such broker, dealer or municipal securities dealer, unless such person qualifies as a municipal securities representative pursuant to subparagraphs (a)(ii)(A), (B) or (C).

(B) Prior experience, of at least 90 days, as a general securities representative, limited representative–investment company and variable contracts products or limited representative–government securities, will meet the requirements of this paragraph (a)(iii).

(b) *Municipal Securities Principal; Municipal Fund Securities Limited Principal*

(i) Definition. The term "municipal securities principal" means a natural person (other than a municipal securities sales principal), associated with a broker, dealer or municipal securities dealer that has filed with the Board in compliance with rule A-12, who is directly engaged in the management, direction or supervision of one or more of the following activities:

(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) processing, clearance, and, in the case of brokers, dealers and municipal securities dealers other than bank dealers, safekeeping of municipal securities;

(D) research or investment advice with respect to municipal securities;

(E) any other activities which involve communication, directly or indirectly, with public investors in municipal securities;

(F) maintenance of records with respect to the activities described in subparagraphs (A) through (E); or

(G) training of municipal securities principals or municipal securities representatives.

*provided, however*, that the activities enumerated in subparagraphs (D) and (E) above shall be limited to such activities as they relate to the activities enumerated in subparagraphs (A) or (B) above.

(ii) Qualification Requirements.

(A) Every municipal securities principal shall take and pass the Municipal Securities Principal Qualification Examination prior to being qualified as a municipal securities principal. The passing grade shall be determined by the Board.

(B) Any person seeking to become qualified as a municipal securities principal in accordance with subparagraph (b)(ii)(A) of this rule, must, prior to being qualified as a municipal securities principal:

(1) have been duly qualified as either a municipal securities representative or a general securities representative; *provided, however*, that any person who qualifies as a municipal securities representative solely by reason of subparagraph (a)(ii)(C) shall not be qualified to take the Municipal Securities Principal Qualification Examination on or after October 1, 2002; or

(2) have taken and passed either the Municipal Securities Representative Qualification Examination or the General Securities Registered Representative Examination.

(C) Any person who ceases to act as a municipal securities principal for two or more years at any time after having qualified as such shall meet the requirements of subparagraphs (b)(ii)(A) and (B) prior to being qualified as a municipal securities principal.

(D) For the first 90 days after becoming a municipal securities principal, the requirements of subparagraph (b)(ii)(A) shall not apply to any person who is qualified as a municipal securities representative, general securities representative or general securities principal, *provided, however*, that such person shall take and pass the Municipal Securities Principal Qualification Examination within that period.

(iii) Numerical Requirements. Every broker, dealer and municipal securities dealer shall have at least two municipal securities principals, except:

(A) every broker, dealer or municipal securities dealer which is a member of a registered securities association and which conducts a general securities business, or

(B) every broker, dealer or municipal securities dealer having fewer than eleven persons associated with it in whatever capacity on a full-time or full-time equivalent basis who are engaged in the performance of its municipal securities activities, or, in the case of a bank dealer, in the performance of its municipal securities dealer activities,

shall have at least one municipal securities principal.

(iv) Municipal Fund Securities Limited Principal.

(A) Definition. The term "municipal fund securities limited principal" means a natural person (other than a municipal securities principal or municipal securities sales principal), associated with a broker, dealer or municipal securities dealer that has filed with the Board in compliance with rule A-12, who is directly engaged in the functions of a municipal securities principal as set forth in paragraph (b)(i), but solely as such activities relate to transactions in municipal fund securities.

(B) Qualification Requirements.

(1) Every municipal fund securities limited principal shall take and pass the Municipal Fund Securities Limited Principal Qualification Examination prior to being qualified as a municipal fund securities limited principal. The passing grade shall be determined by the Board.

(2) Any person seeking to become qualified as a municipal fund securities limited principal in accordance with clause (b)(iv)(B)(1) of this rule must, as a condition to being qualified as a municipal fund securities limited principal:

(a) have been duly qualified as either a general securities principal or an investment company/variable contracts limited principal; or

(b) have taken and passed either the General Securities Principal Qualification Examination or the Investment Company and Annuity Principal Qualification Examination.

(3) Any person who ceases to act as a municipal fund securities limited principal for two or more years at any time after having qualified as such shall meet the requirements of clauses (b)(iv)(B)(1) and (2) prior to being qualified as a municipal fund securities limited principal.

(4) For the first 90 days after becoming a municipal fund securities limited principal, the requirements of clauses (b)(iv)(B)(1) and (2) shall not apply to any person who is qualified as a general securities representative, investment company/variable contracts limited representative, general securities principal or investment company/variable contracts limited principal, *provided, however,* that such person shall meet the requirements of clauses (b)(iv)(B)(1) and (2) within that period.

(C) Actions as Municipal Securities Principal. Any municipal fund securities limited principal may undertake all actions required or permitted under any Board rule to be taken by a municipal securities principal, but solely with respect to activities related to municipal fund securities.

(D) Numerical Requirements. Any broker, dealer or municipal securities dealer whose municipal securities activities are limited exclusively to municipal fund securities may count any municipal fund securities limited principal toward the numerical requirement for municipal securities principal set forth in paragraph (b)(iii).

(E) Temporary Provisions for Municipal Fund Securities Limited Principal. Notwithstanding any other provision of this rule, until March 31, 2003, the following provisions shall apply to any broker, dealer or municipal securities dealer whose municipal securities activities are limited exclusively to municipal fund securities:

(1) the broker, dealer or municipal securities dealer may designate any person who has taken and passed the General Securities Principal Qualification Examination or Investment Company and Annuity Principal Qualification Examination as a municipal fund securities limited principal.

(2) any municipal fund securities limited principal designated as provided in clause (b)(iv)(E)(1) may undertake all actions required or permitted under any Board rule to be taken by a municipal securities principal to the same extent as set forth in subparagraph (b)(iv)(C).

(3) the broker, dealer or municipal securities dealer may count any municipal fund securities limited principal designated as provided in clause (b)(iv)(E)(1) toward the numerical requirement for municipal securities principal to the same extent as set forth in subparagraph (b)(iv)(D).

(4) On and after April 1, 2003, all municipal fund securities limited principals (including any municipal fund securities limited principals designated as provided in clause (b)(iv)(E)(1)) must be qualified as provided in subparagraph (b)(iv)(B).

(c) *Municipal Securities Sales Principal.*

(i) Definition. The term "municipal securities sales principal" means a natural person (other than a municipal securities principal) associated with a broker, dealer or municipal securities dealer (other than a bank dealer) whose supervisory activities with respect to municipal securities are limited exclusively to supervising sales to and purchases from customers of municipal securities.

(ii) Qualification Requirements.

(A) Every municipal securities sales principal shall take and pass the General Securities Sales Supervisor Qualification Examination prior to acting in such capacity. The passing grade shall be determined by the Board.

(B) Any person seeking to become qualified as a municipal securities sales principal in accordance with subparagraph (c)(ii)(A) of this rule, must, prior to being qualified as a municipal securities sales principal:

(1) have been duly qualified as either a municipal securities representative or a general securities rep-

resentative; or

(2) have taken and passed either the Municipal Securities Representative Qualification Examination or the General Securities Registered Representative Examination.

(C) Any person who ceases to act as a municipal securities sales principal for two or more years at any time after having qualified as such shall meet the requirements of subparagraphs (c)(ii)(A) and (B) prior to being qualified as a municipal securities sales principal.

(D) For the first 90 days after becoming a municipal securities sales principal, the requirements of subparagraph (c)(ii)(A) shall not apply to any person who is qualified as a municipal securities representative, general securities representative or general securities principal, provided, however, that such person shall take and pass the General Securities Sales Supervisory Qualification Examination within that period.

(d) *Financial and Operations Principal.*

(i) Definition. The term "financial and operations principal" means a natural person associated with a broker, dealer or municipal securities dealer (other than a bank dealer or a broker, dealer or municipal securities dealer meeting the requirements of subparagraph (a)(2)(iv), (v) or (vi) of rule 15c3-1 under the Act or exempted from the requirements of rule 15c3-1 in accordance with paragraph (b)(3) thereof), whose duties include:

(A) approval of and responsibility for financial reports required to be filed with the Commission or any self-regulatory organization;

(B) final preparation of such reports;

(C) overall supervision of individuals who assist in the preparation of such reports;

(D) overall supervision of and responsibility for individuals who are involved in the maintenance of the books and records from which such reports are derived;

(E) overall supervision and/or performance of the responsibilities of the broker, dealer or municipal securities dealer pursuant to the financial responsibility rules under the Act;

(F) overall supervision of and responsibility for all individuals who are involved in the administration and maintenance of the processing and clearance functions of such broker, dealer or municipal securities dealer; and

(G) overall supervision of and responsibility for all individuals who are involved in the administration and maintenance of the safekeeping functions of such broker, dealer or municipal securities dealer.

(ii) Qualification Requirements.

(A) Every financial and operations principal shall be qualified in such capacity in accordance with the rules of a registered securities association.

(B) Any person who ceases to be associated with a broker, dealer or municipal securities dealer as a financial and operations principal for two or more years at any time after having qualified as such in accordance with this paragraph (d)(ii) shall qualify in such capacity in accordance with the rules of a registered securities association prior to being qualified as a financial and operations principal.

(iii) Numerical Requirements. Every broker, dealer and municipal securities dealer (other than a bank dealer and a broker, dealer or municipal securities dealer meeting the requirements of subparagraph (a)(2)(iv), (v) or (vi) of rule 15c3-1 under the Act or exempted from the requirements of rule 15c3-1 in accordance with paragraph (b)(3) thereof) shall have at least one financial and operations principal, including its chief financial officer, qualified in accordance with paragraph (d)(ii) of this rule.

(e) *Confidentiality of Qualification Examinations.* No associated person of a broker, dealer or municipal securities dealer shall:

(i) in the course of taking a qualification examination required by this rule receive or give assistance of any nature;

(ii) disclose to any person questions, or answers to any questions, on any qualification examination required by this rule;

(iii) engage in any activity inconsistent with the confidential nature of any qualification examination required by this rule, or with its purpose as a test of the qualification of persons taking such examinations; or

(iv) knowingly sign a false certification concerning any such qualification examination.

(f) *Retaking of Qualification Examinations.* Any associated person of a broker, dealer or municipal securities dealer who fails to pass a qualification examination prescribed by the Board shall be permitted to take the examination

again after a period of 30 days has elapsed from the date of the prior examination, except that any person who fails to pass an examination three or more times in succession shall be prohibited from again taking the examination until a period of six months has elapsed from the date of such person's last attempt to pass the examination.

(g) *Waiver of Qualification Requirements.*

(i) The requirements of paragraphs (a)(ii), (a)(iii), (b)(ii), (b)(iv)(B) and (c)(ii) may be waived in extraordinary cases for any associated person of a broker, dealer or municipal securities dealer who demonstrates extensive experience in a field closely related to the municipal securities activities of such broker, dealer or municipal securities dealer. Such waiver may be granted by

(A) a registered securities association with respect to a person associated with a member of such association, or

(B) the appropriate regulatory agency as defined in section 3(a)(34) of the Act with respect to a person associated with any other broker, dealer or municipal securities dealer.

(ii) The requirements of paragraph (d)(ii) may be waived for any associated person of a broker, dealer or municipal securities dealer in circumstances sufficient to justify the granting of a waiver if such person were seeking to register and qualify with a member of a registered securities association as a financial and operations principal. Such waiver may be granted by a registered securities association with respect to a person associated with a member of such association.

(h) *Continuing Education Requirements*

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

(i) Regulatory Element

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

(1) Each registered person shall complete the Regulatory Element beginning with the occurrence of their second registration anniversary date and every three years thereafter or as otherwise prescribed by the Board. On each occasion, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. A person's initial registration date shall establish the cycle of anniversary dates for purposes of this section (i). The content of the Regulatory Element shall be determined by the Board for each registration category of persons subject to the rule.

(2) Persons who have been continuously registered for more than 10 years as of the effective date of this section are exempt from the requirements of this rule relative to participation in the Regulatory Element, provided such persons have not been subject to any disciplinary action within the last 10 years as enumerated in paragraphs (i)(C)(1)-(2) of this section. However, persons delegated supervisory responsibility or authority pursuant to rule G-27 and registered in such supervisory capacity are exempt from participation in the Regulatory Element under this provision only if they have been continuously registered in a supervisory capacity for more than ten years as of the effective date of this rule and provided that such supervisory person has not been subject to any disciplinary action under paragraphs (i)(C)(1)-(2) of this section.

(3) In the event that a registered person who is exempt from participation in the Regulatory Element subsequently becomes the subject of a disciplinary action as enumerated in paragraphs (i)(C)(1)-(2), such person shall be required to satisfy the requirements of the Regulatory Element as if the date the disciplinary action becomes final is the person's initial registration anniversary date.

(B) Failure to Complete—Unless otherwise determined by the Board, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this section shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. A registration that is inactive for a period of two years will be administratively terminated. A person whose registration is so terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of this rule. The appropriate enforcement authority may, upon application and a showing

of good cause, allow for additional time for a registered person to satisfy the program requirements.

(C) Re-entry into Program—Unless otherwise determined by the appropriate enforcement authority, a registered person will be required to re-enter the Regulatory Element and satisfy all of its requirements in the event such person:

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

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

(3) is ordered as a sanction in a disciplinary action to re-enter the continuing education program by any securities governmental agency, the appropriate enforcement authority or securities self-regulatory organization.

Re-entry shall commence with initial participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (1) above, or the completion of the sanction or the disciplinary action becomes final, in the case of (2) or (3) above The date that the disciplinary action becomes final will be deemed the person's initial registration anniversary date for purposes of this section (i).

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

(E) Any former registered person who becomes reassociated in a registered capacity with a broker, dealer or municipal securities dealer more than two years after termination as such will be required to satisfy the program's requirements in their entirety (second registration anniversary and every three years thereafter), based on the most recent registration date.

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

(G) In-Firm Delivery of the Regulatory Element

Brokers, dealers and municipal securities dealers will be permitted to administer the continuing education Regulatory Element program to their registered persons by instituting an in-firm program acceptable to the Board. The following procedures are required:

(1) Principal In-Charge. The broker, dealer or municipal securities dealer has designated a municipal securities principal or a general securities principal to be responsible for the in-firm delivery of the Regulatory Element.

(2) Site Requirements.

(a) The location of all delivery sites will be under the control of the broker, dealer or municipal securities dealer.

(b) Delivery of Regulatory Element continuing education will take place in an environment conducive to training. (Examples: a training facility, conference room or other area dedicated to this purpose would be appropriate. Inappropriate locations would include a personal office or any location that is not or cannot be secured from traffic and interruptions).

(c) Where multiple delivery terminals are placed in a room, adequate separation between terminals will be maintained.

(3) Technology Requirements. The communication links and firm delivery computer hardware must comply with standards defined by the Board or its designated vendor.

(4) Supervision

(a) The broker, dealer or municipal securities dealer's written supervisory procedures must contain the procedures implemented to comply with the requirements of in-firm delivery of the Regulatory Element continuing education.

(b) The broker, dealer or municipal securities dealer's written supervisory procedures must identify the municipal securities principal or general securities principal designated pursuant to section (h)(i)(G)(1) of this rule and contain a list of individuals authorized by the broker, dealer or municipal securities dealer to serve as proctors.

(c) Firm locations for delivery of the Regulatory Element continuing education will be specifically listed in the broker, dealer or municipal securities dealer's written supervisory procedures.

(5) Proctors

(a) All sessions will be proctored by an authorized person during the entire Regulatory Element session. Proctors must be present in the session room or must be able to view the person(s) sitting for Regulatory Element continuing education through a window or by video monitor.

(b) The individual responsible for proctoring at each administration will sign a certification that required procedures have been followed, that no material from Regulatory Element continuing education has been reproduced, and that no candidate received any assistance to complete the session. Such certification may be part of the sign-in log required under section (h)(i)(G)(6)(c) of this rule.

(c) Individuals serving as proctors must be persons registered with a self-regulatory organization and supervised by the designated principal for purposes of in-firm delivery of the Regulatory Element continuing education.

(d) Proctors will check and verify the identification of all individuals taking Regulatory Element continuing education.

(6) Administration.

(a) All appointments will be scheduled in advance using the procedures and software specified by the Board to communicate with the Board's system and designated vendor.

(b) The broker, dealer or municipal securities dealer and its proctor will conduct each session in accordance with the administrative appointment scheduling procedures established by the Board or its designated vendor.

(c) A sign-in log will be maintained at the delivery facility. Logs will contain the date of each session, the name and social security number of the individual taking the session, the fact that required identification was checked, the sign-in time, the sign-out time, and the name of the individual proctoring the session. Such logs are required to be retained pursuant to rules G-8 and G-9.

(d) No material will be permitted to be utilized for the session nor may any session-related material be removed.

(e) Delivery sites will be made available for inspection by the appropriate enforcement authority.

(f) Before commencing the in-firm delivery of the Regulatory Element continuing education, brokers, dealers and municipal securities dealers are required to file with the Board a letter of attestation (as specified below) signed by a municipal securities principal or general securities principal attesting to the establishment of required procedures addressing principal in-charge, supervision, site, technology, proctors, and administrative requirements. Letters filed with the Board should be sent to the Municipal Securities Rulemaking Board, Professional Qualifications Department, 1900 Duke Street, Suite 600, Alexandria, Virginia, 22314.

**Letter of Attestation for In-Firm Delivery of Regulatory Element Continuing Education**

{Name of broker, dealer or municipal securities dealer} has established procedures for delivering Regulatory Element continuing education on its premises. I have determined that these procedures are reasonably designed to comply with SRO requirements pertaining to in-firm delivery of Regulatory Element continuing education, including that such procedures have been implemented to comply with principal in-charge, supervision, site, technology, proctors, and administrative requirements.

Signature

Printed name

Title (Must be signed by a municipal securities principal or general securities principal of the broker, dealer or municipal securities dealer)

Date

(ii) Firm Element

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

(B) Standards for the Firm Element

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

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

(a) General investment features and associated risk factors;

(b) Suitability and sales practice considerations;

(c) Applicable regulatory requirements.

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

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

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

## BACKGROUND

Board rule G-2 establishes the standard for professional qualification as a municipal securities broker or municipal securities dealer and their associated persons. Rule G-3 classifies professional participants in four categories (municipal securities principals, municipal securities sales principals, financial and operations principals and municipal securities representatives) and sets forth specifically the qualification requirements for each.

NOTE: *The Professional Qualification Handbook*, the Board handbook explaining the qualification requirements, is available from the Board's office, (703) 797-6600. This explanation, organized according to the rule G-3 classification of professionals, sets forth in detail the examination, experience, and numerical requirements for professional qualification. Topics such as qualification examination procedures, waiver of qualification examinations, and special qualification circumstances are also discussed.

## MSRB INTERPRETATIONS

### INTERPRETIVE NOTICE ON PROFESSIONAL QUALIFICATIONS

January 27, 1977

On December 23, 1976, the Municipal Securities Rulemaking Board (the "Board") issued an interpretive notice addressing certain questions received by the Board with respect to its professional qualifications rules (rules G-2 through G-7). Since that time, the Board has received additional questions concerning rule G-3 which are discussed in this interpretive notice.

**1. Requirements for Financial and Operations Principals.**

Under the rule G-3(b)(ii)[*1], every municipal securities broker and municipal securities dealer other than a bank dealer is required to have at least one qualified financial and operations principal. As defined in the rule, this person is responsible for the overall supervision and preparation of financial reports to the Securities and Exchange Commission and self-regulatory organizations and for the processing, clearance, safekeeping and recordkeeping activities of the firm. If more than one person shares these overall supervisory responsibilities, each such person must be qualified as a financial and operations principal.

The question has been asked whether a financial and operations principal whose duties relate solely to financial and operational matters and not, for example, to underwriting, trading, or sales functions must qualify also as a municipal securities principal by passing the Board's municipal securities principal examination when it is prescribed. The Board does not intend to impose such a requirement on persons whose functions are limited to those set forth in the definition of a financial and operations principal.

The question has also been asked whether a person performing only the functions of a financial and operations principal on and after December 1, 1975 would be "grandfathered" as a municipal securities principal for purposes of taking the Board's municipal securities principal examination when prescribed if such person begins supervising underwriting, trading or sales functions. Activities relating to financial and operational matters are substantially different from those relating to underwriting, trading and sales or other categories of activities supervised by municipal securities principals. The Board does not intend, therefore, that financial and operations principals be "grandfathered" for purposes of the Board's examination requirements for municipal securities principals, or that a financial and operations principal would be qualified to engage in such other supervisory activities solely by reason of having met the Board's requirements for financial and operations principals.

The Board has also been asked whether senior officers or general partners of a firm, who may bear ultimate legal responsibility for the financial and operational activities of the firm, must be qualified as financial and operations principals under the Board's rules. Although the answer depends on the particular factual situation, officers or partners not directly involved in the financial and operations affairs of a firm generally would not be required to qualify as financial and operations principals.

**2. Activities Requiring Qualification as a Municipal Securities Principal.**

The question has been asked whether supervisory personnel in the processing and clearance areas must qualify as the municipal securities principals under rule G-3. In a securities firm, the financial and operations principal ordinarily would be the only person supervising operations-related activities who will be required to pass an examination. With respect to bank dealer supervisory personnel, to whom the financial and operations principal classification does not apply, qualification in a principal capacity in the operations area will not be required unless the person in question exercises policy-making authority. Thus, an individual may supervise a bank dealer's processing activities without qualifying as a municipal securities principal, regardless of the number of persons supervised by such individual, if policy-making functions and discretionary authority are delegated to a higher level.

Somewhat different considerations apply in determining which persons are required to be qualified as municipal securities principals in connection with underwriting, trading, sales or other activities referred to in the Board's rules as municipal securities principal activities. In these areas, the qualification requirements apply to persons having supervisory responsibility with respect to the day-to-day conduct of the activities in question, even though such persons may not have a policy-making role. The Board's conclusions in this regard are based on the fact that in these other areas the supervisory person is responsible for the activities of personnel who communicate directly with issuers, traders, and investors.

**3. Activities Requiring Qualification as a Municipal Securities Representative.**

In certain cases, communications from customers may be received at a time when a duly qualified municipal securities representative or municipal securities principal is unavailable. Similarly, there may be situations in which it becomes important to advise a customer promptly of transactions effected and orders confirmed, even though the individual responsible for the account may not be able to communicate with the customer at that time.

In many cases under the rules of other self-regulatory organizations, communications of this nature, which in essence reflect a mechanical function, may be received and made by properly supervised competent individuals whose clerical and ministerial functions would not otherwise subject them to qualification requirements. The Board believes the principle underlying this practice and the application of other self-regulatory organizations' qualification rules is sound.

Accordingly, the Board interprets rule G-3 to permit the recording and transmission in customary channels of orders, the reading of approved quotations, and the giving of reports of transactions by non-qualified clerical personnel when the duly qualified municipal securities representative or municipal securities principal who normally handles the account or customer is unavailable. The foregoing interpretation is applicable only to clerical personnel who are: (a) deemed capable and competent by a municipal securities principal or general securities principal to engage in such

activities; (b) specifically authorized in writing to perform such functions on an occasional basis as necessary or directed to perform such functions in specific instances, in either case by a duly qualified municipal securities principal or general securities principal; (c) familiar with the normal type and size of transaction effected with or for the customer or the account; and (d) closely supervised by duly qualified municipal personnel.

All orders for municipal securities received by clerical personnel under the foregoing interpretation must be reviewed and approved by duly qualified municipal personnel familiar with the customer or account prior to being accepted or effected by the municipal securities broker or municipal securities dealer. Solicitation of orders by clerical personnel is not permitted. Confirmations of transactions may be given and quotations read by clerical personnel only when approved by duly qualified municipal personnel. Individuals subject to the 90-day apprenticeship requirements of rule G-3(i)[*] are not clerical personnel and are not authorized or permitted to engage in such activities with members of the public.

Also, the question has been raised whether a bank's branch office personnel, who are not otherwise required to be qualified under rule G-3, will be required to take and pass the qualification examination for municipal securities representatives in order to respond to a depositor's inquiry concerning possible investments in municipal securities. Insofar as the branch office personnel merely refer the depositor to qualified bank dealer personnel for discussion concerning the merits of an investment in municipal securities and execution of the depositor's order, the branch office personnel would not be required to be qualified under the Board's professional qualifications requirements. However, if branch office personnel seek to advise the depositor concerning the merits of a possible investment, or otherwise perform more than a purely ministerial function, qualification under the Board's rules would be required.

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[*][Currently codified at rule G-3(d)(iii).]
[†][Currently codified at rule G-3(a)(iii).]

## Debriefing of Examination Candidates

June 2, 1981

Board rule G-3 sets forth standards of qualifications for municipal securities brokers and municipal securities dealers and their associated persons, including examination requirements for municipal securities principals, municipal securities financial and operations principals, municipal securities sales principals, and municipal securities representatives.

In order to assure that its examinations constitute valid tests of the qualifications of persons who take them, the Board has instituted various procedures, in the question writing as well as the administration phases, which are designed to preserve the confidentiality of the examinations. In addition, on one occasion the Board found it necessary to take legal action, alleging copyright violations, against a securities training school which had used in its training material questions and answers that appeared to have been taken from questions contained in Board qualification examinations.

The Board wishes to point out that the practice of "debriefing" persons who have taken a municipal securities qualifications examination (i.e. requesting or encouraging such persons to reveal the contents of the examinations) may not only give rise to an infringement of the Board's copyright but would, if engaged in by members of the municipal securities industry, constitute a violation of the Board's rules. In this regard, rule G-3(g)[*] provides that no person associated with a municipal securities broker or municipal securities dealer shall (i) disclose to any person any question on any municipal securities qualification examination or the answers to any such questions, (ii) engage in any activity inconsistent with the confidential nature of any such qualification examination or its purpose as a test of the qualifications of persons taking such examination, or (iii) knowingly sign a false certification concerning any such qualification examination.

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[*][Currently codified at rule G-3(e).]

## Use of Nonqualified Individuals to Solicit New Account Business

December 21, 1984

The Board has received inquiries whether individuals who solicit new account business on behalf of municipal securities dealers must be qualified under the Board's rules. In particular, it has come to the Board's attention that nonqualified individuals are making "cold calls" to individuals and, by reading from prepared scripts, introduce the services offered by a municipal securities dealer, prequalify potential customers, or suggest the purchase of specific securities currently being offered by a municipal securities dealer.

Board rule G-3(a) defines municipal securities representative activities to include any activity which involves communication with public investors regarding the sale of municipal securities but exempts activities that are solely clerical or ministerial. In the past, the Board has permitted nonqualified individuals, under the clerical or ministerial exemption, to contact existing customers in very limited circumstances. In an interpretive notice on rule G-3, the Board permitted certain ministerial and clerical functions to be performed by nonqualified individuals when municipal securities representatives and principals who normally handle the customers' accounts are unavailable, subject to strict supervisory requirements. These functions are: the recording and transmission in customary channels of orders, the reading of approved quotations, and the giving of reports of transactions. In this notice, the Board added that solicitation of orders by clerical personnel is not permitted. The Board is of the view that individuals who solicit new account business are not engaging in clerical or ministerial activities but rather are communicating with public investors regarding the sale of municipal securities and thus are engaging in municipal securities representative activities which require such individuals to be qualified as representatives under the Board's rules.

Finally, under rule G-3(i)[*], a person serving an apprenticeship period prior to qualification as a municipal securities representative may not communicate with public investors regarding the sale of municipal securities. The Board sees no reason to allow nonqualified individuals to contact public investors, except for the limited functions noted above, when persons training to become qualified municipal securities representatives may not do so.

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[*][Currently codified at rule G-3(a)(iii).]

## Notice Regarding Regulation of Taxable Municipal Securities

October 6, 1986

Because of recent federal tax law changes which place additional restrictions on the issuance of tax-exempt municipal securities, issuers of municipal securities are issuing, or considering issuing, debt securities that are subject to federal taxation. As a result, the Municipal Securities Rulemaking Board has received numerous inquiries concerning the application of its rules to dealers effecting transactions in taxable municipal securities. The Board wishes to emphasize that its rules apply to transactions effected by brokers, dealers, and municipal securities dealers in all municipal securities. Thus, transactions in taxable municipal securities are subject to the Board's rules, including rules regarding uniform and fair practice, automated clearance and settlement, the payment of the underwriting assessment fee, and the professional qualifications of registered representatives and principals.

## NOTICE CONCERNING MUNICIPAL SECURITIES SALES ACTIVITIES IN BRANCH AFFILIATE AND CORRESPONDENT BANKS WHICH ARE MUNICIPAL SECURITIES DEALERS

March 11, 1983

The Board has received several inquiries from banks concerning the activities which may be performed in connection with the marketing of municipal securities through branch, affiliate, and correspondent banks. Rule G-2 of the Board provides that no municipal securities dealer may effect transactions in, or induce or attempt to induce the purchase or sale of any municipal security, unless the dealer in question and every individual associated with it is qualified in accordance with the rules of the Board. Board rule G-3 establishes qualification requirements for municipal securities representatives and other municipal securities professionals. Board rule G-27 requires supervision of municipal securities activities by qualified municipal securities principals.

**Activities of Branch, Affiliate and Correspondent Bank Personnel**

Bank employees who are not qualified municipal securities representatives may perform certain limited functions in connection with the marketing of municipal securities. Namely, such persons may:

- advise customers that municipal securities investment services are available in the bank;
- make available to customers material concerning municipal securities investments, such as market letters and listings of issues handled by the bank's dealer department, which has been approved for distribution by the dealer department's municipal securities principal; and,
- establish contact between the customer and the dealer department.

Further sales-related activity would be construed as inducing or attempting to induce the purchase or sales of a municipal security, and may only be engaged in by duly-qualified municipal securities representatives.

The Board wishes to emphasize that each bank dealer should take steps to assure that its branch, correspondent, and affiliate bank personnel understand and observe the restrictions outlined above concerning referrals of municipal securities customers to the bank's dealer department.

**Placement and Supervision of Municipal Securities Representatives**

Bank dealers have also directed inquiries to the federal bank regulators and to the Board concerning whether qualified municipal securities representatives in affiliates or branches of a bank dealer may respond to customer inquiries concerning municipal securities and take customer orders for municipal securities if no municipal securities principal is located in such affiliates or branches. Board rule G-27 places on each broker, dealer, and municipal securities dealer the obligation to supervise the municipal securities activities of its associated persons and the conduct of its municipal securities business. The rule requires that municipal securities dealers designate a municipal securities principal as responsible for the supervision and review of municipal securities transactions and other activities. There is no requirement that a municipal securities principal be located in each office or branch of a municipal securities dealer, provided that adequate supervision of all municipal securities activities can be assured. For purposes of the Board rules, each employee of a branch or affiliate of a bank dealer who communicates with public customers on investment opportunities in municipal securities and who takes customers' orders for such securities would be considered an "associated person" to whom the Board's qualification and supervision requirements would apply.

**See also:**

**Rule G-23 Interpretation – Notice on Application of Board Rules to Financial Advisory Services Rendered to Corporate Obligors on Industrial Development Bonds,** May 23, 1983.

## *Interpretive Letters*

**Apprenticeship.** This will acknowledge receipt of your letter dated January 30, 1978 and will confirm our recent telephone conversation.

In your letter you seek clarification of the applicability of the requirements of rule G-3(i)[*] relating to apprenticeship periods to a municipal securities representative who has previously qualified as a general securities representative. As I indicated in our conversation, an individual who was previously qualified as a general securities representative is not required to serve the 90-day apprenticeship period. *MSRB interpretation of February 17, 1978.*

[*][Currently codified at rule G-3(a)(iii).]

**Municipal securities principal.** This will acknowledge receipt of your letter of June 10, 1981. In your letter you indicate that the dealer department of [the bank] has recently been inspected by examiners from the Office of the Comptroller of the Currency, and that, during the course of such inspection, the examiners indicated that they believed certain persons should be qualified as municipal securities principals. You indicate your disagreement with the examiners' conclusions, and request an opinion from the Board concerning the need to qualify these personnel.

The two cases you describe are as follows:

(1) Mr. "X", as head of the Operations Division of the bank's Financial Markets Group, is in charge of the operational support services for the bank's securities activities, including the Tax-Exempt Operations Department. The Tax-Exempt Operations Department is under the immediate supervision of yourself. For purposes of bank organizational structure you report to Mr. "X"; however, you also report to the head of the Tax-Exempt Securities Division in connection with "supporting the Tax-Exempt business operation." You are qualified as a municipal securities principal, as is the head of the Tax-Exempt Securities Division; Mr. "X", however, is not. The national bank examiners have expressed the view that he should be.

(2) Two "senior traders" in the Municipal Dealer Department act under the supervision of the department head with regard to the trading and positioning of municipal securities. In connection with these activities they "direct more junior traders" in their municipal securities activities. These persons are not qualified as municipal securities principals; the national bank examiners contend that they should be.

As a general matter we would hesitate to disagree with the opinion expressed by an on-site examiner in a matter of this sort. The examiner is, of course, in direct contact with the matter in question, and has access to the full details of the situation, rather than an abstraction or summary of the particulars. Accordingly, we are unable to express a view that the examiner's conclusions are incorrect in the circumstances you describe.

With respect to the specific situations presented in your letter, it is certainly not impossible to establish a reporting and supervisory structure such that a person who is in charge of the division which includes the operational aspects of a bank's municipal securities dealer department need not be qualified as a municipal securities principal. As is indicated in a Board interpretive notice concerning qualifications matters, qualification as a municipal securities principal is required of a person who supervises a bank dealer's processing and clearance activities

with respect to municipal securities only to the extent that such person has policy-making authority over such activities. If such person does not have policy-making authority, or if such person's authority extends to the establishment of general guidelines or an overall framework for activities, with the specific function of making policy within that framework reserved for other persons, then such person would not be deemed to be a municipal securities principal.

Further, it is a not uncommon arrangement to have the policy-making authority with respect to the municipal dealer operations activities of a bank allocated between the immediate supervisor of the municipal operations function and a principal in the dealer department itself. In these circumstances the operation supervisor reports to the principal in connection with the municipal dealer activities, and also reports to other, non-qualified persons in connection with bank organizational requirements.

Therefore, the arrangement which you describe would not necessarily require that Mr. "X" be qualified as a municipal securities principal. Whether he should, in fact, be qualified as a municipal securities principal depends, of course, on the extent to which he does exercise policy-making authority over the municipal dealer operations functions; this is a determination that, we suggest, is most appropriately made by yourselves and the national bank examiners.

In the second situation you describe it appears to us clear that the "senior traders" are functioning as municipal securities principals and should be qualified as such. As you may know, the Board's rule defines the term "municipal securities principal" to include persons "who [are] directly engaged in the... direction or supervision of... underwriting, trading or sales of municipal securities... " Your description of the activities of these "senior traders" indicates that they "direct" other persons in trading activities. This certainly supports the conclusion that they are functioning as municipal securities principals. *MSRB interpretation of June 24, 1981.*

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**Municipal securities principal: numerical requirements.** This is in response to your letter of September 28, 1982 concerning the numerical requirements for municipal securities principals in Board rule G-3...

Rule G-3(b)(i)(B)[*] requires that

> ...every municipal securities broker or municipal securities dealer having fewer than eleven persons associated with it in whatever capacity on a full-time or full-time equivalent basis who are engaged in the performance of its municipal securities activities, or, in the case of a bank dealer, in the performance of its municipal securities dealer activities, shall have at least one municipal securities principal.

You inquired as to the meaning of "full-time equivalent basis" in the reference language. This phrase is intended to require the inclusion of individuals who should be considered as full-time employees, but because of some distinctive employment arrangement do not fit the norm of a full-time employee. For example, a municipal securities representative who usually works out of his home which is in a remote location might not fit the firm's norm for "full-time employment" but should nevertheless be counted for purposes of the rule as an associated person.

You also inquired as to whether a bank dealer is required to have only one municipal securities principal even if it has fifteen full-time persons working in the municipal securities business. The provisions of the rule apply equally to securities firms and to bank dealers. Therefore, a bank dealer with eleven or more associated persons "engaged in the performance of its municipal securities dealer activities" is required to have at least two municipal securities principals. *MSRB interpretation of October 15, 1982.*

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[*][Currently codified at rule G-3(b)(iii)(B).]

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**Municipal securities principal: MSRB registered dealer.** This is in response to your March 21, 1994 letter to [name deleted] of the National Association of Securities Dealers, a copy of which you sent to my attention. The issue in question is whether [name deleted] (the "Dealer") is required at this time to have someone qualified as a municipal securities principal.

You note in your letter that the activities that the Dealer will be engaging in currently do not involve municipal securities; therefore, you concluded that the Dealer is not subject to the Board's requirement that the dealer have at least one municipal securities principal.

Board rules apply only to brokers, dealers and municipal securities dealers who have registered as such with the Securities and Exchange Commission ("SEC") and who engage in municipal securities activities. A dealer "registers" with the Board, pursuant to rule A-12, on the Board's initial fee, by submitting a letter with certain information and paying the ... initial fee along with the ... annual fee pursuant to rule A-14, on the Board's annual fee. Rule A-12 requires that the information and fee be submitted to the Board prior to the dealer engaging in municipal securities activities. Once a dealer is "registered" with the Board all Board rules are applicable to that dealer including the requirement in rule G-3, on professional qualifications, that every dealer shall have at least one municipal securities principal.[1]

Regardless of whether the Dealer is currently engaging in municipal securities activities, the dealer has "registered" with the Board and is subject to the Board's requirement that the dealer have a municipal securities principal.[2] If the Dealer determines that it does not wish to remain "registered" with the Board upon its conclusion that it is not engaging in municipal securities activities, rule A-15(a), on notification to Board of termination, requires that the Dealer submit a letter to the Board with a statement of its termination. In the future, should the dealer remain a registered broker or dealer with the SEC and make a determination that it will be engaging in municipal securities activities, the dealer will have to "register" with the Board pursuant to the requirements of rules A-12 and A-14 prior to engaging in municipal securities activities and, of course, meet the Board's numerical requirements concerning municipal securities principals. *MSRB interpretation of March 30, 1994.*

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[1] Rule G-3(b)(iii) requires that a dealer have two municipal securities principals if the dealer performs only municipal securities activities and it employs eleven or more persons associated with it in whatever capacity on a full-time or full-time equivalent basis who are engaged in the performance of its municipal securities activities.

[2] I have enclosed a copy of the December 14, 1993 letter you submitted to the Board pursuant to rule A-12.

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**Municipal securities principal: bank operations.** I am writing in response to your letter of April 26, 1983 concerning the results of a recent examination of your bank's municipal securities dealer department by examiners from the Office of the Comptroller of the Currency. In your letter you indicate that the examiners expressed the view that the bank's present organizational structure did not comport with the definition of a "separately identifiable department or division of a bank" set forth in Board rule G-1. You note that the examiners' basis for this conclusion was their belief that the municipal securities processing functions of the bank were not under the supervision of a qualified municipal securities principal. You state that you disagree with the examiners' conclusions, and you request that the Board indicate whether, in its view, the organizational structure through which the bank presently carries on its municipal securities activities is satisfactory for purposes of compliance with Board rules.

As a general matter we would hesitate to disagree with the opinion expressed by on-site examiners in a matter of this sort. The examiners are, of course, in direct contact with the matter in question, and have access to the full details of the situation, rather than an abstraction or summary of the particulars. Accordingly, we are unable to express a view that the examiners' conclusions are incorrect in the circumstances you describe.

With respect to the specific issues which you raise, it is not impossible for a bank to establish a "separately identifiable department or division" for purposes of rule G-1 which includes areas in the bank which, for other purposes (*e.g.*, for general bank organizational and reporting purposes), would be considered separate. To the extent that such areas are engaged in municipal securities dealer activities (as enumerated in rule G-1), however, they must be under the supervision of the person or persons designated by the bank's board of directors, in accordance with rule G-1(a)(1), as responsible for the conduct of such activities.

As you are aware, the person or persons who are responsible for the management and supervision of the day-to-day activities of the municipal securities processing area need not be qualified as municipal securities principals if they do not have policy-making authority with respect to such activities. However, such activities must be subject to the supervision of a municipal securities principal. Therefore, if those directly involved in the day-to-day supervision of the municipal securities processing activities do not have policy-making authority over such activities and, as a consequence, are not qualified as municipal securities principals, a person who is qualified as a municipal securities principal (whether that person designated by the bank's board of directors pursuant to rule G-1(a)(1) or some other person who is subordinate to that person) must be designated as having responsibility for the supervision of the processing activities. The bank's supervisory procedures should appropriately reflect such designation and set forth the manner in which the designated person will carry out these responsibilities. *MSRB interpretation of May 13, 1983.*

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**Disqualification of municipal securities principals.** In our recent telephone conversation you asked whether the Board has interpreted rule G-3(c)(iv)[*] as to the qualification status of a municipal securities principal in circumstances where the bank dealer, with which the individual is associated, fails to effect a municipal security transaction for a period of two or more years. You proposed that, if there are no municipal securities transactions for the principal to supervise, the individual would not be considered to be "acting as a municipal securities principal" and, consequently, the individual's qualification as a municipal securities principal would lapse after a two-year period of such inactivity.

The Board has considered a similar situation and given an interpretation in the matter. It reaffirmed the interpretation that an individual whose responsibilities no longer include supervision of municipal securities activities probably will not be able to remain adequately informed in the supervisory and compliance matters of concern to municipal securities principals, and that continuing association with a municipal securities dealer, in a capacity other than that of a municipal securities principal, is not sufficient to maintain qualification as a municipal securities principal. However, the Board also concluded that it did not intend this interpretation of rule G-3(c)(iv)[*] to mean that a dealer must necessarily effect transactions in municipal securities in order for its municipal securities principal to maintain such qualification. The Board noted that the definition of a municipal securities principal not only includes supervision of trading or sales, but of other municipal securities activities as well. Consequently, the Board determined that the qualification of a municipal securities principal should not automatically terminate because the individual is associated with a municipal securities broker or dealer which has not effected a municipal securities transaction in two or more years, but that to maintain such qualification the individual must demonstrate clearly that:

> —the municipal securities broker or dealer was engaged in municipal securities activity during this period (*e.g.*, determinations of suitability involving municipal securities, recommendations to customers, advertising, financial advisory activity with respect to municipal issuers); and
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> —the individual in question had been designated with supervisory responsibility for such municipal securities activities during this period. *MSRB interpretation of January 15, 1987.*

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[*][Currently codified at rule G-3(b)(ii)(C).]

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**"Municipal Securities Principal" defined.** This is in response to your letter of January 28, 1987, and subsequent telephone conversations with the Board's staff, requesting an interpretation of Board rule G-3(a)(i)[*], the definition of the term "Municipal Securities Principal". You ask whether an individual, who has day-to-day responsibility for directing the municipal underwriting activities of a firm, must be qualified as a municipal securities principal. You suggest that such activity seems to meet the definition of a municipal securities principal, namely, an individual who is "directly engaged in the management, direction or supervision of . . . underwriting . . . of municipal securities." You note that this individual has the authority to make underwriting commitments in the name of the firm, but that the firm's president is designated with supervisory responsibility for this individual's underwriting activity. Also, you indicated that this individual does not have supervisory responsibility for any other representative.

Your request for an interpretation was referred to a Committee of the Board which has responsibility for professional qualification matters. The Committee concluded that the individual you describe would not be required to qualify as a municipal securities principal, provided that her responsibilities are limited to directing the day-to-day underwriting activities of the dealer, and provided that these responsibilities are carried out within policy guidelines established by the dealer and under the direct supervision of a municipal securities principal. The Committee is also of the opinion that commitment authority alone is not indicative of principal activity, but rather is inherent in the underwriting activities of a municipal securities representative. *MSRB interpretation of February 27, 1987.*

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[*][Currently codified at rule G-3(b)(i).]

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**Municipal securities representative.** Your letter dated October 16, 1978, has been referred to me for response. In your letter, you request clarification of whether personnel in your firm will have to take and pass the Board's qualification examination for municipal securities representatives, since they only effect transactions with other municipal securities professionals.

Board rule G-3(a)(iii)[*] defines the term "municipal securities representative" to mean a natural person associated with a municipal securities broker or municipal securities dealer who performs certain specified functions, which include "trading or sales of municipal securities." A person is deemed to be a municipal securities representative under the rule whether he or she engages in such activities with customers or only other municipal securities professionals. Accordingly, personnel in your firm who only trade with, or sell securities to other municipal securities professionals will have to take and pass the examination for municipal securities representatives, unless they are exempted under the provisions of rule G-3(e)(ii)[†]. *MSRB interpretation of October 27, 1978.*

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[*][Currently codified at rule G-3(a)(i).]

[†][Currently codified at rule G-3(a)(ii)(B).]

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**Municipal securities representative: credit department employees.** This will acknowledge receipt of your letter of October 18, 1979, concerning a proposed arrangement for the performance of municipal credit analysis functions at your bank. In your letter you indicate that the bank wishes to have certain basic statistical and data gathering activities with respect to proposed new issues of municipal securities performed by its Credit Department. The Credit Department will provide the information resulting from these activities to registered personnel in the Investment Department, which will evaluate the credit of the issuer and determine the appropriateness of the issue for the bank's own investment activities and for the bank's customers. You inquire whether the personnel in the Credit Department

would be required to register and qualify as municipal securities representatives due to their performance of these activities.

Your question was referred to a committee of the Board which has the responsibility for administering the professional qualifications program on the Board's behalf. The Committee concluded that such persons would not be required to register and qualify as representatives if their functions are limited to information-gathering and performance of basic statistical computations. However, if such persons engage in any type of evaluative activity or if such persons make recommendations or suggest conclusions with respect to the securities, registration and qualification would be required. Further, should these persons produce any documents or research products intended for distribution or for use in the solicitation of customers, they would be required to register and qualify. *MSRB interpretation of December 10, 1979.*

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**Clerical or ministerial duties.** This will acknowledge receipt of your letter in which you request advice concerning whether certain persons employed by [Name deleted] must qualify as municipal securities representatives under rule G-3.

In the case of one of the individuals, you state in your letter that he is responsible for calculating coupon rates for new issue securities, based on information provided to him by persons in [Name deleted] underwriting department. According to your letter, the individual has some discretion to "revise coupon rates to a more marketable figure," but all of his activities are subject to the approval of, and supervised by, municipal securities professionals in the department. We understand that he does not communicate with issuers, customers or other municipal securities dealers.

Based upon the facts set forth in your letter, we are of the view that the individual described performs only clerical or ministerial functions in calculating the coupon scale, and he is therefore not a municipal securities representative within the meaning of rule G-3.

In your letter, you also request advice regarding certain individuals whose only function is to receive telephonic orders for municipal securities from municipal securities dealers. We understand that these individuals do not solicit orders, negotiate prices or the terms of transactions, or transmit offers to prospective purchasers, nor do they communicate at any time with customers. Based upon the facts you have provided, we are of the opinion that these individuals perform only clerical or ministerial functions, and they are therefore also not municipal securities representatives within the meaning of rule G-3. *MSRB interpretation of December 8, 1978.*

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**Clerical or ministerial duties.** I refer to your letter of June 22, 1979, in which you request advice regarding the applicability of rule G-3 on professional qualifications to an employee of [Company name deleted]. According to your letter, the activities of the employee in question are limited to checking the mathematical accuracy of bids received by an issuer for which [Company name deleted] acts as financial advisor and reporting the results to the issuer.

Based on the facts stated in your letter, the employee is not required to qualify as a municipal securities representative under rule G-3. The Board does not intend the qualification requirements of the rule to apply to persons performing solely clerical or ministerial functions, such as in this case. *MSRB interpretation of July 24, 1979.*

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**"Finder" of potential issuers.** This responds to your letter of May 14, 1981 requesting our advice concerning the application of the qualification provisions of rule G-3 to a person employed by a municipal securities broker or dealer whose activities are limited solely to acting as a "finder" of potential issuers. Based upon the facts contained in your letter, and assuming that such person is not providing financial advisory or consultant services for issuers, it would appear that he or she is not performing functions, which are enumerated in rule G-3(a), the performance of which would require qualification as a municipal securities principal or a municipal securities representative. *MSRB interpretation of June 24, 1981.*

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**Persons engaged in financial advisory activities.** I am writing to confirm our telephone conversation of this afternoon concerning the registration and qualification requirements applicable to persons in your firm's public finance department. In our conversation you inquired whether persons who function as financial advisors to municipal issuers, providing advice to such issuers regarding the structure, timing and terms of new issues of municipal securities to be sold by such issuers, are required to be qualified. As I indicated, such persons are required to be registered and qualified as municipal securities representatives. Furthermore, persons who supervise representatives performing such financial advisory services are required to be registered and qualified as municipal securities principals.

For your information, the provision of financial advisory services to municipal issuers is defined to be a municipal securities representative function in Board rule G-3(a)(iii)(B)[*]. The requirement that persons performing such function be qualified is set forth generally in rules G-2 and G-3, and the specific qualification requirements applicable to such persons are stated in rules G-3(e)[†] and (i)[‡]. *MSRB interpretation of June 10, 1982.*

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[*][Currently codified at rule G-3(a)(i)(B).]

[†][Currently codified at rule G-3(a)(ii).]

[‡][Currently codified at rule G-3(a)(iii).]

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**Cold calling.** This is in response to your letter regarding the application of rule G-3, concerning professional qualifications, to non-qualified individuals contacting institutional investors. You refer to the Board's December 21, 1984 notice stating that non-qualified individuals making "cold calls" to individuals and introducing the services offered by a municipal securities dealer, prequalifying potential customers or suggesting the purchase of securities must be qualified as a municipal securities representatives. You ask whether a non-qualified individual may make a "cold call" to an institutional portfolio manager solely for the purpose of introducing the name of the municipal securities dealer to the portfolio manager and to inquire as to the type of securities in which it invests. You state that the individual or individuals making the calls would be specifically instructed not to discuss the purchase or sale of any specific security.

Board rule G-3(a)(iii)[*] defines municipal securities representative activities to include any activity which involves communication with public investors regarding the sale of municipal securities but exempts activities that are solely clerical or ministerial. As you noted, in December 1984, the Board issued an interpretation of rule G-3 which states that individuals who solicit new account business are not engaging in clerical or ministerial activities but rather are communicating with public investors regarding the sale of municipal securities and thus are engaging in municipal securities representative activities which require such individuals to be qualified as representatives under the Board's rules. Examples of solicitation of new account business stated in the notice included "cold calls" to individuals during which the non-qualified individual introduces the services offered by the dealers, prequalified potential customers, or suggests the purchase of specific securities currently being offered by a municipal securities dealer. An individual who introduces the name of the municipal securities dealer and inquires as to the type of securities in which a portfolio manager invests would be communicating with the public in an attempt to prequalify potential customers and thus must be qualified as a municipal securities representative. *MSRB interpretation of January 5, 1987.*

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[*][Currently codified at rule G-3(a)(i).]

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**Supervision of data processing functions.** I am writing in response to your letter of November 7, 1988 and our subsequent tele-

phone conversation by which you requested an interpretation of the Board's qualification requirements for municipal securities principals. You asked whether an individual, who is presently qualified as a representative, additionally must be qualified as a municipal securities principal because he has oversight and supervisory responsibility for the firm's data processing department.

Board rule G-3(a)(i)[*] defines a municipal securities principal as a person directly engaged in the management, direction or supervision of one or more enumerated representative activities. Consequently, whether or not this individual must be qualified as a municipal securities principal depends on whether he is supervising such activities, i.e., whether the data processing department employees are functioning as municipal securities representatives.

You state that the data processing department assists this individual by performing the calculations necessary in the structuring of municipal bond issues and underwritings. Moreover, you note that the employees in the data processing department do not communicate with customers, including issuers, in carrying out their duties and that the above financial advisory and underwriting activities are otherwise supervised by a qualified municipal securities principal.

Based upon the facts set forth above, we are of the view that the individual described supervises only clerical or ministerial functions, and he is therefore not a municipal securities principal within the meaning of Board rule G-3. *MSRB interpretation of December 9, 1988.*

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[*][Currently codified at rule G-3(b)(i).]

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See also:

**Rule G-1 Interpretive Letter – Portfolio credit analyst,** *MSRB interpretation of June 8, 1978.*

**Rule G-2 Interpretive Letter – Execution of infrequent unsolicited orders,** *MSRB interpretation of October 2, 1998.*

**Rule G-27 Interpretive Letter – Supervisory structure,** *MSRB interpretation of March 11, 1987.*

## Rule G-4: Statutory Disqualifications

(a) Except as otherwise provided in sections (b) and (c) of this rule, no broker, dealer or municipal securities dealer or natural person shall be qualified for purposes of rule G-2 if, by action of a national securities exchange or registered securities association, such broker, dealer or municipal securities dealer has been and is expelled or suspended from membership or participation in such exchange or association, or such natural person has been and is barred or suspended from being associated with a member of such exchange or association:

(i) for violation of any rules of such exchange or association which prohibit any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or which requires any act the omission of which constitutes conduct inconsistent with such just and equitable principles of trade; or

(ii) by reason of any statutory disqualification of the character described in subparagraphs (C), (D), (E) or (F) of section 3(a)(39) of the Act.

(b) A broker, dealer or municipal securities dealer or natural person shall be qualified for purposes of rule G-2, notwithstanding the provisions of paragraph (a)(i) of this rule, if the Commission shall so determine upon application by such broker, dealer or municipal securities dealer or natural person in accordance with such standards and procedures as are set forth in rule 19h-1(d) under the Act with respect to registered brokers and dealers and their associated persons.

(c) Notwithstanding the provisions of paragraph (a)(ii) of this rule, a broker, dealer or municipal securities dealer or natural person shall be qualified for purposes of rule G-2 upon a determination by a registered securities association in the case of one of its members or such member's associated persons, by the Commission in the case of any other broker, dealer or municipal securities dealer (other than a bank dealer) or their associated persons, or by the appropriate regulatory authority in the case of any bank dealer or such bank dealer's associated persons, upon application by such broker, dealer, or municipal securities dealer or natural person.

## Rule G-5: Disciplinary Actions by Appropriate Regulatory Agencies; Remedial Notices by Registered Securities Associations

(a) No broker, dealer or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security in contravention of any effective restrictions imposed upon such broker, dealer or municipal securities dealer by the Commission pursuant to sections 15(b)(4) or (5) or 15B(c)(2) or (3) of the Act or by an appropriate regulatory agency pursuant to section 15B(c)(5) of the Act or by a registered securities association pursuant to rules adopted under section 15A(b)(7) of the Act, and no natural person shall be associated with a broker, dealer or municipal securities dealer in contravention of any effective restrictions imposed upon such person by the Commission pursuant to sections 15(b)(6) or 15B(c)(4) of the Act or by an appropriate regulatory agency pursuant to section 15B(c)(5) of the Act or by a registered securities association pursuant to rules adopted under section 15A(b)(7) of the Act.

(b) No broker, dealer or municipal securities dealer that is a member of a registered securities association shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security, or otherwise act in contravention of or fail to act in accordance with rules adopted by the association as of April 3, 1984, pertaining to remedial activities of members experiencing financial or operational difficulties, as if such rules were applicable to such broker, dealer or municipal securities dealer.

## Rule G-6: Fidelity Bonding Requirements

No broker, dealer or municipal securities dealer that is a member of a registered securities association shall be qualified for purposes of rule G-2 unless such broker, dealer or municipal securities dealer has met the fidelity bonding requirements set forth in the rules of such association, to the same extent as if such rules were applicable to such broker, dealer or municipal securities dealer.

### *BACKGROUND*

Rule G-6 prescribes fidelity bonding requirements for brokers, dealers and municipal securities dealers (other than bank dealers).

## NASD Rule 3020: Fidelity Bonds

(a) Coverage Required

Each member required to join the Securities Investor Protection Corporation who has employees and who is not a member in good standing of the American Stock Exchange, Inc.; the Boston Stock Exchange; the Midwest Stock Exchange, Inc.; the New York Stock Exchange, Inc.; the Pacific Exchange, Inc.; the Philadelphia Stock Exchange, Inc.; or the Chicago Board Options Exchange shall:

(1) Maintain a blanket fidelity bond, in a form substantially similar to the standard form of Brokers Blanket Bond promulgated by the Surety Association of America, covering officers and employees which provides against loss and has agreements covering at least the following:

(A) Fidelity

(B) On Premises

(C) In Transit

(D) Misplacement

(E) Forgery and Alteration (including check forgery)

(F) Securities Loss (including securities forgery)

(G) Fraudulent Trading

(H) Cancellation Rider providing that the insurance carrier will use its best efforts to promptly notify the National Association of Securities Dealers, Inc. in the event the bond is cancelled, terminated or substantially modified.

(2) Maintain minimum coverage for all insuring agreements required in this paragraph (a) of not less than $25,000;

(3) Maintain required minimum coverage for Fidelity, On Premises, In Transit, Misplacement and Forgery and Alteration insuring agreements of not less than 120% of its required net capital under SEC Rule 15c3-1 up to $600,000. Minimum coverage for required net capital in excess of $600,000 shall be determined by reference to the following table:

| Net Capital Requirement under Rule 15c3-1 | Minimum Coverage |
|---|---|
| $ 600,000 – 1,000,000 | 750,000 |
| 1,000,001 – 2,000,000 | 1,000,000 |
| 2,000,001 – 3,000,000 | 1,500,000 |
| 3,000,001 – 4,000,000 | 2,000,000 |
| 4,000,001 – 6,000,000 | 3,000,000 |
| 6,000,001 – 12,000,000 | 4,000,000 |
| 12,000,001 and above | 5,000,000 |

(4) Maintain Fraudulent Trading coverage of not less than $25,000 or 50% of the coverage required in paragraph (a)(3), whichever is greater, up to $500,000;

(5) Maintain Securities Forgery coverage of not less than $25,000 or 25% of the coverage required in paragraph (a)(3), whichever is greater, up to $250,000.

(b) **Deductible Provision**

(1) A deductible provision may be included in the bond of up to $5,000 or 10% of the minimum insurance requirement established hereby, whichever is greater.

(2) If a member desires to maintain coverage in excess of the minimum insurance requirement then a deductible provision may be included in the bond of up to $5,000 or 10% of the amount of blanket coverage provided in the bond purchased, whichever is greater. The excess of any such deductible amount over the maximum permissible deductible amount described in subparagraph (1) above must be deducted from the member's net worth in the calculation of the member's net capital for purposes of SEC Rule 15c3-1. Where the member is a subsidiary of another Association member the excess may be deducted from the parent's rather than the subsidiary's net worth, but only if the parent guarantees the subsidiary's net capital in writing.

(c) **Annual Review of Coverage**

(1) Each member, other than members covered by subparagraph (2), shall annually review, as of the anniversary date of the issuance of the bond, the adequacy thereof by reference to the highest required net capital during the immediately preceding twelve-month period, which amount shall be used to determine minimum required coverage for the succeeding twelve-month period pursuant to subparagraphs (a)(2), (3), (4) and (5).

(2) Each member which has been in business for one year shall, as of the first anniversary date of the issuance of its original bond, review the adequacy thereof by reference to an amount calculated by dividing the highest aggregate indebtedness it experienced during its first year by 15. Such amount shall be used in lieu of required net capital under SEC Rule 15c3-1 in determining the minimum required coverage to be carried in the member's second year pursuant to subparagraphs (a)(2), (3), (4) and (5). Notwithstanding the above, no such member shall carry less minimum bonding coverage in its second year than it carried in its first year.

(3) Each member shall make required adjustments not more than sixty days after the anniversary date of the issuance of such bond.

(4) Any member subject to the requirements of this paragraph (c) may apply for an exemption from the requirements of this paragraph (c). The application shall be made pursuant to Rule 9610 of the Code of Procedure. The exemption may be granted upon a showing of good cause, including a substantial change in the circumstances or nature of the member's business that results in a lower net capital requirement. The NASD may issue an exemption subject to any condition or limitation upon a member's bonding coverage that is deemed necessary to protect the public and serve the purposes of this Rule.

(d) **Notification of Change**

Each member shall report the cancellation, termination or substantial modification of the bond to the Association within ten business days of such occurrence.

(e) **Definitions**

For purposes of fidelity bonding the term "employee" or "employees" shall include any person or persons associated with a member firm (as defined in Article I, paragraph (q) of the By-Laws) except:

(1) Sole Proprietors

(2) Sole Stockholders

(3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.

## Rule G-7: Information Concerning Associated Persons

(a) No associated person (as hereinafter defined) of a broker, dealer or municipal securities dealer shall be qualified for purposes of rule G-2 of the Board unless such associated person meets the requirements of this rule. The term "associated person" as used in this rule means (i) a municipal securities principal, (ii) a municipal securities sales principal, (iii) a financial and operations principal, and (iv) a municipal securities representative.

(b) Every broker, dealer and municipal securities dealer shall obtain from each of its associated persons (as defined in section (a) of this rule), and each associated person shall furnish to the broker, dealer or municipal securities dealer with which such person is or seeks to be associated, a questionnaire, which shall be signed by a municipal securities principal or general securities principal, containing at least the following information:

(i) such person's name, residence address, social security number, and the starting date or anticipated starting date of such person's employment or other association with such broker, dealer or municipal securities dealer;

(ii) date of birth;

(iii) a complete, consecutive statement of employment and personal history for at least the immediately preceding ten years, including full time and part time employment, self employment, military service, unemployment, or full-time education. For each period of employment, the position held at the time of leaving said employment;

(iv) a record of all residential addresses for at least the immediately preceding five years;

(v) a record of any denial of membership or registration, and of any disciplinary action taken against, or sanction imposed upon, such person by any federal or state securities or federal or state bank regulatory agency or by any national securities exchange or registered securities association, including any finding that such person was a cause of any disciplinary action or violated any law;

(vi) a record of any denial, suspension or revocation of registration with the Commission as a broker, dealer, or municipal securities dealer or of any denial, suspension or revocation of, or expulsion from, membership in a national securities exchange or a registered securities association, of any broker, dealer, or municipal securities dealer with which such person was associated in any capacity when such action was taken;

(vii) a record of any permanent or temporary injunction entered against such person pursuant to which such person was enjoined from acting as an investment advisor, underwriter, broker, dealer, or municipal securities dealer, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with purchase or sale of any security;

(viii) a record of any convictions of such person within the past ten years involving the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense; or arising out of the conduct of the business of a broker, dealer, municipal securities dealer, investment advisor, bank, insurance company or fiduciary; or involving the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or involving the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of title 18, United States Code;

(ix) a record of any refusal by a surety company to issue a fidelity bond covering such person; any payments made by a surety company on coverage of such person or cancellation of such coverage; and a statement whether such person is currently bonded; and

(x) a record of any other name or names by which such person has been known or which such person has used.

A completed Form U-4 or similar form prescribed by the Commission or a registered securities association for brokers, dealers and municipal securities dealers other than bank dealers or, in the case of a bank dealer a completed Form MSD-4 or similar form prescribed by the appropriate regulatory agency for such bank dealer, containing the foregoing information, shall satisfy the requirements of this section.

(c) To the extent any information furnished by an associated person pursuant to section (b) of this rule is or becomes materially inaccurate or incomplete, such associated person shall furnish in writing to the broker, dealer or municipal securities dealer with which such person is or seeks to be associated a statement correcting such information.

(d) For the purpose of verifying the information furnished by an associated person pursuant to section (b) of this rule, every broker, dealer and municipal securities dealer shall make inquiry of all employers of such associated person during the three years immediately preceding such person's association with such broker, dealer or municipal securities dealer concerning the accuracy and completeness of such information as well as such person's record and reputation as related to the person's ability to perform his or her duties and each such prior employer which is a broker, dealer or municipal securities dealer shall make such information available within ten business days following a request made pursuant to the requirements of this section (d).

(e) Every broker, dealer and municipal securities dealer shall maintain and preserve a copy of the questionnaire furnished pursuant to section (b) of this rule, and of any additional statements furnished pursuant to section (c) of this rule, until at least three years after the associated person's employment or other association with such broker, dealer or municipal securities dealer has terminated.

(f) Every broker, dealer and municipal securities dealer shall maintain and preserve a record of the name and residence address of each associated person, designated by the category of function performed (whether municipal securities principal, municipal securities sales principal, municipal securities representative or financial and operations principal) and indicating whether such person has taken and passed the qualification examination for municipal securities principals, municipal securities sales principals, municipal securities representatives or financial and operations principals prescribed by the Board or was exempt from the requirement to take and pass such examination, indicating the basis for such exemption, until at least three years after the associated person's employment or other association with such broker, dealer or municipal securities dealer has terminated.

(g) Every broker, dealer and municipal securities dealer which is a member of a registered securities association shall file with such association, every bank dealer shall file with the appropriate regulatory agency for such bank dealer, and every broker, dealer or municipal securities dealer other than a bank dealer which is not a member of a registered securities association shall file with the Commission, such of the information prescribed by this rule as such association, agency, or the Commission, respectively, shall by rule or regulation require.

(h) Any records required to be maintained and preserved pursuant to this rule shall be preserved in accordance with the requirements of sections (d), (e) and (f) of rule G-9 of the Board.

***BACKGROUND***

Rule G-7 prescribes certain types of information that associated persons are required to submit to the municipal securities brokers and municipal securities dealer with which they are associated. This information relates generally to such associated persons' employment history and professional background, including any disciplinary sanctions and the bases claimed, if any, for exemption from the Board's examination requirements for municipal securities principals, financial and operations principals, and municipal securities representatives.

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

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

(i) *Records of Original Entry*. "Blotters" or other records of original entry containing an itemized daily record of all purchases and sales of municipal securities, all receipts and deliveries of municipal securities (including certificate numbers and, if the securities are in registered form, an indication to such effect), all receipts and disbursement of cash with respect to transactions in municipal securities, all other debits and credits pertaining to transactions in municipal securities, and in the case of brokers, dealers and municipal securities dealers other than bank dealers, all other cash receipts and disbursements if not contained in the records required by any other provision of this rule. The records of original entry shall show the name or other designation of the account for which each such transaction was effected (whether effected for the account of such broker, dealer or municipal securities dealer, the account of a customer, or otherwise), the description of the securities, the aggregate par value of the securities, the dollar price or yield and aggregate purchase or sale price of the securities, accrued interest, the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered. With respect to accrued interest and information relating to "when issued" transactions which may not be available at the time a transaction is effected, entries setting forth such information shall be made promptly as such information becomes available. Dollar price, yield and accrued interest relating to any transaction shall be required to be shown only to the extent required to be included in the confirmation delivered by the broker, dealer or municipal securities dealer in connection with such transaction under rule G-12 or rule G-15.

(ii) *Account Records*. Account records for each customer account and account of such broker, dealer or municipal securities dealer. Such records shall reflect all purchases and sales of municipal securities, all receipts and deliveries of municipal securities, all receipts and disbursements of cash, and all other debits and credits relating to such account. A bank dealer shall not be required to maintain a record of a customer's bank credit or bank debit balances for purposes of this subparagraph.

(iii) *Securities Records*. Records showing separately for each municipal security all positions (including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, securities in safekeeping) carried by such broker, dealer or municipal securities dealer for its account or for the account of a customer (with all "short" trading positions so designated), the location of all such securities long and the offsetting position to all such securities short, and the name or other designation of the account in which each position is carried. Such records shall also show all long security count differences and short count differences classified by the date of physical count and verification on which they were discovered. Such records shall consist of a single record system. With respect to purchases or sales, such records may be posted on either a settlement date basis or a trade date basis, consistent with the manner of posting the records of original entry of such broker, dealer or municipal securities dealer. For purposes of this subparagraph, multiple maturities of the same issue of municipal securities, as well as multiple coupons of the same maturity, may be shown on the same record, provided that adequate secondary records exist to identify separately such maturities and coupons. With respect to securities which are received in and delivered out by such broker, dealer or municipal securities dealer the same day on or before the settlement date, no posting to such records shall be required. Anything herein to the contrary notwithstanding, a non-clearing broker, dealer or municipal securities dealer which effects transactions for the account of customers on a delivery against payment basis may keep the records of location required by this subparagraph in the form of an alphabetical list or lists of securities showing the location of such securities rather than a record of location separately for each security. Anything herein to the contrary notwithstanding, a bank dealer shall maintain records of the location of securities in its own trading account.

(iv) *Subsidiary Records*. Ledgers or other records reflecting the following information:

(A) *Municipal securities in transfer*. With respect to municipal securities which have been sent out for transfer, the description and the aggregate par value of the securities, the name in which registered, the name in which the securities are to be registered, the date sent out for transfer, the address to which sent for transfer, former certificate numbers, the date returned from transfer, and new certificate numbers.

(B) *Municipal securities to be validated*. With respect to municipal securities which have been sent out for validation, the description and the aggregate par value of the securities, the date sent out for validation, the address to which sent for validation, the certificate numbers, and the date returned from validation.

(C) *Municipal securities borrowed or loaned*. With respect to municipal securities borrowed or loaned, the date borrowed or loaned, the name of the person from whom borrowed or to whom loaned, the description and the aggregate par value of the securities borrowed or loaned, the value at which the securities were borrowed or loaned, and the date returned.

(D) *Municipal securities transactions not completed on settlement date*. With respect to municipal securities trans-

actions not completed on the settlement date, the description and the aggregate par value of the securities which are the subject of such transactions, the purchase price (with respect to a purchase transaction not completed on the settlement date), the sale price (with respect to a sale transaction not completed on the settlement date), the name of the customer, broker, dealer or municipal securities dealer from whom delivery is due or to whom delivery is to be made, and the date on which the securities are received or delivered. All municipal securities transactions with brokers, dealers and municipal securities dealers not completed on the settlement date shall be separately identifiable as such. For purposes of this rule, the term "settlement date" means the date upon which delivery of the securities is due in a purchase or sale transaction.

Such records shall be maintained as subsidiary records to the general ledger maintained by such broker, dealer or municipal securities dealer. Anything herein to the contrary notwithstanding, the requirements of this subparagraph will be satisfied if the information described is readily obtainable from other records maintained by such broker, dealer or municipal securities dealer.

(v) *Put Options and Repurchase Agreements*. Records of all options (whether written or oral) to sell municipal securities (*i.e.*, put options) and of all repurchase agreements (whether written or oral) with respect to municipal securities, in which such broker, dealer or municipal securities dealer has any direct or indirect interest or which such broker, dealer or municipal securities dealer has granted or guaranteed, showing the description and aggregate par value of the securities, and the terms and conditions of the option, agreement or guarantee.

(vi) *Records for Agency Transactions*. A memorandum of each agency order and any instructions given or received for the purchase or sale of municipal securities pursuant to such order, showing the terms and conditions of the order and instructions, and any modification thereof, the account for which entered, the date and time of receipt of the order by such broker, dealer or municipal securities dealer, the price at which executed, the date of execution and, to the extent feasible, the time of execution and, if such order is entered pursuant to a power of attorney or on behalf of a joint account, corporation or partnership, the name and address (if other than that of the account) of the person who entered the order. If an agency order is canceled by a customer, such records shall also show the terms, conditions and date of cancellation, and, to the extent feasible, the time of cancellation. Orders entered pursuant to the exercise of discretionary power by such broker, dealer or municipal securities dealer shall be designated as such. For purposes of this subparagraph, the term "agency order" shall mean an order given to a broker, dealer or municipal securities dealer to buy a specific security from another person or to sell a specific security to another person, in either case without such broker, dealer or municipal securities dealer acquiring ownership of the security. Customer inquiries of a general nature concerning the availability of securities for purchase or opportunities for sale shall not be considered to be orders. For purposes of this subparagraph and subparagraph (vii) below, the term "memorandum" shall mean a trading ticket or other similar record. For purposes of this subparagraph, the term "instructions" shall mean instructions transmitted within an office with respect to the execution of an agency order, including, but not limited to, instructions transmitted from a sales desk to a trading desk.

(vii) *Records for Transactions as Principal*. A memorandum of each transaction in municipal securities (whether purchase or sale) for the account of such broker, dealer or municipal securities dealer, showing the price and date of execution and, to the extent feasible, the time of execution; and in the event such purchase or sale is with a customer, a record of the customer's order, showing the date and time of receipt, the terms and conditions of the order, and the name or other designation of the account in which it was entered and, if such order is entered pursuant to a power of attorney or on behalf of a joint account, corporation, or partnership, the name and address (if other than that of the account) of the person who entered the order.

(viii) *Records of Syndicate Transactions*. With respect to each syndicate or similar account formed for the purchase of municipal securities, records shall be maintained by a managing underwriter designated by the syndicate or account to maintain the books and records of the syndicate or account, showing the description and aggregate par value of the securities, the name and percentage of participation of each member of the syndicate or account, the terms and conditions governing the formation and operation of the syndicate or account (including a separate statement of all terms and conditions required by the issuer), all orders received for the purchase of the securities from the syndicate or account (except bids at other than syndicate price), all allotments of securities and the price at which sold, the date and amount of any good faith deposit made to the issuer, the date of settlement with the issuer, the date of closing of the account, and a reconciliation of profits and expenses of the account.

(ix) *Copies of Confirmations, Periodic Statements and Certain Other Notices to Customers*. A copy of all confirmations of purchase or sale of municipal securities, of all periodic written statements disclosing purchases, sales or redemptions of municipal fund securities pursuant to rule G-15(a)(viii), of written disclosures to customers, if any, as required under rule G-15(f)(iii) and, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, of all other notices sent to customers concerning debits and credits to customer accounts or, in the case of a bank dealer, notices of debits and credits for municipal securities, cash and other items with respect to transactions in municipal securities.

(x) *Financial Records*. Every broker, dealer and municipal securities dealer subject to the provisions of rule 15c3-1 under the Act shall make and keep current the books and records described in subparagraphs (a)(2), (a)(4)(iv) and (vi), and (a)(11) of rule 17a-3 under the Act.

(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) customer's name and residence or principal business address;

(B) whether customer is of legal age;

(C) tax identification or social security number;

(D) occupation;

(E) name and address of employer;

(F) information about the customer used pursuant to rule G-19(c)(ii) in making recommendations to the customer. For non-institutional accounts, all data obtained pursuant to rule G-19(b) shall be recorded.

(G) name and address of beneficial owner or owners of such account if other than the customer and transactions are to be confirmed to such owner or owners;

(H) signature of municipal securities representative, general securities representative or limited representative–investment company and variable contracts products introducing the account and signature of a municipal securities principal, municipal securities sales principal or general securities principal indicating acceptance of the account;

(I) with respect to discretionary accounts, customer's written authorization to exercise discretionary power or authority with respect to the account, written approval of municipal securities principal or municipal securities sales principal who supervises the account, and written approval of municipal securities principal or municipal securities sales principal with respect to each transaction in the account, indicating the time and date of approval;

(J) whether customer is employed by another broker, dealer or municipal securities dealer;

(K) in connection with the hypothecation of the customer's securities, the written authorization of, or the notice provided to, the customer in accordance with Commission rules 8c-1 and 15c2-1; and

(L) with respect to official communications, customer's written authorization, if any, that the customer does not object to the disclosure of its name, security position(s) and contact information to a party identified in G-15(g)(iii)(A)(1) for purposes of transmitting official communications under G-15(g).

For purposes of this subparagraph, the terms "general securities representative," "general securities principal" and "limited representative–investment company and variable contracts products" 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 (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); 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 broker, dealer 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) *Customer Complaints*. A record of all written complaints of customers, and persons acting on behalf of customers, and what action, if any, has been taken by such broker, dealer or municipal securities dealer in connection with each such complaint. The term "complaint" shall mean any written statement alleging a grievance involving the activities of the broker, dealer or municipal securities dealer or any associated persons of such broker, dealer or municipal securities dealer with respect to any matter involving a customer's account.

(xiii) *Records Concerning Deliveries of Official Statements*. A record of all deliveries to purchasers of new issue municipal securities, of official statements or other disclosures concerning the underwriting arrangements required under rule G-32 and, if applicable, a record evidencing compliance with section (a)(i)(C) of rule G-32.

(xiv) *Designation of Persons Responsible for Recordkeeping*. A record of all designations of persons responsible for the maintenance and preservation of books and records as required by rule G-27(b)(ii).

(xv) *Records Concerning Delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to the Board or its Designee*. A broker, dealer or municipal securities dealer that acts as an underwriter in a primary offering of municipal securities subject to rule G-36 (or, in the event a syndicate or similar account has been

formed for the purpose of underwriting the issue, the managing underwriter) shall maintain:

(A) a record of the name, par amount and CUSIP number or numbers for all such primary offerings of municipal securities; the dates that the documents and written information referred to in rule G-36 are received from the issuer and are sent to the Board or its designee; the date of delivery of the issue to the underwriters; and, for issues subject to Securities Exchange Act Rule 15c2-12, the date of the final agreement to purchase, offer or sell the municipal securities; and

(B) copies of the Forms G-36(OS) and G-36(ARD) and documents submitted to the Board or its designee along with the certified or registered mail receipt or other record of sending such forms and documents to the Board or its designee.

(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 non-MFP 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;

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

(F) the contributions, direct or indirect, to officials of an issuer made by each municipal finance professional, any political action committee controlled by a municipal finance professional, and non-MFP executive officer for the current year, which records shall include: (i) the names, titles, city/county and state of residence of contributors, (ii) the names and titles (including any city/county/state or other political subdivision) of the recipients of such contributions, (iii) the amounts and dates of such contributions, and (iv) whether any such contribution was the subject of an automatic exemption, pursuant to Rule G-37(j), including the amount of the contribution, the date the broker, dealer or municipal securities dealer discovered the contribution, the name of the contributor, and the date the contributor obtained a return of the contribution; provided, however, that such records need not reflect any contributions made by a municipal finance professional or non-MFP executive officer to officials of an issuer for whom such person is entitled to vote if the contributions made by such person, in total, are not in excess of $250 to any official of an issuer, per election. In addition, brokers, dealers and municipal securities dealers shall maintain separate listings for each of the previous two calendar years containing the information required pursuant to this subparagraph (F) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (A) and (B) of rule G-37(g)(iv) and for any political action committee controlled by such individuals, and separate listings for the previous six months containing the information required pursuant to this subparagraph (F) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (C), (D) and (E) of rule G-37(g)(iv) and for any political action committee controlled by such individuals and for any non-MFP executive officers; and

(G) the payments, direct or indirect, to political parties of states and political subdivisions made by all municipal finance professionals, any political action committee controlled by a municipal finance professional, and non-MFP executive officers for the current year, which records shall include: (i) the names, titles, city/county and state of residence of contributors, (ii) the names and titles (including any city/county/state or other political subdivision) of the recipients of such payments, and (iii) the amounts and dates of such payments; provided, however, that such records need not reflect those payments made by any municipal finance professional or non-MFP executive officer to a political party of a state or political subdivision in which such persons are entitled to vote if the payments made by such person, in total, are not in excess of $250 per political party, per year. In addition, brokers, dealers and municipal securities dealers shall maintain separate listings for each of the previous two calendar years containing the information required pursuant to this subparagraph (G) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (A) and (B) of rule G-37(g)(iv) and for any political action committee controlled by such individuals, and separate listings for the previous six months containing the information

required pursuant to this subparagraph (G) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (C), (D) and (E) of rule G-37(g)(iv) and for any political action committee controlled by such individuals and for any non-MFP executive officers.

(H) Brokers, dealers and municipal securities dealers shall maintain copies of the Forms G-37/G-38 and G-37x sent to the Board along with the certified or registered mail receipt or other record of sending such forms to the Board.

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

(J) No record is required by this paragraph (a)(xvi) of (i) any municipal securities business done or contribution to officials of issuers or political parties of states or political subdivisions made prior to April 25, 1994 or (ii) any payment to political parties of states or political subdivisions made prior to March 6, 1995.

(K) No broker, dealer or municipal securities dealer shall be subject to the requirements of this paragraph (a)(xvi) during any period that such broker, dealer or municipal securities dealer has qualified for and invoked the exemption set forth in clause (A)(2) of paragraph (e)(ii) of rule G-37; provided, however, that such broker, dealer or municipal securities dealer shall remain obligated to comply with clause (H) of this paragraph (a)(xvi) during such period of exemption. At such time as a broker, dealer or municipal securities dealer that has been exempted by this clause (K) from the requirements of this paragraph (a)(xvi) engages in any municipal securities business, all requirements of this paragraph (a)(xvi) covering the periods of time set forth herein (beginning with the then current calendar year and the two preceding calendar years) shall become applicable to such broker, dealer or municipal securities dealer.

(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.

(xviii) *Records Concerning Consultants Pursuant to Rule G-38.* Each broker, dealer and municipal securities dealer shall maintain:

(A) a listing of the name of the consultant pursuant to the Consultant Agreement, business address, role (including the state or geographic area in which the consultant is working on behalf of the broker, dealer or municipal securities dealer) and compensation arrangement of each consultant;

(B) a copy of each Consultant Agreement referred to in rule G-38(b);

(C) a listing of the compensation paid in connection with each such Consultant Agreement;

(D) where applicable, a listing of the municipal securities business obtained or retained through the activities of each consultant;

(E) a listing of issuers and a record of disclosures made to such issuers, pursuant to rule G-38(d), concerning each consultant used by the broker, dealer or municipal securities dealer to obtain or retain municipal securities business with each such issuer;

(F) records of each reportable political contribution (as defined in rule G-38(a)(vi)), which records shall include:

(1) the names, city/county and state of residence of contributors;

(2) the names and titles (including any city/county/state or other political subdivision) of the recipients of such contributions; and

(3) the amounts and dates of such contributions;

(G) records of each reportable political party payment (as defined in rule G-38(a)(vii)), which records shall include:

(1) the names, city/county and state of residence of contributors;

(2) the names and titles (including any city/county/state or other political subdivision) of the recipients of such payments; and

(3) the amounts and dates of such payments;

(H) records indicating, if applicable, that a consultant made no reportable political contributions (as defined in rule G-38(a)(vi)) or no reportable political party payments (as defined in rule G-38(a)(vii));

(I) a statement, if applicable, that a consultant failed to provide any report of information to the dealer concerning reportable political contributions or reportable political party payments; and

(J) the date of termination of any consultant arrangement.

(xix) *Telemarketing Requirements.*

(A) Each broker, dealer and municipal securities dealer shall make and maintain a centralized do-not-call list of persons who do not wish to receive telephone solicitations from such broker, dealer or municipal securities dealer or its associated persons.

(B) No broker, dealer or municipal securities dealer or person associated with such broker, dealer or municipal securities dealer shall obtain from a customer or submit for payment a check, draft or other form of negotiable paper drawn on a customer's checking, savings, share, or similar account, without that person's express written authorization, which may include the customer's signature on the negotiable instrument.

(xx) *Records Concerning Compliance with Rule G-27.* Each broker, dealer and municipal securities dealer shall maintain the records required under G-27(c) and G-27(d).

(xxi) *Records Concerning Sign-in Logs for In-Firm Delivery of the Regulatory Element Continuing Education.* If applicable, each broker, dealer and municipal securities dealer shall maintain the records required by rule G-3 (h)(i)(G)(6)(c).

(xxii) *Records Concerning Electronic Mail Contacts.* Records reflecting copies of Form G-40 and any amended forms, as required by Rule G-40.

(b) *Manner in which Books and Records are to be Maintained.* Nothing herein contained shall be construed to require a broker, dealer or municipal securities dealer to maintain the books and records required by this rule in any given manner, provided that the information required to be shown is clearly and accurately reflected thereon and provides an adequate basis for the audit of such information, nor to require a broker, dealer or municipal securities dealer to maintain its books and records relating to transactions in municipal securities separate and apart from books and records relating to transactions in other types of securities; provided, however, that in the case of a bank dealer, all records relating to transactions in municipal securities effected by such bank dealer must be separately extractable from all other records maintained by the bank.

(c) *Non-Clearing Brokers, Dealers and Municipal Securities Dealers.* A broker, dealer or municipal securities dealer which executes transactions in municipal securities but clears such transactions through a clearing broker, dealer, or bank, or through a clearing agency, shall not be required to make and keep such books and records prescribed in this rule as are customarily made and kept by a clearing broker, dealer, bank or clearing agency; provided that, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the arrangements with such clearing broker, dealer or bank meet all applicable requirements prescribed in subparagraph (b) of rule 17a-3 under the Act, or the arrangements with such clearing agency have been approved by the Commission or, in the case of a bank dealer, such arrangements have been approved by the appropriate regulatory agency for such bank dealer; and further provided that such broker, dealer or municipal securities dealer shall remain responsible for the accurate maintenance and preservation of such books and records if they are maintained by a clearing agent other than a clearing broker or dealer.

(d) *Introducing Brokers, Dealers and Municipal Securities Dealers.* A broker, dealer or municipal securities dealer which, as an introducing broker, dealer or municipal securities dealer, clears all transactions with and for customers on a fully disclosed basis with a clearing broker, dealer or municipal securities dealer, and which promptly transmits all customer funds and securities to the clearing broker, dealer or municipal securities dealer which carries all of the accounts of such customers, shall not be required to make and keep such books and records prescribed in this rule as are customarily made and kept by a clearing broker, dealer or municipal securities dealer and which are so made and kept; and such clearing broker, dealer or municipal securities dealer shall be responsible for the accurate maintenance and preservation of such books and records.

(e) *Definition of Customer.* For purposes of this rule, the term "customer" shall not include a broker, dealer or municipal securities dealer acting in its capacity as such or the issuer of the securities which are the subject of the transaction in question.

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

(g) *Transactions in Municipal Fund Securities.*

(i) Books and Records Maintained by Transfer Agents. Books and records required to be maintained by a broker, dealer or municipal securities dealer under this rule solely with respect to transactions in municipal fund securities may be maintained by a transfer agent registered under Section 17A(c)(2) of the Act used by such broker, dealer or municipal securities dealer in connection with such transactions; provided that such broker, dealer or municipal securities dealer shall remain responsible for the accurate maintenance and preservation of such books and records.

(ii) Price Substituted for Par Value of Municipal Fund Securities. For purposes of this rule, each reference to the term "par value," when applied to a municipal fund security, shall be substituted with (A) in the case of a purchase

of a municipal fund security by a customer, the purchase price paid by the customer, exclusive of any commission, and (B) in the case of a sale or tender for redemption of a municipal fund security by a customer, the sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.

## BACKGROUND

Under rule G-8, municipal securities brokers and municipal securities dealers are required to make and keep current certain specified records concerning their municipal securities business. Rule G-9 requires that records relating to a firm or bank dealer's municipal securities business be preserved for specified periods of time.

Rules G-8(f) and G-9(g) provide that municipal securities brokers and municipal securities dealers other than bank dealers, who are in compliance with the recordkeeping rules of the Commission, will be deemed to be in compliance with Board rules G-8 and G-9, provided that the following additional records, not specified in the Commission's rules, are maintained by such firms: records of uncompleted transactions involving customers (subparagraph (a)(iv)(D)); records relating to syndicate transactions (paragraph (a)(viii)); a new account information (paragraph (a)(xi)); and information concerning customer complaints (paragraph (a)(xii)). With respect to records on uncompleted customer transactions, the requirements of the Board's rule will be satisfied if the information is readily obtainable from other records maintained by a firm or bank dealer.

The Commission has adopted concurrent amendments to its own recordkeeping rules, rules 17a-3 and 17a-4, which provide that securities firms engaged in the municipal securities business will satisfy all regulatory requirements concerning recordkeeping with respect to such business if they are in compliance with the Board's rules. *See* Securities Exchange Act Release No. 13295 (Feb. 24, 1977). An integrated securities firm could choose to follow rule G-8 with respect to records concerning its municipal business, and the Commission's rules on recordkeeping for all other aspects of its business. In addition, a sole municipal securities firm could follow either the Commission's or the Board's rules in full, even though a portion of its business relates to federal government securities. (*See* Securities Exchange Act Release No. 13106 (Dec. 23, 1976).) Bank dealers must follow the Board's recordkeeping rules.

Securities firms will not be required to file a formal written notice of election to comply with the Board's or the Commission's rules, but satisfactory compliance with either set of rules will be subject to determination in the course of periodic compliance examinations conducted by the regulatory organizations charged with enforcement of Board and Commission rules.

## MSRB INTERPRETATIONS

### INTERPRETIVE NOTICE ON RECORDKEEPING

July 29, 1977

The Municipal Securities Rulemaking Board (the "Board") has received a number of inquiries concerning Board rules G-8 and G-9. These rules require municipal securities brokers and municipal securities dealers to make and keep current certain specified records concerning their municipal securities business and to preserve such records for specified periods of time. This interpretive notice addresses several of the more frequent inquiries received by the Board regarding these rules.

**General Purposes of Recordkeeping Rules**

The Board's recordkeeping rules are designed to require organizations engaged in the municipal securities business to maintain appropriate records concerning their activities in such business. In writing the rules, the Board adopted the approach of specifying in some detail the information to be reflected in the various records. The Board believed that this approach would provide helpful guidance to municipal securities professionals as well as the regulatory agencies charged with the responsibility of examining the records of such firms. At the same time, the Board attempted to provide a degree of flexibility to firms concerning the manner in which their records are to be maintained, recognizing that various recordkeeping systems could provide a complete and accurate record of a firm's municipal securities activities. The interpretations set forth in this notice are intended to be consistent with the foregoing purposes.

This notice is not intended to address all of the questions which have arisen, or may arise; the Board will continue its policy of responding to written requests for individual interpretations and may issue further interpretive notices on recordkeeping should additional questions of general interest arise.

The following topics are covered in this interpretive notice:

*Topic*

General Purposes of Recordkeeping Rules
Election to Follow Board or Commission Recordkeeping Rules
Maintenance of Records on a Trade Date or Settlement Date Basis
Current Posting of Records
Unit System Method of Recordkeeping
Rule G-8(a)(ii)—Account Records
Rule G-8(a)(iii)—Securities Records
Rules G-8(a)(vi) and (vii)—Records for Agency and Principal Transactions
Rule G-8(a)(xi)—Customer Account Information
Rule G-8(c)—Non-Clearing Municipal Securities Brokers and Municipal Securities Dealers
Rule G-9(b)(viii)(C)—Preservation of Written Communications

**Election to Follow Board or Commission Recordkeeping Rules**

Rules G-8(f) and G-9(g) provide that municipal securities brokers and municipal securities dealers other than bank dealers, who are in compliance with the recordkeeping rules of the Securities and Exchange Commission (the "Commission"), will be deemed to be in compliance with Board rules G-8 and G-9, provided that the following additional records, not specified in the Commission's rules, are maintained by such firms: records of uncompleted transactions involving customers (subparagraph (a)(iv)(D)); records relating to syndicate transactions (paragraph (a)(viii)); new account information (paragraph (a)(xi)); and information concerning customer complaints (paragraph (a)(xii)). Conversely, Commission rules 17a-3 and 17a-4 provide that securities firms engaged in the municipal securities business will satisfy all regulatory requirements con-

cerning recordkeeping with respect to their municipal securities business if they are in compliance with the Board's rules.

Securities firms must determine to comply with either the Board or Commission rules, but are not required to file with either the Board or the commission a formal written notice of election. Satisfactory compliance with either set of rules will be subject to determination in the course of periodic compliance examinations conducted by the regulatory organizations charged with enforcement of Board and Commission rules.

**Maintenance of Records on a Trade Date or Settlement Date Basis**

Under rule G-8, records concerning purchases and sales of municipal securities may be maintained on either a trade date or settlement date basis, provided that all records relating to purchases and sales are maintained on a consistent basis. For example, if a municipal securities broker or municipal securities dealer maintains its records of original entry concerning purchases and sales (rule G-8(a)(i)) on a settlement date basis, the municipal securities broker or municipal securities dealer must also maintain its account records (rule G-8(a)(ii)) and securities records (rule G-8(a)(iii)) on the same basis.

The above records may not be maintained on a clearance date basis, that is, the date the securities are actually delivered or received. Records maintained on a clearance date basis would not accurately reflect obligations of a municipal securities broker or municipal securities dealer to deliver or accept delivery of securities. Of course, the date of clearance should be noted in the records of original entry, account records and securities records, regardless of whether these records are kept on a trade date or settlement date basis.

**Current Posting of Records**

Rule G-8 provides that every municipal securities broker or municipal securities dealer must make and keep current the records specified in the rule. The Board has received inquiries as to the time within which records must be posted to satisfy the currency requirement.

Blotters or other records of original entry showing purchases and sales of municipal securities should be prepared no later than the end of the business day following the trade date. Transactions involving the purchase and sale of securities should be posted to the account records no later than settlement date and to the securities records no later than the end of the business day following the settlement date. Records relating to securities movements and cash receipts and disbursements should reflect such events on the date they occur and should be posted to the appropriate records no later than the end of the following business day.

Commission rule 17a-11 requires municipal securities dealers, other than bank dealers, to give immediate notice to the Commission and their designated examining authorities of any failure to make and keep current the required records, and to take corrective action within forty-eight hours after the transmittal of such notice.

**Unit System Method of Recordkeeping**

Under rule G-8, records may be maintained in a variety of ways, including a unit system of recordkeeping. In such a system, records are kept in the form of a group of documents or related groups of documents. For example, customer account records may consist of copies of confirmations and other related source documents, if necessary, arranged by customer.

A unit system of recordkeeping is an acceptable system for purposes of rule G-8 if the information required to be shown is clearly and accurately reflected and there is an adequate basis for audit. This would require in most instances that each record in a unit system be arranged in appropriate sequence, whether chronological or numerical, and fully integrated into the overall recordkeeping system for purposes of posting to general ledger accounts.

**Rules G-8(a)(ii)—Account Records**

Rule G-8(a)(ii) requires every municipal securities broker and municipal securities dealer to maintain account records for each customer account and the account of the municipal securities broker and municipal securities dealer, showing all purchases and sales, all receipts and deliveries of securities, all receipts and disbursements of cash, and all other debits and credits to such account.

The account records may be kept in several different formats. Ledger entries organized separately for each customer and for the municipal securities broker or municipal securities dealer, showing the requisite information, would clearly satisfy the requirements of rule G-8(a)(ii).

The requirements of rule G-8(a)(ii) can also be satisfied by a unit system of recordkeeping. See discussion above. Under such a system, a municipal securities professional might maintain files, organized by customer, containing copies of confirmations and other pertinent documents, if necessary, which reflect all the information required by rule G-8(a)(ii).

The question has also been raised whether the account records requirement of rule G-8(a)(ii) can be satisfied by an electronic data processing system which can produce account records by tracing through separate transactions. The Board is of the view that such a system is acceptable if the account records should be obtainable without delay, although the records need not be maintained by customer prior to being produced. The account records so produced must also reflect clearly and accurately all the required information, provide an adequate basis for audit and be fully integrated into the overall recordkeeping system. Under rule G-27, on supervision, a municipal securities principal is required to supervise the activities of municipal securities representatives with respect to customer accounts and other matters. In this connection, it may be appropriate to obtain printouts of customer accounts on a periodic basis.

The Board believes that it is important to maintain account records in the fashion described above in view of several of the Board's fair practice rules, such as the rules on suitability and churning. Account records will be important both as a tool for management to detect violations of these rules and for enforcement of these rules by the regulatory agencies conducting compliance examinations or responding to complaints.

The requirement to maintain account records does not apply to a firm which effects transactions exclusively with other municipal securities professionals and has no customers, as defined in paragraph (e) of rule G-8.

**Rule G-8(a)(iii)—Securities Records**

Rule G-8(a)(iii) requires that records be kept showing separately for each municipal security all long and short positions carried by a municipal securities broker or municipal securities dealer for its account or for the account of a customer, the location of all such securities long and the offsetting position to all such securities short, and the name or other designation of the account in which each position is carried.

The securities records should reflect not only purchases and sales, but also any movement of securities, such as whether securities have been sent out for validation or transfer. If there is no activity with respect to a particular security, it is not necessary to make daily entries for the security in the securities records. The last entry will be deemed to be carried forward until there is further activity involving the security.

Rule G-8(a)(iii) requires that the securities records show all long security count differences and short count differences classified by the date of physical count and verification on which they were discovered. The Board currently has no rule requiring municipal securities professionals to make periodic securities counts. However, if such counts are made, all count differences must be noted as provided in this section. Commission rule 17a-13 requires municipal securities dealers, other than bank dealers and

certain securities firms exempted from the rule, to examine and count securities at least once in each quarter.

The requirement to maintain securities records under rule G-8 does not apply to a firm which effects municipal securities transactions exclusively with other municipal securities professionals and has no customers, as defined in paragraph (e) of rule G-8, provided the firm does not carry positions for its own account and records or fails to deliver, fails to receive and bank loans are reflected in other records of the firm.

**Rules G-8(a)(vi) and (vii)–Records for Agency and Principal Transactions**

Rules G-8(a)(vi) and (vii) require municipal securities brokers and municipal securities dealers to make and keep records for each agency order and each transaction effected by the municipal securities broker or municipal securities dealer as principal. The records may be in the form of trading tickets or similar documents. In each case, the records must contain certain specified information, including "to the extent feasible, the time of execution."

The phrase "to the extent feasible" is intended to require municipal securities professionals to note the time of execution for each agency and principal transaction except in extraordinary circumstances when it is impossible to determine the exact time of execution. In such cases, the municipal securities professional should note the approximate time of execution and indicate that it is an approximation.

**Rule G-8(a)(xi)—Customer Account Information**

Rule G-8(a)(xi) requires a municipal securities broker or municipal securities dealer to obtain certain information for each customer. Several distinct questions have been raised with respect to this provision.

The requirement to obtain the requisite information may be satisfied in a number of ways. Some municipal securities brokers and municipal securities dealers have prepared questionnaires which they have had their customers complete and return. Others have instructed their salesmen to obtain the information from customers over the telephone at the time orders are placed. It is not necessary to obtain a written statement from a customer to be in compliance with the provision.

Except for the tax identification or social security number of a customer, the customer account information required by this provision must be obtained prior to the settlement of a transaction. The Board believes that such a requirement is reasonable since the information is basic and important.

The requirement in subparagraph (C) of rule G-8(a)(xi) to obtain the tax identification or social security number of a customer tracks the requirement in section 103.35, Part 103 of Title 31 of the Code of Federal Regulations, which was adopted by the Treasury Department and became effective in June 1972. Under this section, every broker, dealer and bank must obtain the tax identification or social security number of customers. If a broker, dealer or bank is unable to secure such information after reasonable effort, it must maintain a record identifying all such accounts. The Board interprets subparagraph (C) of rule G-8(a)(xi) in a similar fashion to require municipal securities professionals to make a reasonable effort to obtain a customer's tax identification or social security number and, if they are unable to do so, to keep a record of that fact.

Several inquiries have focused on the scope of subparagraph (G) of rule G-8(a)(xi) which requires that a record be made and kept of

> the name and address of the beneficial owner or owners of such account if other than the customer and transactions are to be confirmed to such owner or owners.

This provision applies to the situation in which securities are confirmed to an account which has not directly placed the order for the securities. This frequently occurs in connection with investment advisory accounts, where the investment advisor places an order for a client and directs the executing firm to confirm the transaction directly to the investment advisor's client.

Under rule G-8, the only information which must be obtained in such circumstances for the account to which the transaction is confirmed is the name and address of the account, information which would have to be obtained in any event in order to transmit the confirmation. Since the investment advisor itself is the customer, the other items of customer account information set forth in rule G-8(a)(xi) need not be obtained for the investment advisor's client. The customer account information applicable to institutional accounts, however, must be obtained with respect to the investment advisor. Also, the account records required by rule G-8(a)(ii) would not be required to be maintained for the investment advisor's client, although such records would have to be maintained with respect to the account of the investment advisor.

A municipal securities professional is not required to ascertain the name and address of the beneficial owner or owners of an account if such information is not voluntarily furnished. Subparagraph G-8(a)(xi)(G) applies only when an order is entered on behalf of another person and the transaction is to be confirmed directly to the other person.

A recent court decision, *Rolf v. Blyth Eastman Dillon & Co. Inc., et al.* issued on January 17, 1977, in the United States District Court, Southern District of New York, may have important implications with respect to the obligations generally of securities professionals to beneficial owners of accounts, especially to clients of investment advisors. We commend your attention to this decision, which has been appealed.

**Rule G-8(c)—Non-Clearing Municipal Securities Brokers and Municipal Securities Dealers**

Rule G-8(c) provides that a non-clearing municipal securities broker or municipal securities dealer is not required to make and keep the books and records prescribed by rule G-8 if they are made and kept by a clearing broker, dealer, bank or clearing agency. Accordingly, to the extent that records required by rule G-8 are maintained for a municipal securities broker or municipal securities dealer by a clearing agent, the municipal securities broker or municipal securities dealer does not have to maintain such records. A non-clearing municipal securities broker or municipal securities dealer is still responsible for the accurate maintenance and preservation of the records if they are maintained by a clearing agent other than a clearing broker or dealer, and should assure itself that the records are being maintained by the clearing agent in accordance with applicable record-keeping requirements of the Board.

In the case of a bank dealer, clearing arrangements must be approved by the appropriate regulatory agency for the bank dealer. The bank regulatory agencies are each considering the adoption of procedures to approve clearing arrangements. It is contemplated that these procedures will require the inclusion of certain provisions in clearing agreements, such as an undertaking by the clearing agent to maintain the bank dealer's records in compliance with rules G-8 and G-9, and will specify the mechanics for having such arrangements considered and approved. The bank regulatory agencies indicate that they will advise bank dealers subject to their respective jurisdictions on this matter in the near future.

In the case of a securities firm, Commission approval is required for all clearing arrangements with entities other than a broker, dealer or bank. The Commission has recently proposed an amendment to its rule 17a-4 which would eliminate the need to obtain Commission approval of clearing arrangements with such other entities, provided that certain specified conditions are met. If the proposed rule is adopted, the Board would make a corresponding change in rule G-8.

If an agent clears transactions, but transmits copies of all records to the municipal securities broker or municipal securities dealer, and these

records are preserved by the municipal securities broker or municipal securities dealer in accordance with rule G-9, the clearing arrangement is not subject to the rule G-8(c).

**Rule G-9(b)(viii)(C)—Preservation of Written Communications**

Subparagraph (C) of rule G-9(b)(viii) requires municipal securities brokers and municipal securities dealers to preserve for three years

> all written communications received or sent, including inter-office memoranda, relating to the conduct of the activities of such municipal securities broker or municipal securities dealer with respect to municipal securities.

The communications required to be preserved by this provision relate to the conduct of a firm's activities with respect to municipal securities. Accordingly, such documents as internal memoranda regarding offerings or bids, letters to or from customers and other municipal securities professionals regarding municipal securities, and research reports must be preserved. Documents pertaining purely to administrative matters, such as vacation policy and the like, would not have to be preserved for purposes of the rule.

## NOTICE OF INTERPRETATION CONCERNING RECORDS OF CERTIFICATE NUMBERS OF SECURITIES CLEARED BY CLEARING AGENTS

October 10, 1986

Rule G-8(a)(i) requires that dealers maintain records of original entry that include certificate numbers of all securities received or delivered. The Board has received inquiries whether a dealer must maintain in its records of original entry the certificate numbers of securities that are received or delivered by a clearing agent on behalf of the dealer or whether it is permissible for the clearing agent to maintain records of the certificate numbers for the dealer.

The Board has concluded that, for transactions in which physical securities are cleared by a clearing agent, records of the certificate numbers of the securities required by rule G-8(a)(i) may be maintained by the agent on behalf of the dealer if the dealer obtains an agreement in writing from the agent in which the following conditions are specified: (i) a complete and current record of certificate numbers of physical securities cleared by the agent will be maintained on behalf of the dealer by the agent; (ii) the agent will preserve such record, and will provide such record to the dealer promptly upon request, in a manner allowing the dealer to comply with Board rule G-9 on maintenance and preservation of records. The Board emphasizes that a dealer allowing a clearing agent to maintain records of certificate numbers on its behalf continues to be responsible for the accurate maintenance and preservation of such records in conformance with the Board's recordkeeping rules.

See also:

**Rule G-17 Interpretation – Notice Concerning Application of Board Rules to Put Option Bonds,** September 30, 1985.

**Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities,** May 14, 2002.

**Rule G-27 Interpretation – Supervisory Procedures for the Review of Correspondence with the Public,** March 24, 2000.

**Rule G-32 Interpretations – Notice Regarding the Disclosure Obligations of Brokers, Dealers and Municipal Securities Dealers in Connection with New Issue Municipal Securities Under Rule G-32,** November 19, 1998.

**– Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## *Interpretive Letters*

**Syndicate records: participations.** This will acknowledge receipt of your letter of November 24, 1981 concerning certain of the requirements of Board rule G-8(a)(viii) regarding syndicate records to be maintained by managers of underwritings of new issues of municipal securities.

You note that this provision requires, in pertinent part, that,

> [w]ith respect to each syndicate..., records shall be maintained ... showing ... the name and percentage of participation of each member of the syndicate or account...

You inquire whether this provision necessitates the designation of an actual percentage or decimal participation, or, alternatively,

> whether a listing of the... dollar participation [of each member]... along with [the] aggregate par value of the syndicate meets the requirement... of the Rule.

The rule should not be construed to require in all cases an indication of a numerical percentage for each member's participation, if other information from which a numerical percentage can easily be determined is set forth. The method you propose, showing the par value amount of the member's participation, is certainly acceptable for purposes of compliance with this provision of the rule. *MSRB interpretation of December 8, 1981.*

**Syndicate records: sole underwriter.** This is in response to your letter regarding rule G-8 on recordkeeping. You note that rule G-8(a)(viii) requires the managing underwriter of a syndicate to maintain certain records pertaining to syndicate transactions. You ask if this rule applies to an underwriter in a sole underwriting.

Rule G-11(a)(viii) defines a syndicate as an account formed by two or more persons for the purpose of purchasing, directly or indirectly, all or any part of a new issue of municipal securities from the issuer, and making a distribution thereof. Since a sole underwriting does not involve a syndicate, rule G-8(a)(viii) does not apply to sole underwritings. Of course, the sole underwriter must maintain other required records for transactions in the new issue. *MSRB interpretation of May 12, 1989.*

**Recordkeeping by introducing brokers.** Your letter of September 16, 1982, has been referred to me for response. In your letter you indicate that your firm functions as an "introducing broker", and, in such capacity, effects an occasional transaction in municipal securities. You inquire as to the recordkeeping requirements applying to a firm acting in this capacity, and you also inquire as to the possibility of an exemption from the Board's rules, in view of the extremely limited nature of your municipal securities business.

As you recognize, the provision Board rule G-8 on recordkeeping with particular relevance to introducing brokers is section (d), which provides as follows:

> A municipal securities broker or municipal securities dealer which, as an introducing municipal securities broker or municipal securities dealer, clears all transactions with and for customers on a fully disclosed basis with a clearing broker, dealer or municipal securities dealer, and which promptly transmits all customer funds and securities to the clearing broker, dealer or municipal securities dealer which carries all of the accounts of such customers, shall not be required to make and keep *such books and records prescribed in this rule as are customarily made and kept by a clearing broker, dealer or municipal securities dealer and which are so made and kept*; and such clearing broker, dealer or municipal securities dealer shall be responsible for the accurate maintenance and

preservation of such books and records. (emphasis supplied)

As you can see, this provision states that the introducing broker need not make and keep those records which are "customarily made and kept by" the clearing dealer, as long as the clearing dealer does, in fact, make and keep those records. The introducing broker is still required, however, to make and keep those records which are not "customarily made and kept by" the clearing firm.

The majority of the specific records you name in your letter fall into the latter category of records which are not customarily made and kept by the clearing firm and therefore remain the responsibility of the introducing broker. Your firm would, therefore, be required to make the records of customer account information required under rule G-8(a)(xi), with all of the itemized details of information recorded on such records. Your firm would also be required to maintain the records of agency and principal transactions ("order tickets") required under rules G-8(a)(vi) and (vii) respectively. In both cases, however, if, for some reason, the clearing firm does make and keep these records, your firm would not be required to make and keep duplicates.

In the case of the requirement to keep confirmation copies, it is my understanding that the clearing firm generally maintains such records. If the clearing firm to which you introduce transactions follows this practice and maintain copies of the confirmations of such transactions, you would not be required to maintain the same record.

In adopting each of these recordkeeping requirements the Board concluded that the information required to be recorded was the minimum basic data necessary to ensure proper handling and recordation of the transaction and customer protection. I note also that these requirements parallel in most respects those of Commission rule 17a-3, to which you are already subject by virtue of your registration as a broker/dealer.

With respect to your inquiry regarding an exemption from the Board's requirements, I must advise that the Board does not have the authority to grant such exemptions. The Securities and Exchange Commission does have the authority to grant such an exemption in unusual circumstances. Any letter regarding such an exemption should be directed to the Commission's Division of Market Regulation. *MSRB interpretation of September 21, 1982.*

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**Securities record.** In your letter, you question the application of Board rule G-8(a)(iii) and, in particular, the requirement that "such [securities] records shall consist of a single record system," to a situation in which a securities firm maintains such records organized by ownership of the securities. It is my understanding that the firm in question maintains records showing securities in the firm's trading account, and offsetting positions long and short, and separate records showing securities owned by customers and the offsetting location for those securities.

Rule G-8(a)(iii) requires, in part

> [r]ecords showing separately for each municipal security all positions ... carried by such municipal securities broker or municipal securities dealer for its account or for the account of a customer...

Therefore, securities records should be maintained by security, although this can be accomplished by separate sheets showing positions in that security held for trading or investment purposes and positions owned by customers. A record organized by customer, showing several securities and offsetting positions held by that customer, is not acceptable for purposes of rule G-8(a)(iii).

With respect to your question regarding the multiple maturity provision of rule G-8(a)(iii), the relevant position of the rule states

> multiple maturities of the same issue of municipal securities, as well as multiple coupons of the same maturity, may be shown on the same record, provided that adequate secondary records exist to identify separately such maturities and coupons.

Therefore, the securities to be shown on a single securities record must be identical as to issue date or maturity date. Securities which are identical as to issuer may be shown on a single securities record only if the securities have either the same issue date or the same maturity date, and if adequate secondary records exist to identify separately the securities grouped on the record. *MSRB interpretation of April 8, 1978.*

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**Maintenance of securities record.** I refer to your letter of April 9, 1979 concerning rule G-8(a)(iii), which requires the maintenance of a securities record. This letter is intended to address your questions concerning that provision.

Rule G-8(a)(iii) requires every municipal securities dealer to make and keep

> records showing separately for each municipal security all positions (including, in the case of a municipal securities dealer other than a bank dealer, securities in safekeeping) carried by such municipal securities dealer for its own account or for the account of a customer (with all "short" trading positions so designated), the location of all such securities long and the offsetting position to all such securities short, and the name or other designation of the account in which each position is carried.

Rule G-8(a)(iii) further provides that "[s]uch records shall consist of a single record system...," and that "...a bank dealer shall maintain records of the location of securities in its own trading account."

The purpose of the requirement to maintain a "securities record" is to provide a means of securities control, ensuring that all securities owned by the dealer or with respect to which the dealer has outstanding contractual commitments are accounted for in the dealer's records. To achieve this purpose, the record is commonly constructed in "trial balance" format, with information as to the "ownership" of securities reflected on the "long," or debit side, and information as to the location on the "short," or credit side of the record. The record therefore serves a different function from the subsidiary records, such as the "fail" records, required to be maintained under other provisions of the rule. The subsidiary records reflect the details of particular securities transactions; the securities record assures that a municipal securities dealer's over-all position is in balance.

In your letter you inquire specifically whether this record can be constructed through the use of duplicate copies of subsidiary records. The rule requires a system of records organized by security, showing all positions in such security. Record systems organized by position or locations, showing all securities held in such position or location, cannot serve the same balancing and control function.

The securities record, however, does not have to be maintained on a single sheet or ledger card per security. Although this is the most common means of maintaining a securities record, certain municipal securities dealers prepare segments of the record in different physical locations, bringing the segments together at the close of the business day to compose the securities record. This practice is permissible under the rule.

Finally, you have inquired regarding the possibility of maintaining the securities record on a unit system basis. Records in such a system are kept in the form of a group of documents or related groups of documents, most often files of duplicate confirmations. The maintenance of the securities record on such a basis would be acceptable provided that the required information is clearly and accurately reflected and there is an adequate basis for audit. I would note, however, that utilization of a unit system would probably only be feasible for a municipal securities dealer with very limited activity.

I hope this letter is helpful to you in responding to inquiries from your members. If

you or any of your members have any further questions regarding this matter, please do not hesitate to contact us. *MSRB interpretation of April 16, 1979.*

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**Securities control.** Your letter dated February 24, 1978, has been referred to me for response. In addition, I understand that you have had several subsequent telephone conversations about your question. In these conversations, you describe the procedures for securities control followed by your bank's dealer department.

Briefly, as we understand your procedures, the dealer department records all certificate numbers of municipal securities received or delivered by the department. This information is recorded in a manner which relates the physical receipt and delivery of specific certificates to specific transactions. Once in safekeeping, the certificates are kept in a vault, and filed by issue, rather than filed separately by account, chronologically, or by transaction. In your letter, you inquired whether this system of filing in the vault raises problems of compliance with Board rule G-8.

Since your bank records in records of original entry the certificate numbers upon receipt and delivery of municipal securities by your dealer department, it appears that your system satisfies the requirement under rule G-8(a)(i) that such information be recorded on the "record of original entry." The safekeeping procedures used by the bank are specifically excluded from the scope of the rule under the provisions of paragraph G-8(a)(iii), which requires

> [r]ecords showing...all positions (including, in the case of a municipal securities broker or municipal securities dealer other than a bank dealer, securities in safekeeping)...

Therefore, based on the information you have provided, we believe that your system is in compliance with the applicable provisions of rule G-8. *MSRB interpretation of April 10, 1978.*

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**Customer account information.** I am writing in response to your letter of May 25, 1982 concerning the maintenance of customer account information records in connection with certain orders placed with you by a correspondent bank. In your letter you indicate that a correspondent bank periodically purchases securities from your dealer department for the accounts of specified customers. The confirmations of these transactions are sent to the correspondent bank, with a statement on each confirmation designating, by customer name, the account for which the transaction was effected. No confirmations or copies of confirmations are sent to the customers identified by the correspondent bank. You inquire whether customer account information records designating these customers as the "beneficial owners" of these accounts need be maintained by your dealer department.

As you know, rule G-8(a)(xi) requires a municipal securities dealer to record certain information about each customer for which it maintains an account. Subparagraph (G) of such paragraph requires that this record identify the

> name and address of beneficial owner or owners of such account if other than the customer *and transactions are to be confirmed to such owner or owners...*
> (emphasis added)

If the transactions are not to be confirmed to the customers identified as the owners of the accounts for which the transactions are effected, then such information need not be recorded.

In the situation you cite, therefore, the names of the customers need not be recorded on the customer account information record. *MSRB interpretation of June 1, 1982.*

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**Use of electronic signatures.** This is in response to your letter and a number of subsequent telephone conversations regarding your dealer department's proposed use of a bond trading system. The system is an online, realtime system that integrates all front and back office functions. The system features screen input of customer account and trading information which would allow the dealer department to eliminate the paper documents currently in use. The signature of the representative introducing a customer account, required to be recorded with customer account information by rule G-8, and the signature of the principal signifying approval of each municipal securities transaction, required by rule G-27, would be performed electronically, *i.e.*, by input in a restricted datafield. The signature of the principal approving the opening of the account, required by rule G-8, will continue to be performed manually on a printout of the customer information.[1]

Rule G-8(a)(vi) and (vii) require dealers to make and keep records for each agency and principal transaction. The records may be in the form of trading tickets or similar documents. In addition, rule G-8(a)(xi), on recordkeeping of customer account information, requires, among other things, the signature of the representative introducing the account and the principal indicating acceptance of the account to be included on the customer account record. Rule G-27(c)(ii)[*] requires, among other things, the prompt review and written approval of each transaction in municipal securities. In addition, the rule requires the regular and frequent examination of customer accounts in which municipal securities transactions are effected in order to detect and prevent irregularities and abuses. The approvals and review must be made by the designated municipal securities principal or the municipal securities sales principal. Rule G-9(e), on preservation of records, allows records to be retained electronically provided that the dealer has adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies.

The Board recognizes that efficiencies would be obtained by the replacement of paper files with electronic data bases and filing systems and generally allows records to be retained in that form.[2] Moreover, as dealers increasingly automate, there will be more interest in deleting most physical records. Electronic trading tickets and automated customer account information satisfy the recordkeeping requirements of rule G-8 as long as such information is maintained in compliance with rule G-9(e).

The Board and your enforcement agency are concerned, however, that it may be difficult to verify a representative's signature on opening the account or a principal's signature approving municipal securities transactions or periodically reviewing customer accounts if the signatures are noted only electronically. Your enforcement agency has advised us of its discussions with you. Apparently, it is satisfied that appropriate security and audit procedures can be developed to permit the use of electronic signatures of representatives and principals and ensure that such signatures are verifiable. Thus, the Board has determined that rules G-8 and G-27 permit the use of electronic signatures when security and audit procedures are agreed upon by the dealer and its appropriate enforcement agency. Whatever procedures are agreed upon must be memorialized in the dealer's written supervisory procedures required by rule G-27. *MSRB Interpretation of February 27, 1989.*

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[1] In addition, you noted in a telephone conversation that the periodic review of customer accounts required by rule G-27(c)(ii)[*] also will be handled electronically using the principal's electronic signature to signify approval.

[2] See rule G-9(e).

[*][Currently codified at rule G-27(c)(vii).]

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**Records of original entry.** Your letter dated October 13, 1978, has been referred to me for response. In your letter you inquire whether a certain method of keeping "records of original entry" is satisfactory for purposes of the requirement to maintain "current" books and records. In particular, you suggest that such records could be maintained by means of a "unit" or "ticket" system during the period from trade date to settlement date, and then recorded on a blotter as of the settlement date.

As indicated to you, such a method of preserving these records is acceptable, provided that all information required to be shown is

clearly and accurately reflected in both forms of the record, and both forms provide adequate audit controls. *MSRB interpretation of October 26, 1978.*

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**Records of original entry.** This will acknowledge receipt of your letter of June 13, 1979, concerning the requirement under Board rule G-8 for records of original entry. In your letter you discuss a "Bond Register" used by your firm, which is organized by security, and presents on separate cards all transactions in particular securities arranged in chronological order. You inquire whether this is satisfactory for purposes of the Board's recordkeeping rule.

The "record of original entry" required under rule G-8(a)(i) is intended to reflect all transactions effected by a municipal securities dealer on a particular day, all transactions cleared on such day, and all receipts and disbursements of cash on such day. The record is intended to provide a complete review of the dealer's activity for the day in question. It is therefore necessary that the record be organized by date. A record organized by security would not serve the purposes of a record of original entry as envisioned in the Board's rule. *MSRB interpretation of August 9, 1979.*

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**Records of original entry: unit system.** This will acknowledge receipt of your letter of November 20, 1981 concerning compliance with certain of the provisions of Board rule G-8 through the use of a "unit system" method of recordkeeping. In your letter you indicate that the bank wishes to maintain the record of original entry required under rule G-8(a)(i) in the form of a collection of duplicate copies of confirmations filed in transaction settlement date order; in addition, you enclose a copy of the confirmation form used by the bank. You inquire whether maintaining the record in this manner would be satisfactory for purposes of the rule.

In a July 29, 1977 interpretive notice on rule G-8 the Board stated:

> Under rule G-8, records may be maintained in a variety of ways, including a unit system of recordkeeping. In such a system, records are kept in the form of a group of documents or related groups of documents....
>
> A unit system of recordkeeping is an acceptable system for purposes of rule G-8 if the information required to be shown is clearly and accurately reflected and there is an adequate basis for audit. This would require in most instances that each record in a unit system be arranged in appropriate sequence, whether chronological or numerical, and fully integrated into the over-all recordkeeping system for purposes of posting to general ledger accounts.

Therefore, the type of recordkeeping system you propose may be used for purposes of compliance with rule G-8 if (1) the records show, in a clear and accurate fashion, all of the information that is required to be shown, and (2) the records are maintained in a form that provides an adequate basis for audit by bank employees or examiners. It is my understanding that recordkeeping systems similar to that which you propose have been inspected by banking regulatory authorities during examinations of other bank municipal securities dealer departments, and have been found to meet these two criteria.

In your letter you indicate that the confirmation form used by your bank "contains all the information needed" to meet the recordkeeping requirement. Our review of your form indicates that this is not the case. The rule requires the record of original entry to contain

> an itemized daily record of all purchases and sales of municipal securities, all receipts and deliveries of municipal securities (including bond or note numbers and, if the securities are in registered form, an indication to such effect), all receipts and disbursements of cash with respect to transactions in municipal securities, [and] all other debits and credits pertaining to transactions in municipal securities ... The records of original entry shall show the name or other designation of the account for which each such transaction was effected (whether effected for the account of such municipal securities broker or municipal securities dealer, the account of a customer, or otherwise), the description of the securities, the aggregate par value of the securities, the dollar price or yield and aggregate purchase or sale price of the securities, accrued interest, the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered.

The confirmation form you enclosed does not appear to provide a space for notation of "the name or other designation of the account for which [the] transaction was effected." This information is distinct from "the name or other designation of the person from whom purchased ... or to whom sold ..." (which would appear in the "name and address" portion of your form) and requires an indication of the account, whether it be the bank's trading inventory or portfolio, or the contra-principal on an agency transaction, in which the securities were held prior to a sale or will be held subsequent to a purchase. For example, if the bank sells $100,000 par value securities from its trading account to "Mr. Smith", the record of original entry would reflect that this transaction was effected for the account of the [bank's] trading account. A subsequent sale of these securities effected as agent for the customer would be reflected on the record of original entry as for the account of "Mr. Smith."

I note also that, in addition to a record of purchase and sale transactions (which could easily be maintained in the form of duplicate copies of confirmations), the record of original entry must contain information about transactions cleared on the date of the record as well as cash disbursements and receipts. Your letter does not indicate how your bank would comply with these latter requirements. As you may be aware, other banks using unit recordkeeping systems use additional copies of the confirmation as "clearance" records, with information on receipts and deliveries of securities and movements of cash noted on these copies. These "clearance" records are then aggregated with the purchase and sale records to form a complete record of original entry.

In summary, the method of maintaining a record of original entry which your bank proposes can be used to comply with the requirements of the rule. Certain aspects of the information required by the rule are not contained on the document you propose to use, however, and provision would have to be made for inclusion of these items in the records before the system you propose would be satisfactory for compliance with the rule's requirements. *MSRB interpretation of November 24, 1981.*

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**Records of original entry: accessibility of records.** As I indicated to you in my previous letter of February 1, 1982, your inquiry of January 21, 1982 was referred to the committee of the Board charged with responsibility for interpreting the requirements of Board rules G-8 and G-9 on books and records. That committee has authorized my sending you this response.

In your letter you indicate that during the course of an examination of your bank's municipal securities dealer department by the Office of the Comptroller of the Currency certain criticisms were made by the examiners regarding the recordkeeping system used by your bank. In particular, the examiners noted that the "record of original entry" maintained by the bank did not contain seven specified items of information,[1] and expressed the view that customer account records more than one year old were not "maintained and preserved in an easily accessible place" within the meaning of rule G-9. You disagree with the examiner's interpretation of "easily accessible." Further, while conceding that the specified items of information are not contained on the record, you indicate that this information is readily available upon specific inquiry to the bank's system data base, and express the view that this should be sufficient for purposes of compliance with Board rule G-8. You request the Board's views on these subjects.

As a general matter we would hesitate to disagree with the opinion expressed by an

on-site examiner concerning the auditability of records maintained by a municipal securities dealer. The examiner is, of course, in direct contact with the matter in question, and has access to the full details of the situation, rather than an abstraction or summary of the particulars. Accordingly, we are unable to express a view that the examiner's criticisms are incorrect in the specific circumstances you describe.

With respect to the particular questions which you raise, we note that rule G-8 does require that all of the specified information appear on the record or system of records designated as the dealer's "record of original entry." It is not sufficient that the dealer has the capability of researching specific items, or constructing a record upon request from information maintained in other formats. The record of original entry is intended to provide a journal of all of the basic details of a dealer's activity on a given day. A record that can only be put together on request, or that is missing basic details of information, is not sufficient for this purpose.

We note also that, in reviewing the attachments to your letter, it appears that the absence of several of the specified items of information would be easy to rectify—institution of controls to prevent duplication of customer and security abbreviations would appear to resolve the problems with these details, and a system of grouping transaction input could be devised so that trades for different trade dates are not shown on the same blotter. Similarly, bond or note numbers could be designated on transaction tickets maintained as an augmentation of the computerized records; the attachments indicate that you already maintain such tickets as part of an existing unit system.

With respect to the question of accessibility, we note that this is generally construed by the examining authorities to mean accessibility within 24 or 48 hours. If a system could be devised whereby requests from the dealer department for aged customer account records could be given priority and processed on an expedited basis, this might rectify the problem you describe. *MSRB interpretation of April 27, 1982.*

[1] Dollar price or yield, trade date, name of contraparty (due to use of abbreviations), security identification (due to use of abbreviations), designation of account for which transaction was effected, bond or note numbers, and designation if securities were registered.

**Time of receipt and execution of orders.** This is in response to your March 3, 1987 letter regarding the application of rule G-8, on recordkeeping, to [name deleted]'s (the "Bank") procedure on time stamping of municipal securities order tickets. You note that it is the Bank's policy to indicate on order tickets the date and time of receipt of the order and the date and time of execution of the order. You note, however, that when the order and execution occur simultaneously, it is your procedure to time stamp the order ticket once. You ask for Board approval of this policy.

Rule G-8(a)(vi) provides in pertinent part for a "memorandum of each agency order . . . showing the date and time of receipt of the order . . . and the date of execution and to the extent feasible, the time of execution . . ." Rule G-8(a)(vii) includes a similar requirement for principal transactions with customers. As noted in a Board interpretive notice on recordkeeping, the phrase "to the extent feasible" is intended to require municipal securities professionals to note the time of execution of each transaction except in extraordinary circumstances when it might be impossible to determine the exact time of execution. However, even in those unusual situations, the rule requires that at least the approximate time be noted.[1] This rule parallels SEC rule 17a-3(a)(6) and (7) on recordkeeping.

Thus, rule G-8(a)(vi) and (vii) require agency and principal orders to be time stamped upon receipt and upon execution. The requirement is designed to allow the dealer and the appropriate examining authority to determine whether the dealer has complied with rule G-18, on execution of transactions, and rule G-30, on pricing. Rule G-18 states that when a dealer is "executing a transaction in municipal securities for or on behalf of a customer as an agent, it shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions." Rule G-30(a) states that a dealer shall not effect a principal transaction with a customer except at a fair and reasonable price, taking into consideration all relevant factors including the fair market value of the securities at the time of the transaction. It is impossible to determine what the prevailing market conditions were at the time of the execution of the order if the date and time of execution are not recorded. In addition, it is important to time stamp the receipt and execution of an order so that a record can be maintained of when the order is executed.

Thus, even when the order and execution occur simultaneously, rule G-8 requires that two time stamps be included on order tickets. *MSRB interpretation of April 20, 1987.*

[1] See [Rule G-8 Interpretation –] Interpretive Notice on Recordkeeping (July 29, 1977) [reprinted in *MSRB Rule Book*].

**Contract sheets.** This will respond to your letter of May 28, 1987, and confirm our telephone conversation of the same date concerning recordkeeping of "contract sheets." You ask whether dealers are required by Board rules G-8 and G-9 to maintain records of "contract sheets" of municipal securities transactions.

Rule G-8(a)(ix) requires dealers to maintain records of all confirmations of purchases and sales of municipal securities, including inter-dealer transactions. Rule G-12(f), in certain instances, requires inter-dealer transactions to be compared through an automated comparison system operated by a clearing agency registered with the Securities and Exchange Commission, rather than by physical confirmations.[1] These automated comparison systems generate "contract sheets" to each party of a trade, which confirm the existence and the terms of the transaction.

This will confirm my advice to you that such contract sheets are deemed to be confirmations of transactions for purposes of rule G-8(a)(ix). Thus, dealers are required to include contract sheets in their records of confirmations and, under rule G-9(b)(v), are required to maintain these records for no less than three years.[2] *MSRB interpretation of June 25, 1987.*

[1] Rule G-12(c) governs the content of and procedures for sending physical confirmations.

[2] You also ask about the interpretation of rules 17a-3 and 17a-4 under the Securities Exchange Act. The Board is not authorized to interpret these Securities and Exchange Commission rules. You may wish to contact the SEC for guidance on this matter.

See also:

**Rule G-36 Interpretive Letter – Multiple underwriters,** *MSRB interpretation of January 30, 1998.*

## Rule G-9: Preservation of Records

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

(i) the records of original entry described in rule G-8(a)(i);

(ii) the account records described in rule G-8(a)(ii);

(iii) the securities records described in rule G-8(a)(iii);

(iv) the records of syndicate transactions described in rule G-8(a)(viii), provided, however, that (1) such records need not be preserved for a syndicate or similar account which is not successful in purchasing an issue of municipal securities, and (2) information concerning orders received by a syndicate or similar account to which securities were not allocated by such syndicate or account need not be preserved after the date of final settlement of the syndicate or account;

(v) the customer complaint records described in rule G-8(a)(xii);

(vi) if such broker, dealer or municipal securities dealer is subject to rule 15c3-1 under the Act, the general ledgers described in paragraph (a)(2) of rule 17a-3 under the Act;

(vii) the record, described in rule G-27(b)(ii), of each person designated as responsible for supervision of the municipal securities activities of the broker, dealer, or municipal securities dealer and the designated principal's supervisory responsibilities, provided that such record shall be preserved for the period of designation of each person designated and for at least six years following any change in such designation;

(viii) the records to be maintained pursuant to rule G-8(a)(xvi); *provided, however,* that copies of Forms G-37x shall be preserved for the period during which such Forms G-37x are effective and for at least six years following the end of such effectiveness;

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

(x) the records required to be maintained pursuant to rule G-8(a)(xviii).

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

(i) the subsidiary records described in rule G-8(a)(iv);

(ii) the records of put options and repurchase agreements described in rule G-8(a)(v);

(iii) the records relating to agency transactions described in rule G-8(a)(vi);

(iv) the records of transactions as principal described in rule G-8(a)(vii);

(v) the copies of confirmations and other notices described in rule G-8(a)(ix);

(vi) the customer account information described in rule G-8(a)(xi), provided that records showing the terms and conditions relating to the opening and maintenance of an account shall be preserved for a period of at least six years following the closing of such account;

(vii) if such broker, dealer or municipal securities dealer is subject to rule 15c3-1 under the Act, the records described in subparagraphs (a)(4)(iv) and (vi) and (a)(11) of rule 17a-3 and subparagraphs (b)(5) and (b)(8) of rule 17a-4 under the Act;

(viii) the following records, to the extent made or received by such broker, dealer or municipal securities dealer in connection with its business as such broker, dealer or municipal securities dealer and not otherwise described in this rule:

(A) check books, bank statements, canceled checks, cash reconciliations and wire transfers;

(B) bills receivable or payable;

(C) all written and electronic communications received and sent, including inter-office memoranda, relating to the conduct of the activities of such broker, dealer or municipal securities dealer with respect to municipal securities;

(D) all written agreements entered into by such broker, dealer or municipal securities dealer, including agreements with respect to any account; and

(E) 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.

(ix) all records relating to fingerprinting which are required pursuant to paragraph (e) of rule 17f-2 under the Act;

(x) all records of deliveries of rule G-32 disclosures and, if applicable, a record evidencing compliance with section

(a)(i)(C) of rule G-32 required to be retained as described in rule G-8(a)(xiii);

(xi) the records to be maintained pursuant to rule G-8(a)(xv);

(xii) the authorization required by rule G-8(a)(xix)(B); however, this provision shall not require maintenance of copies of negotiable instruments signed by customers;

(xiii) each advertisement from the date of each use;

(xiv) the records to be maintained persuant to rule G-8(a)(xx);

(xv) the records to be maintained persuant to rule G-8(a)(xxi); and

(xvi) the records to be maintained persuant to rule G-8(a)(xxii).

(c) *Records to be Preserved for Life of Enterprise.* Every broker, dealer and municipal securities dealer other than a bank dealer shall preserve during the life of such broker, dealer or municipal securities dealer and of any successor broker, dealer or municipal securities dealer all partnership articles or, in the case of a corporation, all articles of incorporation or charter, minute books and stock certificate books.

(d) *Accessibility and Availability of Records.* All books and records required to be preserved pursuant to this rule shall be available for ready inspection by each regulatory authority having jurisdiction under the Act to inspect such records, shall be maintained and preserved in an easily accessible place for a period of at least two years and thereafter shall be maintained and preserved in such manner as to be accessible to each such regulatory authority within a reasonable period of time, taking into consideration the nature of the record and the amount of time expired since the record was made.

(e) *Method of Record Retention.* Whenever a record is required to be preserved by this rule, such record may be retained either as an original or as a copy or other reproduction thereof, or on microfilm, electronic or magnetic tape, or by the other similar medium of record retention, provided that such broker, dealer or municipal securities dealer shall have available adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies thereof and, in the case of records retained on microfilm, electronic or magnetic tape, or other similar medium of record retention, duplicates of such records shall be stored separately from each other for the periods of time required by this rule.

(f) *Effect of Lapse of Registration.* The requirements of this rule shall continue to apply, for the periods of time specified, to any broker, dealer or municipal securities dealer which ceases to be registered with the Commission, except in the event a successor registrant shall undertake to maintain and preserve the books and records described herein for the required periods of time.

(g) *Compliance with Rules 17a-3 and 17a-4.* Brokers, dealers and municipal securities dealers other than bank dealers which are in compliance with rules 17a-3 and 17a-4 under the Act will be deemed to be in compliance with the requirements of this rule, provided that the records enumerated in section (f) of rule G-8 of the Board shall in any event be preserved for the applicable time periods specified in this rule.

## MSRB INTERPRETATION

### Interpretation on the Application of Rules G-8 and G-9 to Electronic Recordkeeping

March 26, 2001

The Municipal Securities Rulemaking Board (the "MSRB") has received requests for interpretive guidance regarding the maintenance in electronic form of records under rule G-8, on books and records, and rule G-9, on preservation of records. As the MSRB has previously noted, rules G-8 and G-9 provide significant flexibility to brokers, dealers and municipal securities dealers ("dealers") concerning the manner in which their records are to be maintained, recognizing that various recordkeeping systems could provide a complete and accurate record of a dealer's municipal securities activities.[1] Part of the reason for providing this flexibility was that a variety of enforcement agencies, including the Securities and Exchange Commission, NASD Regulation, Inc. and the banking regulatory agencies, all may inspect dealer records.

Rule G-8(b) does not specify that a dealer is required to maintain its books and records in a specific manner so long as the information required to be shown by the rule is clearly and accurately reflected and provides an adequate basis for the audit of such information. Further, rule G-9(e) allows records to be retained electronically provided that the dealer has adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies.

The MSRB previously has recognized that efficiencies would be obtained by the replacement of paper files with electronic data bases and filing systems and stated that it generally allows records to be retained in that form.[2] In noting that increased automation would likely lead to elimination of most physical records, the MSRB has stated that electronic trading tickets and automated customer account information satisfy the recordkeeping requirements of rule G-8 so long as such information is maintained in compliance with rule G-9(e). The MSRB believes that this position also applies with respect to the other recordkeeping requirements of rule G-8 so long as such information is maintained in compliance with rule G-9(e) and the appropriate enforcement agency is satisfied that such manner of record creation and retention provides an adequate basis for the audit of the information to be maintained. In particular, the MSRB believes that a dealer that meets the requirements of Rule 17a-4(f) under the Securities Exchange Act of 1934 with respect to maintenance and preservation of required books and records in the formats described therein would presumptively meet the requirements of rule G-9(e).

[1] See Rule G-8 Interpretation – Interpretive Notice on Recordkeeping, July 29, 1977, reprinted in *MSRB Rule Book* (January 1, 2001) at 42.

[2] See Rule G-8 Interpretive Letters – Use of electronic signatures, MSRB interpretation of February 27, 1989, reprinted in *MSRB Rule Book* (January 1, 2001) at 47.

See also:

Rule G-8 Interpretations – Interpretive Notice on Recordkeeping, July 29, 1977.

– Notice of Interpretation Concerning Records of Certificate Numbers of Securities Cleared by Clearing Agents, October 10, 1986.

Rule G-27 Interpretation – Supervisory Procedures for the Review of Correspondence with the Public, March 24, 2000.

## *Interpretive Letters*

**Syndicate records.** I am writing in response to your letters of October 2 and October 19, 1981 concerning a particular recordkeeping arrangement used by an NASD-member firm in connection with its underwriting activities. In your letters you indicate that the firm conducts its underwriting activities from its main office and four regional branch office "commitment centers," with the committing branch offices authorized to commit to underwriting new issues on the firm's behalf. You inquire whether the firm is in compliance with the Board's recordkeeping and record retention rules if it maintains only part of the records on its underwritings in the main office. Correspondence from a field examiner attached to your letters indicates that the committing branch office originating a particular underwriting maintains all of the records with respect to such underwriting. The majority of these records are the original copies; the copies of confirmations, good faith checks, and syndicate settlement checks maintained at the committing branch office are duplicates of original records maintained at the firm's main office.

Rule G-9(d) requires that books and records shall be maintained and preserved in an easily accessible place for two years and shall be available for ready inspection by the proper regulatory authorities. The fact that the member firm does not maintain all records with respect to all of its underwriting activities in a single location does not contravene these provisions of Board rule G-9. Rule G-9 would permit the arrangement described in your letters, whereby a firm maintains copies of all of the records pertaining to a particular underwriting in the office responsible for that underwriting. *MSRB interpretation of October 21, 1981.*

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**Microfilming of records.** I am writing in response to your letter of May 20, 1983 regarding our previous conversations about the requirements of Board rules G-1 and G-9 as they would apply to the bank's retention of dealer department records on microfilm. In your letter and our previous conversations you indicated that the bank wishes to retain all of the records required to be maintained by its municipal securities dealer department on microfilm, with the hard copy of each record destroyed immediately after it has been microfilmed. You inquired as to the circumstances under which this method of record retention could be used. You also inquired about the extent to which municipal securities dealer department records could be commingled with records of other departments on the same strips of microfilm.

As you are aware, Board rule G-9(e) provides that

> a record... required to be preserved by this rule... may be retained... on microfilm, electronic or magnetic tape, or by the other similar medium of record retention, provided that [the] municipal securities broker or municipal securities dealer shall have available adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies thereof and, in the case of records retained on microfilm, electronic or magnetic tape, or other similar medium of record retention, duplicates of such records shall be stored separately from each other for the periods of time required by this rule.

Therefore, the following three conditions must be met, if records are to be retained on microfilm:

> (1) facilities for ready retrieval and inspection of the records (such as a microfilm reader or other similar piece of equipment) must be available;
>
> (2) facilities for the reproduction of a hard copy facsimile of a particular record must also be available; and
>
> (3) duplicate copies of the microfilm must be made and stored separately for the necessary time periods.

If these conditions are met, the retention of records by means of microfilm is satisfactory for purposes of the Board's rules, and hard copy records need not be retained after the microfilming is completed.

With respect to the establishment of a separately identifiable municipal securities dealer department of a bank, Board rule G-1 provides that all of the records relating to the municipal securities activities of such department must be

> separately maintained in or separately extractable from such [department's] own facilities or the facilities of the bank... [and must be] so maintained or otherwise accessible as to permit independent examination thereof and enforcement of applicable provisions of the Act, the rules and regulations thereunder and the rules of the Board.

These requirements would not preclude you from maintaining the required records on microfilm which also contained other bank records, as long as the required records were "separately extractable." The course of action you propose, maintaining all municipal securities dealer department records together as the first items on a roll of microfilm, would seem to be an appropriate way of complying with these requirements. *MSRB interpretation of June 6, 1983.*

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See also:

**Rule G-8 Interpretive Letters – Contract sheets,** *MSRB interpretation of June 25, 1987.*

**– Use of electronic signatures,** *MSRB interpretation of February 27, 1989.*

## Rule G-10: Delivery of Investor Brochure

(a) Each broker, dealer and municipal securities dealer shall deliver a copy of the investor brochure to a customer promptly upon receipt of a complaint by the customer.

(b) For purposes of this rule, the following terms have the following meanings:

(i) the term "investor brochure" shall mean the publication or publications so designated by the Board, and

(ii) the term "complaint" is defined in rule G-8(a)(xii).

### *MSRB INTERPRETATION*

See:

Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

## Rule G-11: Sales of New Issue Municipal Securities During the Underwriting Period

(a) *Definitions.* For purposes of this rule, the following terms have the following meanings:

(i) The term "accumulation account" means an account established in connection with a municipal securities investment trust to hold securities pending their deposit in such trust.

(ii) The term "date of sale" means, in the case of competitive sales, the date on which all bids for the purchase of securities must be submitted to an issuer, and, in the case of negotiated sales, the date on which the contract to purchase securities from an issuer is executed.

(iii) The term "group order" means an order for securities held in syndicate, which order is for the account of all members of the syndicate on a pro rata basis in proportion to their respective participations in the syndicate. Any such order submitted directly to the senior syndicate manager will, for purposes of this rule, be deemed to be the submission of such order by such manager to the syndicate.

(iv) The term "municipal securities investment trust" means a unit investment trust, as defined in the Investment Company Act of 1940, the portfolio of which consists in whole or in part of municipal securities.

(v) The term "order period" means the period of time, if any, announced by a syndicate during which orders will be solicited for the purchase of securities held in syndicate.

(vi) The term "priority provisions" means the provisions adopted by a syndicate governing the allocation of securities to different categories of orders.

(vii) The term "related portfolio," when used with respect to a broker, dealer or municipal securities dealer, means a municipal securities investment portfolio of such broker, dealer or municipal securities dealer or of any person directly or indirectly controlling, controlled by or under common control with such broker, dealer or municipal securities dealer.

(viii) The term "syndicate" means an account formed by two or more persons for the purpose of purchasing, directly or indirectly, all or any part of a new issue of municipal securities from the issuer, and making a distribution thereof.

(ix) The term "underwriting period" means the period commencing with the first submission to a syndicate of an order for the purchase of new issue municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending at such time as the issuer delivers the securities to the syndicate or the syndicate no longer retains an unsold balance of securities, whichever last occurs.

(x) The term "qualified note syndicate" means any syndicate formed for the purpose of purchasing and distributing a new issue of municipal securities that matures in less than two years where:

(A) the new issue is to be purchased by the syndicate on other than an "all or none" basis; or

(B) the syndicate has provided that:

(1) there is to be no order period;

(2) only group orders will be accepted; and,

(3) the syndicate may purchase and sell the municipal securities for its own account.

(b) *Disclosure of Capacity.* Every broker, dealer or municipal securities dealer which is a member of a syndicate that submits an order to a syndicate or to a member of a syndicate for the purchase of municipal securities held by the syndicate shall disclose at the time of submission of such order if the securities are being purchased for its dealer account, for the account of a related portfolio of such broker, dealer or municipal securities dealer, for a municipal securities investment trust sponsored by such broker, dealer or municipal securities dealer, or for an accumulation account established in connection with such a municipal securities investment trust.

(c) *Confirmations of Sale.* Sales of securities held by a syndicate to a related portfolio, municipal securities investment trust or accumulation account referred to in section (b) above shall be confirmed by the syndicate manager directly to such related portfolio, municipal securities investment trust or accumulation account or for the account of such related portfolio, municipal securities investment trust or accumulation account to the broker, dealer or municipal securities dealer submitting the order. Nothing herein contained shall be construed to require that sales of municipal securities to a related portfolio, municipal securities investment trust or accumulation account be made for the benefit of the syndicate.

(d) *Disclosure of Group Orders.* Every broker, dealer or municipal securities dealer that submits a group order to a syndicate or to a member of a syndicate shall disclose at the time of submission of such order the identity of the person for whom the order is submitted. This section shall not apply to a qualified note syndicate as defined in paragraph (a)(x) above.

(e) *Priority Provisions.* Every syndicate shall establish priority provisions and, if such priority provisions may be changed, the procedure for making changes. For purposes of this rule, the requirement to establish priority provisions shall not be sat-

isfied if a syndicate provides only that the syndicate manager or managers may determine in the manager's or managers' discretion the priority to be accorded different types of orders. Notwithstanding the preceding sentence, a syndicate may include a provision permitting the syndicate manager or managers on a case-by-case basis to allocate securities in a manner other than in accordance with the priority provisions, if the syndicate manager or managers determine in its or their discretion that it is in the best interests of the syndicate. In the event any such allocation is made, the syndicate manager or managers shall have the burden of justifying that such allocation was in the best interests of the syndicate.

(f) *Communications Relating to Issuer Syndicate Requirements, Priority Provisions and Order Period.* Prior to the first offer of any securities by a syndicate, the senior syndicate manager shall furnish in writing to the other members of the syndicate (i) a written statement of all terms and conditions required by the issuer, (ii) the priority provisions, (iii) the procedure, if any, by which such priority provisions may be changed, (iv) if the senior syndicate manager or managers are to be permitted on a case-by-case basis to allocate securities in a manner other than in accordance with the priority provisions, the fact that they are to be permitted to do so, and (v) if there is to be an order period, whether orders may be confirmed prior to the end of the order period. Any change in the priority provisions shall be promptly furnished in writing by the senior syndicate manager to the other members of the syndicate. Syndicate members shall promptly furnish in writing the information described in this section to others, upon request. If the senior syndicate manager, rather than the issuer, prepares the written statement of all terms and conditions required by the issuer, such statement shall be provided to the issuer.

(g) *Designations and Allocations of Securities.* The senior syndicate manager shall:

(i) within 24 hours of the sending of the commitment wire, complete the allocation of securities; provided however, that, if at the time allocations are made the purchase contract in a negotiated sale is not yet signed or the award in a competitive sale is not yet made, such allocations shall be made subject to the signing of the purchase contract or the awarding of the securities, as appropriate, and the purchaser must be informed of this fact;

(ii) within two business days following the date of sale, disclose to the other members of the syndicate, in writing, a summary, by priority category, of all allocations of securities which are accorded priority over members' take-down orders, indicating the aggregate par value, maturity date and price of each maturity so allocated, including any allocation to an order confirmed at a price other than the original list price. The summary shall include allocations of securities to orders submitted through the end of the order period or, if the syndicate does not have an order period, through the first business day following the date of sale;

(iii) disclose, in writing, to each member of the syndicate all available information on designations paid to syndicate and non-syndicate members expressed in total dollar amounts within 10 business days following the date of sale and all information about designations paid to syndicate and non-syndicate members expressed in total dollar amounts with the sending of the designation checks pursuant to rule G-12(k); and

(iv) disclose to the members of the syndicate, in writing, the amount of any portion of the take-down directed to each member by the issuer. Such disclosure is to be made by the later of 15 business days following the date of sale or three business days following receipt by the senior syndicate manager of notification of such set asides of the take-down.

(h) *Disclosure of Syndicate Expenses and Other Information.* At or before the final settlement of a syndicate account, the senior syndicate manager shall furnish to the other members of the syndicate:

(i) an itemized statement setting forth the nature and amounts of all actual expenses incurred on behalf of the syndicate. Notwithstanding the foregoing, any such statement may include an item for miscellaneous expenses, provided that the amount shown under such item is not disproportionately large in relation to other items of expense shown on the statement and includes only minor items of expense which cannot be easily categorized elsewhere in the statement. Discretionary fees for clearance costs to be imposed by a syndicate manager and management fees shall be disclosed to syndicate members prior to the submission of a bid, in the case of a competitive sale, or prior to the execution of a purchase contract with the issuer, in the case of a negotiated sale. For purposes of this section, the term "management fees" shall include, in addition to amounts categorized as management fees by the syndicate manager, any amount to be realized by a syndicate manager, and not shared with the other members of the syndicate, which is attributable to the difference in price to be paid to an issuer for the purchase of a new issue of municipal securities and the price at which such securities are to be delivered by the syndicate manager to the members of the syndicate; and

(ii) a summary statement showing:

(A) the identity of each related portfolio, municipal securities investment trust, or accumulation account referred to in section (b) above submitting an order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated;

(B) the identity of each person submitting a group order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated except that this subparagraph shall not apply to the senior syndicate manager of a qualified note syndicate as defined in paragraph (a)(x) above; and

(C) the aggregate par values and prices (expressed in terms of dollar prices or yields) of all securities sold from the syndicate account. This subparagraph shall not apply to a qualified note syndicate as defined in paragraph (a)(x) above.

## MSRB INTERPRETATIONS

### SYNDICATE SETTLEMENT PRACTICE VIOLATIONS NOTED

July 1981

The Board continues to be concerned about industry compliance with certain of the requirements of Board rules G-11, "Sales of New Issue Municipal Securities During the Underwriting Period," and G-12, "Uniform Practice," with respect to the settlement of syndicate accounts. Board rule G-11(g)[*] requires, among other matters, that syndicate managers provide to members at the time of settlement of a syndicate account a detailed statement of the expenses incurred by the syndicate.[1] Rule G-12(j) requires that settlement of a syndicate account and distribution of any profit due to members be made within 60 days of delivery of the syndicate's securities. In addition, rule G-12(i) requires that good faith deposits be returned within two business days of settlement with an issuer, and rule G-12(k) requires that sales credits designated by a customer be distributed within 30 days following delivery of the securities [by the issuer to the syndicate.]

The Board has from time to time received complaints from industry members concerning certain managers' non-compliance with these requirements. These persons allege that certain managers unduly delay the sending of syndicate settlement checks and other disbursements, and furnish settlement statements that provide little or no detail about the nature of the expenses incurred by the syndicate. These persons have also, on occasion, furnished to the Board copies of syndicate statements which illustrate clearly these managers' failure to provide the requisite information and to meet the time requirement for these disbursements. The Board has referred each of these complaints to the appropriate regulatory agency for investigation and appropriate action.

The Board wishes to emphasize strongly the need for compliance with these provisions. The Board continues to be of the view that the time periods and other requirements of the rules, which were arrived at after considerable deliberation, are fair and reasonable. The Board believes that failure to comply with these provisions is inexcusable. The Board does not accept the rationale offered by some, that the difficulties in obtaining bills for syndicate expenses justify these undue delays; the Board believes that it is incumbent upon managers to assure that such bills are received and processed in timely fashion, to permit compliance with the rule. The Board strongly urges syndicate managers who have failed to comply with these requirements to bring their practices into compliance with the requirements of the rules.

The Board also is communicating these views to the enforcement organizations and stressing its concern with respect to compliance with these provisions. It strongly urges all syndicate members to notify the appropriate enforcement organization of any violations by managers of these provisions.

1 The rule contemplates that the statement will set forth a detailed breakdown of expenses into specified categories, such as advertising, printing, legal, computer services, packaging and handling, etc. The statement may include an item for miscellaneous expenses, provided that the amount shown under such an item is not disproportionately large in relation to other items of expense shown and includes only items of expense which cannot be easily categorized elsewhere in the statement.

[*][Currently codified at rule G-11(h).]

**NOTE: Revised to reflect subsequent amendments.**

### NOTICE CONCERNING SYNDICATE EXPENSES

November 14, 1991

Board rule G-11, concerning syndicate practices, among other things, requires syndicates to establish priorities for different categories of orders and requires certain disclosures to syndicate members which are intended to assure that allocations are made in accordance with those priorities. Rule G-11(h)(i) requires that a senior syndicate manager, at or before final settlement of a syndicate account, furnish to syndicate members "an itemized statement setting forth the nature and amount of all actual expenses incurred on behalf of the syndicate." One of the purposes of this section is to render managers accountable for their handling of syndicate funds.

Over the years, the Board, pursuant to rule G-11 and rule G-17, on fair dealing, has urged syndicate managers to provide members with a clear and accurate itemized statement of all actual expenses incurred in the underwriting of each issue. In a 1984 notice, the Board stated that expense items must be sufficiently described to make the expenditures readily understandable by syndicate members, and that generalized categories of expenses are not sufficient if they do not portray the specific nature of the expenses.[1] In 1985, the Board issued a notice specifically warning managers to take care in determining actual syndicate expenses, and noting that managers may violate rule G-17 if the expenses charged to syndicate members bear no relation to, or otherwise overstate, the actual expenses incurred.[2] And in 1987, in response to industry complaints concerning the amount of syndicate expenses charged by managers, the Board issued another notice reiterating that Board rules prohibit managers from overstating actual syndicate expenses.[3]

The Board wishes to reiterate its interpretation of rules G-11 and G-17 that syndicate expenses charged to members must be clearly identified and must be the actual expenses incurred on behalf of the syndicate.[4] The Board continues to be concerned over the number of complaints about syndicate managers who may be charging expenses that are overstated or excessive, particularly with respect to clearance fees for designated sales and computer expenses. Board rules specifically prohibit managers from overstating actual syndicate expenses.

The Board urges syndicate members to report possible overstatements of syndicate expenses and other problems in compliance with rule G-11(h)(i). The Board will continue to monitor this situation, and will refer any complaints it receives in this area to the appropriate enforcement agencies. In addition, the NASD has alerted the Board that it will accept telephone complaints or information from syndicate members who do not wish to reveal their identities.

1 Notice Concerning Disclosure of Syndicate Expenses (January 12, 1984), [reprinted in *MSRB Reports*, Vol. 4, No. 1 (Feb. 1984) at 9].

2 Notice Concerning Syndicate Managers Charging Excessive Fees for Designated Sales (July 29, 1985), [reprinted in MSRB *Reports*, Vol. 5, No. 5 (Aug. 1985) at 17].

3 Notice Concerning Syndicate Expenses that Appear Excessive (March 3, 1987), [reprinted in *MSRB Reports*, Vol. 7, No. 2 (March 1987) at 5].

4 See *MSRB Reports*, vol. 5, no. 6 (November 1985) [at 5], and vol. 5, no. 5 (August 1985) [at 5].

### SYNDICATE EXPENSES: PER BOND FEE FOR BOOKRUNNING EXPENSES

June 14, 1995

Board rule G-11, concerning syndicate practices, among other things, requires syndicates to establish priorities for different categories of orders and requires certain disclosures to syndicate members which are intended

to assure that allocations are made in accordance with those priorities. In addition, the rule requires that the manager provide certain accounting information to syndicate members. In particular, rule G-11(h)(i) provides that: "Discretionary fees for clearance costs to be imposed by a syndicate manager and management fees shall be disclosed to syndicate members prior to the submission of a bid, in the case of a competitive sale, or prior to the execution of a purchase contract with the issuer, in the case of a negotiated sale."[1] The purpose of this provision is to provide information useful to syndicate members in determining whether to participate in a syndicate account. The rule also requires that the senior syndicate manager, at or before final settlement of a syndicate account, furnish to the syndicate members "an itemized statement setting for the nature and amount of all actual expenses incurred on behalf of the syndicate." One of the purposes of this section is to render managers accountable for their handling of syndicate funds.

The Board has received inquiries regarding the appropriateness of a per-bond fee for the bookrunning expenses or management fees of the senior syndicate manager. Discretionary fees for clearance costs and management fees may be expressed as a per-bond charge. These expenses, however, must be disclosed to members prior to the submission of a bid or prior to the execution of a purchase contract with the issuer; for example, in the Agreement Among Underwriters. The itemized statement setting forth a detailed breakdown of actual expenses incurred on behalf of the syndicate, such as advertising, printing, legal, computer services, etc., must be disclosed to syndicate members at or before final settlement of the syndicate account. With respect to these fees, the Board has previously noted that managers who assess a per-bond charge for designated sales may be acting in violation of rule G-17 if the expenses charged to members bear no relation to or otherwise overstate the actual expenses incurred on behalf of the syndicate.[2] The Board believes a per-bond fee creates the appearance that it is not an actual expense related to and incurred on behalf of the syndicate.

The Board is concerned about the charging of syndicate expenses and compliance with rule G-11. Managers should exercise care in accounting for syndicate funds, and any charge that has not been disclosed to members prior to the submission of a bid or prior to the execution of a purchase contract may be charged to syndicate members only if it is an actual expense incurred on behalf of the syndicate. The Board will continue to monitor syndicate practices and will notify the appropriate enforcement agency of any complaints it receives in this area. Syndicate members are encouraged to notify directly the appropriate enforcement agency of any violations of these provisions.

[1] The rule defines management fees to include, "in addition to amounts categorized as management fees by the syndicate manager, any amount to be realized by a syndicate manager, and not shared with the other members of the syndicate, which is attributable to the difference in price to be paid to an issuer for the purchase of a new issue of municipal securities and the price at which such securities are to be delivered by the syndicate manager to the members of the syndicate."

[2] Syndicate Managers Charging Excessive Fees for Designated Sales (July 29, 1985), [reprinted in MSRB *Reports*, Vol 7, No. 2 (March 1987) at 5].

See also:

**Rule G-17 Interpretation – Notice of Interpretation Concerning Priority of Orders for New Issue Securities: Rule G-17,** December 22, 1987.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## *Interpretive Letters*

**Communication of information.** I refer to your letter dated October 23, 1978 in which you request advice concerning the application of certain provisions of rule G-11. In your letter, you state that it is your understanding that the requirement in the rule for a syndicate manager to communicate information regarding the priority to be accorded to different orders could be satisfied if an agreement among underwriters provides for the managing underwriters, in their discretion, to establish the priorities to be accorded to different types of orders for the purchase of bonds from the syndicate so long as information as to the priorities so established is furnished to the members of the syndicate prior to the beginning of the order period.

Rule G-11 would permit the inclusion of a provision delegating to the managing underwriters the authority to establish the priority provisions under which the syndicate would operate. However, under section (f) of rule G-11, such information must be provided by the senior syndicate manager in writing to other members of a syndicate "prior to the first offer of any securities by a syndicate." Accordingly, if there is a presale period, the required disclosure must be made prior to the commencement of such period, and not prior to "the beginning of the order period." The procedures outlined in your letter would be permissible under the rule only if no securities are offered by a syndicate prior to the order period. *MSRB interpretation of November 9, 1978.*

**Fixed-price offerings.** This responds to your letter of February 17, 1984, requesting our view on the applicability of the Board's rules to the following situation:

[Name deleted] the ("Dealer") is an underwriter of industrial revenue bonds. It underwrites on average three or four issues per month and sells them almost entirely on a retail basis to individual investors. The coupon rates are fixed at current market levels. The bonds are then offered to the public at par. Official statements are provided to investors, fully disclosing all pertinent information and making clear note of the fact that the initial offering price of par may be changed without prior notice.

Recently, interest rates dropped significantly during the two or three-week time period needed for the Dealer to sell out a bond issue. This caused the offering price of the fixed rate municipal bonds to rise above the initial offering price stated in the official statement. All of this occurred before the closing of the syndicate account. You ask specifically whether, under the Board's rules, it is permissible to raise the offering price of municipal bonds which are part of a new issue above the initial price before the close of the underwriting period.

Board rule G-11 generally requires syndicates to establish priorities for different categories of orders and requires that certain disclosures be made to syndicate members which are intended to assure that allocations are made in accordance with those priorities. The rule also requires that the manager provide account information to syndicate members in writing. The Board has described rule G-11 as a "disclosure rule" designed to provide information to new issue participants so that they can understand and evaluate syndicate practices. The rule does not, however, dictate what those practices must be. Thus, rule G-11 does not require that the offering price of new issue municipal securities remain fixed through the underwriting period. The Board considered the issue of fixed-price offerings when it formulated rule G-11 and again when the Public Securities Association, in 1981, asked the Board to consider the adoption of rules governing the granting of concessions in new issues of municipal securities. Since the kind of fixed-price offering system developed for corporate securities has not been the primary means of distributing municipal securities and in light of industry concerns that any such proposed regulations could unnecessarily restrict prices and increase the borrowing costs for municipal issues, the Board

determined not to adopt any rules addressing the issue.[1]

Finally, we know of no laws or regulations which purport to require fixed-price offerings for new issue municipal securities, and the NASD's rules in this area do not apply to transactions in municipal securities.[1] Of course, Board rule G-30, on prices and commissions, prohibits a dealer from buying municipal securities for its own account from a customer or selling municipal securities for its own account to a customer at an aggregate price unless that price is reasonable taking into consideration all relevant factors. *MSRB interpretation of March 16, 1984.*

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[1] For a fuller explanation of the Board's review of G-11 in this area, [see] *Notice Concerning Board Determination Not to Adopt Concession Rules*, [*MSRB Reports*, Vol. 2, No. 5 (July 1982) at 7].

[2] See NASD Rules of Fair Practice, Article II, Section 1, subsection (m) [currently codified as NASD Rule 114].

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**Concessions and discounts.** This is in response to your October 13, 1986 letter asking if the Board's rules prohibit a dealer from granting a price concession on a new issue security to a customer. The Board's rules do not address the granting of concessions or price discounts to customers on new issue offerings; however, the terms of the applicable syndicate agreement may address this issue. *MSRB interpretation of October 22, 1986.*

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See also:

**Rule G-8 Interpretive Letter – Syndicate records: sole underwriter,** *MSRB interpretation of May 12, 1989.*

## Rule G-12: Uniform Practice

(a) *Scope and Notice.*

(i) All transactions in municipal securities between any broker, dealer or municipal securities dealer and any other broker, dealer or municipal securities dealer shall be subject to the provisions of this rule, provided, however, that a transaction submitted to a registered clearing agency for comparison shall be exempt from the provisions of section (c) and, to the extent such transaction is compared by the clearing agency, section (d) of this rule, and a transaction which is settled or cleared through the facilities of a registered clearing agency shall be exempt from the provisions of section (e) of this rule.

(ii) Failure to deliver securities sold or to pay for securities as delivered, on or after the settlement date does not effect a cancellation of a transaction which is subject to the provisions of this rule, unless otherwise provided in this rule or agreed upon by the parties.

(iii) Unless otherwise specifically indicated, any "immediate" notice required by this rule or any notice required to be given "immediately" shall be given by telephone, telegraph or other means of communication having same day receipt capability and confirmed in writing within one business day.

(b) *Settlement Dates.*

(i) *Definitions.* For purposes of this rule, the following terms shall have the following meanings:

(A) *Settlement Date.* The term "settlement date" shall mean the day used in price and interest computations, which shall also be the day delivery is due unless otherwise agreed by the parties.

(B) *Business Day.* The term "business day" shall mean a day recognized by the National Association of Securities Dealers, Inc. as a day on which securities transactions may be settled.

(ii) *Settlement Dates.* Settlement dates shall be as follows:

(A) for "cash" transactions, the trade date;

(B) for "regular way" transactions, the third business day following the trade date;

(C) for "when, as and if issued" transactions, a date agreed upon by both parties, which date: (1) with respect to transactions required to be compared in an automated comparison system under rule G-12(f)(i), shall not be earlier than two business days after notification of initial settlement date for the issue is provided to the registered clearing agency by the managing underwriter for the issue as required by rule G-34(a)(ii)(D)(2); and (2) with respect to transactions not eligible for automated comparison, shall not be earlier than the third business day following the date that the confirmation indicating the final settlement date is sent; and

(D) for all other transactions, a date agreed upon by both parties, provided, however, that a broker, dealer or municipal securities dealer shall not effect or enter into a transaction for the purchase or sale of a municipal security (other than a "when, as and if issued" transaction) that provides for payment of funds and delivery of securities later than the third business day after the date of the transaction unless expressly agreed to by the parties, at the time of the transaction.

(c) *Dealer Confirmations.* All municipal securities transactions that are ineligible for automated comparison in a system operated by a registered clearing agency shall be subject to the provisions of this section (c).

(i) Except as otherwise indicated in this section (c), each party to a transaction shall send a confirmation of the transaction to the other party on the trade date.

(ii) Confirmations of cash transactions shall be exchanged by telephone on the trade date, with written confirmation sent within one business day following the trade date.

(iii) For transactions effected on a "when, as and if issued" basis, initial confirmations shall be sent within one business day following the trade date. Confirmations from a syndicate or account manager to the members of the syndicate or account may be in the form of a letter, covering all maturities of the issue, setting forth the information hereafter specified in this section (c). Confirmations indicating the final settlement date shall be sent by the seller at least three business days prior to the settlement date.

(iv) Reserved for future use.

(v) Each confirmation shall contain the following information:

(A) confirming party's name, address and telephone number;

(B) "contra party" identification;

(C) designation of purchase from or sale to;

(D) par value of the securities;

(E) description of the securities, including at a minimum the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities and in the case of any securities, if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown;

(F) CUSIP number, if any, assigned to the securities;

(G) trade date;

(H) settlement date;

(I) yield at which transaction was effected and resulting dollar price, except in the case of securities which are traded on the basis of dollar price or securities sold at par, in which event only dollar price need be shown (in cases in which securities are priced to call or to par option, this must be stated and the call or option date and price used in the calculation must be shown, and where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity);

(J) amount of concession, if any, per $1000 par value unless stated to be an aggregate figure, *provided, however,* that for a transaction in securities maturing in two or more years and, at the time of the transaction, paying investment return solely through capital appreciation, the concession, if any, shall be expressed as a percentage of the price of these securities;

(K) amount of accrued interest;

(L) extended principal amount;

(M) total dollar amount of transaction; and

(N) instructions, if available, regarding receipt or delivery of securities, and form of payment if other than as usual and customary between the parties.

The confirmation for a transaction in securities traded on a discounted basis (other than discounted securities traded on a yield-equivalent basis) shall not be required to show the pricing information specified in subparagraph (I) nor the accrued interest specified in subparagraph (K). Such information shall, however, contain the rate of discount and resulting dollar price. Such confirmation may, in lieu of the resulting dollar price and the extended principal amount specified in subparagraph (L), show the total dollar amount of the discount.

The confirmation for a transaction in securities maturing in more than two years and paying investment return solely at redemption shall not show the par value of the securities specified in subparagraph (D) and shall not be required to show the amount of accrued interest specified in subparagraph (K). Such confirmation shall, however, show the maturity value of the securities and specify that the interest rate on the securities is "0%."

The initial confirmation for a "when, as and if issued" transaction shall not be required to contain the information specified in subparagraphs (H), (K), (L), and (M) of this paragraph or the resulting dollar price as specified in subparagraph (I).

(vi) In addition to the information required by paragraph (v) above, each confirmation shall contain the following information, if applicable:

(A) dated date if it affects the price or interest calculation, and first interest payment date, if other than semi-annual;

(B) If the securities are available only in book-entry form, a designation to such effect;

(C) if the securities are identified by the issuer or sold by the underwriter as subject to federal taxation, a designation to that effect;

(D) if the interest on the securities is identified by the issuer or the underwriter as subject to the alternative minimum tax, a designation to that effect;

(E) if the securities are "called" or "pre-refunded," a designation to such effect, the date of maturity which has been fixed by the call notice, and the amount of the call price;

(F) denominations of securities other than bonds, and, in the case of bonds, denominations other than those specified in paragraph (e)(v) hereof;

(G) if the securities pay periodic interest and are sold by the underwriter as original issue discount securities, a designation that they are "original issue discount" securities;

(H) any special instructions or qualifications, or factors affecting payment of principal or interest, such as (1) "ex legal," or (2) if the securities are traded without interest, "flat," or (3) if the securities are in default as to the payment of interest or principal, "in default," or (4) with respect to securities with periodic interest payments, if such securities pay interest on other than a semi-annual basis, a statement of the basis on which interest is paid; and

(I) such other information as may be necessary to ensure that the parties agree to the details of the transaction.

(d) *Comparison and Verification of Confirmations; Unrecognized Transactions.*

(i) Upon receipt of a confirmation, each party to a transaction shall compare and verify such confirmation to ascertain whether any discrepancies exist. If any discrepancies exist in the information as set forth in two compared confirmations, the party discovering such discrepancies shall promptly communicate such discrepancies to the contra party and both parties shall promptly attempt to resolve the discrepancies. In the event the parties are able to resolve the discrepancies, the party in error shall within one business day following such resolution, send a corrected confirmation to the contra party. Such confirmation shall indicate that it is a correction and the date of the corrected confirmation. In the event the parties are unable to resolve the discrepancies, each party shall promptly send to the contra party a written notice, return receipt requested, indicating nonrecognition of the transaction.

(ii) In the event a party receives a confirmation for a transaction which it does not recognize, it shall promptly seek to ascertain whether a trade occurred and the terms of the trade. In the event it determines that a trade occurred and the confirmation it received was correct, such party shall immediately notify the confirming party by telephone and, within one business day thereafter, send a written confirmation of the transaction to the confirming party. In the event a party cannot confirm the trade, such party shall immediately notify the confirming party by telephone and, within one business day, thereafter send a written notice, return receipt requested, to the confirming party, indicating nonrecognition of the transaction. Promptly upon receipt of such notice, the confirming party shall verify its records and, if it agrees with the non-confirming party, promptly send a notice of cancellation of the transaction, return receipt requested, to the non-confirming party.

(iii) In the event a party has sent a confirmation of a transaction, but fails to receive a confirmation from the contra party or a notice indicating nonrecognition of the transaction, the confirming party shall, not earlier than the fourth business day following the trade date (the sixth business day following the trade date, in the case of an initial confirmation of a transaction effected on a "when, as and if issued" basis) nor later than the eighth business day following the trade date, seek to ascertain whether a trade occurred. If, after such verification, such party believes that a trade occurred, it shall immediately notify the non-confirming party by telephone to such effect and send within one business day thereafter, a written notice, return receipt requested, to the non-confirming party, indicating failure to confirm. Promptly following receipt of telephone notice from the confirming party, the non-confirming party shall seek to ascertain whether a trade occurred and the terms of the trade. In the event the non-confirming party determines that a trade occurred, it shall immediately notify the confirming party by telephone to such effect and, within one business day thereafter, send a written confirmation of the transaction to the confirming party. In the event a party cannot confirm the trade, such party shall promptly send a written notice, return receipt requested, to the confirming party, indicating nonrecognition of the transaction.

(iv) If procedures are initiated pursuant to paragraph (ii) of this section, the procedures required by paragraph (iii) need not be followed; and conversely, if procedures are initiated pursuant to paragraph (iii) of this section, the procedures required by paragraph (ii) need not be followed.

(v) In the event any material discrepancies or differences, basic to the transaction, remain unresolved by the close of the business day following receipt by a party of a written notice indicating nonrecognition or by the close of the business day following the date the confirming party gives telephone notice of the transaction to the non-confirming party pursuant to paragraph (iii) above, whichever first occurs, the transaction may be cancelled by the confirming party or, in the event there exists disagreement concerning the terms of the transaction, by either confirming party. Nothing herein contained shall be construed to affect whatever rights the confirming party or parties may otherwise have with respect to a transaction which is cancelled pursuant to this paragraph.

(vi) Nothing herein contained shall be construed to prevent the settlement of a transaction prior to completion of the procedures prescribed in this section (d); provided that each party to the transaction shall be responsible for sending to the other party, within one business day of such settlement, a confirmation evidencing the terms of the transaction.

(vii) The notices referred to in this section indicating nonrecognition of a transaction or failure to confirm a transaction shall contain sufficient information to identify the confirmation to which the notice relates including, at a minimum, the information set forth in subparagraphs (A) through (E), (G) and (H) of paragraph (c)(v), as well as the confirmation number. In addition, such notice shall identify the firm and person providing such notice and the date thereof. The requirements of this paragraph may be satisfied by providing a copy of the confirmation of an unrecognized transaction, marked "don't know," together with the name of the firm and person providing such notice and the date thereof.

(e) *Delivery of Securities*. The following provisions shall, unless otherwise agreed by the parties, govern the delivery of securities:

(i) *Place and Time of Delivery*. Delivery shall be made at the office of the purchaser, or its designated agent, between the hours established by rule or practice in the community in which such office is located. If the parties so agree, book entry or other delivery through the facilities of a registered clearing agency will constitute good delivery for purposes of this rule.

(ii) *Securities Delivered*.

(A) All securities delivered on a transaction shall be identical as to the information set forth in subparagraph (E) of paragraph (c)(v) and, to the extent applicable, the information set forth in subparagraphs (A) and (E) of paragraph (c)(vi). All securities delivered shall also be identical as to the call provisions and the dated date of such securities.

(B) *CUSIP Numbers*.

(1) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of subparagraph (c)(v)(F) of this rule; *provided, however*, that, for purposes of this item (1), a security shall be deemed to have the same CUSIP number as that specified on the confirmation (a) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (b) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security.

(2) A new issue security delivered by an underwriter who is subject to the provisions of rule G-34 shall have the CUSIP number assigned to the security imprinted on or otherwise affixed to the security.

(iii) *Delivery Ticket*. A delivery ticket shall accompany the delivery of securities. Such ticket shall contain the information set forth in subparagraphs (A), (B), (D) (except in the case of transactions in zero coupon, compound interest and multiplier securities, in which case the maturity value shall be shown), (E) through (H), (M) and (N) of paragraph (c)(v) and, to the extent applicable, the information set forth in subparagraphs (A) through (I) of paragraph (c)(vi) and shall have attached to it an extra copy of the ticket which may be used to acknowledge receipt of the securities.

(iv) *Partial Delivery*. The purchaser shall not be required to accept a partial delivery with respect to a single trade in a single security. For purposes of this paragraph, a "single security" shall mean a security of the same issuer having the same maturity date, coupon rate and price. The provisions of this paragraph shall not apply to deliveries made pursuant to balance orders or other similar instructions issued by a registered clearing agency.

(v) *Units of Delivery*. Delivery of bonds shall be made in the following denominations:

(A) for bearer bonds, in denominations of $1,000 or $5,000 par value; and

(B) for registered bonds, in denominations which are multiples of $1,000 par value, up to $100,000 par value.

Delivery of other municipal securities shall be made in the denominations specified on the confirmation as required pursuant to paragraph (c)(vi) of this rule except that deliveries of notes may be made in denominations smaller than those specified if the notes delivered can be aggregated to constitute the denominations specified.

(vi) *Form of Securities*.

(A) *Bearer and Registered Form*. Delivery of securities which are issuable in both bearer and registered form may be in bearer form unless otherwise agreed by the parties; *provided, however*, that delivery of securities which are required to be in registered form in order for interest thereon to be exempt from Federal income taxation shall be in registered form.

(B) *Book-Entry Form*. Notwithstanding the other provisions of this section (e), with respect to a security which may be transferred only by bookkeeping entry, without the physical delivery of securities certificates, on books maintained for this purpose by a person who is not a registered clearing agent, a delivery of such security shall be made only by a book-entry transfer of the ownership of the security to the purchasing dealer or a person designated by the purchasing dealer.

(vii) *Mutilated Certificates*. Delivery of a certificate which is damaged to the extent that any of the following is not ascertainable:

(A) name of issuer;

(B) par value;

(C) signature;

(D) coupon rate;

(E) maturity date;

(F) seal of the issuer; or

(G) certificate number

shall not constitute good delivery unless validated by the trustee, registrar, transfer agent, paying agent or issuer of the securities or by an authorized agent or official of the issuer.

(viii) Coupon Securities.

(A) Coupon securities shall have securely attached to the certificate in the correct sequence all appropriate coupons, including supplemental coupons if specified at the time of trade, which in the case of securities upon which interest is in default shall include all unpaid or partially paid coupons. All coupons attached to the certificates must have the same serial number as the certificate.

(B) Anything herein to the contrary notwithstanding, if securities are traded "and interest" and the settlement date is on or after the interest payment date, such securities shall be delivered without the coupon payable on such interest payment date.

(C) If delivery of securities is made on or after the thirtieth calendar day prior to an interest payment date, the seller may deliver to the purchaser a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, in an amount equal to the interest due in lieu of the coupon.

(ix) *Mutilated or Cancelled Coupons*. Delivery of a certificate which bears a coupon which is damaged to the extent that any one of the following cannot be ascertained from the coupon:

(A) title of the issuer;

(B) certificate number;

(C) coupon number or payment date (if either the coupon number or the payment date is ascertainable from the coupon, the coupon will not be considered mutilated); or

(D) the fact that there is a signature;

or which coupon has been cancelled, shall not constitute good delivery unless the coupon is endorsed or guaranteed. In the case of damaged coupons, such endorsement or guarantee must be by the issuer or by a commercial bank. In the case of cancelled coupons, such endorsement or guarantee must be by the issuer or an authorized agent or official of the issuer, or by the trustee or paying agent.

(x) *Delivery of Certificates Called for Redemption*.

(A) A certificate for which a notice of call applicable to less than the entire issue of securities has been published on or prior to the delivery date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

(B) A certificate for which a notice of call applicable to the entire issue of securities has been published on or prior to the trade date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

(C) For purposes of this paragraph (x) and Items (D)(2) and (D)(3) of paragraph G-12(g)(iii), the term "entire issue of securities" shall mean securities of the same issuer having the same date of issue, maturity date and interest rate.

(xi) *Delivery Without Legal Opinions or Other Documents*. Delivery of certificates without legal opinions or other documents legally required to accompany the certificates shall not constitute good delivery unless identified as "ex legal" at the time of trade.

(xii) *Insured Securities*. Delivery of certificates for securities traded as insured securities shall be accompanied by evidence of such insurance, either on the face of the certificate or in a document attached to the certificate.

(xiii) *Endorsements for Banking or Insurance Requirements*. A security bearing an endorsement indicating that it was deposited in accordance with legal requirements applicable to banking institutions or insurance companies shall not constitute good delivery unless it bears a release acknowledged before an officer authorized to take such acknowledgments and was designated as a released endorsed security at the time of trade.

(xiv) *Delivery of Registered Securities*

(A) *Assignments*. Delivery of a certificate in registered form must be accompanied by an assignment on the certificate or on a separate bond power for such certificate, containing a signature or signatures which corresponds in every particular with the name or names written upon the certificate, except that the following shall be interchangeable: "and" or "&"; "Company" or "Co."; "Incorporated" or "Inc."; and "Limited" or "Ltd."

(B) *Detached Assignment Requirements*. A detached assignment shall provide for the irrevocable appointment of an attorney, with power of substitution, a full description of the security, including the name of the issuer, the maturity date and interest date, the bond or note number, and the par value (expressed in words and numerals).

(C) *Power of Substitution*. When the name of an individual or firm has been inserted in an assignment as attorney, a power of substitution shall be executed in blank by such individual or firm. When the name of an individual or firm has been inserted in a power of substitution as a substitute attorney, a new power of substitution shall be executed in blank by such substitute attorney.

(D) *Guarantee*. Each assignment, endorsement, alteration and erasure shall bear a guarantee acceptable to the transfer agent or registrar.

(E) *Form of Registration*. Delivery of a certificate accompanied by the documentation required in this paragraph (xiv) shall constitute good delivery if the certificate is registered in the name of:

(1) an individual or individuals;

(2) a nominee;

(3) a member of a national securities exchange whose specimen signature is on file with the transfer agent or any other broker, dealer or municipal securities dealer who has filed specimen signatures with the transfer agent and places a statement to this effect on the assignment; or

(4) an individual or individuals acting in a fiduciary capacity.

(F) *Certificate in Legal Form*. Good transfer of a security in legal form shall be determined only by the transfer agent for the security. Delivery of a certificate in legal form shall not constitute good delivery unless the certificate is identified as being in such form at the time of trade. A certificate shall be considered to be in legal form if documentation in addition to that specified in this paragraph (xiv) is required to complete a transfer of the securities.

(G) *Payment of Interest*. If a registered security is traded "and interest" a delivery of such security made on a date after the record date for the determination of registered holders for the payment of interest shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, for the amount of the interest.

(H) Registered Securities in Default. If a registered security is in default (*i.e.*, is in default in the payment of principal or interest) and a date for payment of interest due has been established, a delivery of such security made on a date after the date established as the record date for the determination of registered holders for the payment of interest shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, for the amount of the payment to be made by the issuer, unless the security is traded "ex-interest."

(xv) *Expenses of Shipment*. Expenses of shipment of securities, including insurance, postage, draft, and collection charges, shall be paid by the seller.

(xvi) *Money Differences*. The following money differences shall not be sufficient to cause rejection of delivery:

| Par Value | Maximum Differences Per Transaction |
|---|---|
| $1,000 to 24,999 | $10 |
| 25,000 to 99,999 | 25 |
| 100,000 to 249,999 | 60 |
| 250,000 to 999,999 | 250 |
| 1,000,000 and over | 500 |

The calculations of the seller shall be utilized in determining the maximum permissible differences and amount of payment to be made upon delivery. The parties shall seek to reconcile any such money differences within ten business days following settlement.

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

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, 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) Notwithstanding the provisions of section (e) of this rule, a transaction eligible for book-entry settlement at a securities depository registered with the Securities and Exchange Commission (depository) shall be settled by book-entry through the facilities of a depository or through the interface between two depositories. Each party to such a transaction shall submit or cause to be submitted to a depository all information and instructions required from the party by the depository for book-entry settlement of the transaction to occur; *provided that*, if a party to a transaction has made arrangements, through its clearing agent or otherwise, to use one or more depositories exclusively, a transaction by that party shall not be subject to the requirements of this paragraph (ii) if the transaction is ineligible for book-entry settlement at all such depositories with which such arrangements have been made.

(iii) For purposes of paragraph (i) of this section (f) a broker, dealer or municipal securities dealer who clears a transaction through an agent who is a member of a registered clearing agency shall be deemed to be a member of such registered clearing agency with respect to such transaction.

(g) *Rejections and Reclamations.*

(i) *Definitions.* For purposes of this section, the terms "rejection" and "reclamation" shall have the following meanings:

(A) "Rejection" shall mean refusal to accept securities which have been presented for delivery.

(B) "Reclamation" shall mean return by the receiving party of securities previously accepted for delivery.

(ii) *Basis for Rejection.* Securities presented for delivery may be rejected if the contra party fails to make a good delivery.

(iii) *Basis for Reclamation and Time Limits.* A reclamation may be made by the receiving party or a demand for reclamation may be made by the delivering party if, subsequent to delivery, information is discovered which, if known at the time of the delivery, would have caused the delivery not to constitute good delivery, provided such reclamation or demand for reclamation is made within the following time limits:

(A) Reclamation or demand for reclamation by reason of the following shall be made within one business day following the date of delivery:

(1) not good delivery because a coupon, or an interest check in lieu thereof, required by this rule to accompany delivery was missing; or

(2) not good delivery because a certificate or coupon was mutilated in a manner inconsistent with the provisions of paragraphs (e)(vii) or (ix) hereof; or

(3) not good delivery because a legal opinion or other documents referred to in paragraph (e)(xi) hereof were missing.

(B) Reclamation or demand for reclamation because an interest check accompanying delivery was not honored shall be made within three business days following receipt by the purchaser of the notice of dishonor.

(C) reclamation or demand for reclamation by reason of the following shall be made within 18 months following the date of delivery:

(1) irregularity in delivery, including, but not limited to, delivery of the wrong issue (*i.e.*, issuer, coupon rate or maturity date), duplicate delivery, delivery to the wrong party or location, or over delivery; or

(2) refusal to transfer or deregister by the transfer agent due to presentation of documentation in connection with the transfer or deregistration which the transfer agent deems inadequate; or

(3) information pertaining to the description of the securities was inaccurate for either of the following reasons:

(i) information required by subparagraph (c)(v)(E) of this rule was omitted or erroneously noted on a confirmation, or

(ii) information material to the transaction but not required by subparagraph (c)(v)(E) of this rule was erroneously noted on a confirmation.

(D) Reclamation or demand for reclamation by reason of the following may be made without any time limitation:

(1) the security delivered is reported missing, stolen, fraudulent or counterfeit;

(2) the security delivered is the subject of a notice of call applicable to less than the entire issue of securities that was published on or prior to the delivery date and the security was not identified as "called" at the time of trade; or

(3) the security delivered is the subject of a notice of call applicable to the entire issue of securities that was published on or prior to trade date and the security was not identified as "called" at the time of trade.

The running of any of the time periods specified in this paragraph shall not be deemed to foreclose a party's right to pursue its claim via other means, including arbitration.

(iv) *Procedure for Rejection or Reclamation.*

(A) If a party elects to reject or reclaim securities, rejection or reclamation shall be effected by returning the securities to the party who had previously delivered them. In the case of a reclamation, the reclaiming party may reclaim all (or, in the case of a reclamation of securities reported to be missing, stolen, fraudulent or counterfeit, any part) of the securities which were not in "good delivery" form on the delivery date in lieu of reclaiming all of the securities delivered. In the case of a reclamation of securities reported missing, stolen, fraudulent or counterfeit, in the event that the securities have been seized by the issuer, an agent of the issuer, or a law enforcement official, reclamation by means of a presentation of a receipt for such securities executed by such person will meet the requirements of this subparagraph (A).

(B) The rejecting or reclaiming party shall also provide a written notice which contains sufficient information to identify the delivery to which the notice relates. The notice shall have attached to it a copy of the original delivery ticket or other proof of delivery, and shall state, to the extent not set forth on the attached document, the following:

(1) the name of the party delivering the securities;

(2) the name of the party receiving the securities;

(3) a description of the securities;

(4) the date the securities were delivered;

(5) the date of rejection or reclamation;

(6) the par value of the securities which are being rejected or reclaimed;

(7) in the case of a reclamation, the amount of money the securities are reclaimed for;

(8) the reason for rejection or reclamation; and

(9) the name and telephone number of the person to contact concerning the rejection or reclamation.

(C) A party demanding reclamation of securities shall send to the contra-party a notice demanding reclamation of the securities. Such notice shall have attached to it a copy of the original delivery ticket or other proof of delivery, and shall state, to the extent not set forth on the attached document, the information specified in items (1) through (9) of subparagraph (B) above.

(D) In the event of a reclamation or a demand for reclamation of a security reported missing, stolen, fraudulent or counterfeit, the reclaiming party or the party demanding reclamation shall also provide a document or documents made available by the issuer, an agent of the issuer, or other authorized person evidencing the report and, in the cause of securities reported missing or stolen, evidencing that the loss or theft that is the subject of the report had occurred on or prior to the original delivery date.

(v) *Manner of Settlement of Reclamation.* Upon reclamation properly made pursuant to this rule, the party receiving the reclamation shall immediately give the party making the reclamation either the correct securities in proper form for delivery in exchange for the securities originally delivered, or the money amount (or the appropriate portion of the money amount) of the original transaction. A party receiving a notice of demand for reclamation shall reclaim the securities which are the subject of such notice as promptly as possible.

(vi) *Effect of Rejection or Reclamation.* Rejection or reclamation of securities shall not constitute a cancellation of the transaction. In the event of a reclamation of securities, unless otherwise agreed, the party to whom the securities have been reclaimed shall be deemed to be failing to deliver the securities, as of the original transaction settlement date, until such time as a proper delivery is made or the transaction is closed out in accordance with section (h) of this rule.

(h) *Close-Out.* Transactions which have been confirmed or otherwise agreed upon by both parties but which have not been completed may be closed out in accordance with this section, or as otherwise agreed by the parties.

(i) *Close-Out by Purchaser.* With respect to a transaction which has not been completed by the seller according to its terms and the requirements of this rule, the purchaser may close out the transaction in accordance with the following procedures:

(A) *Notice of Close-Out.* If the purchaser elects to close out a transaction in accordance with this paragraph (i), the purchaser shall, not earlier than the fifth business day following the settlement date, notify the seller by telephone of the purchaser's intention to close out the transaction. The purchaser shall state that unless the transaction is completed by a specified date and time, which shall not be earlier than the close of the tenth business day following the date the telephonic notice is given (the fifth business day, in the case of a second or subsequent notice), the transaction may be closed out in accordance with this section at any time during the period of time, which shall not be more than five business days, specified by the purchaser for such purpose. The purchaser shall immediately thereafter send, return receipt requested, a written notice of close-out to the seller. Such notice shall contain the information specified in item (1) of subparagraph (C) below.

(B) *Retransmittal.* Any party receiving a notice of close-out may retransmit the notice to another party from whom the securities are due. The retransmitting party shall, not later than the first business day following its receipt of the telephone notice of close-out, notify the party to whom it is retransmitting by telephone of its intention to retransmit such notice, specifying the name of the originator and the applicable dates for delivery and effectiveness of the notice. The retransmitting party shall immediately thereafter send, return receipt requested, a written notice of retransmittal which shall contain the information specified in item (2) of subparagraph (C) below. The first such retransmittal shall extend the dates for close-out by five business days, and the first retransmitting party shall specify the extended dates on its notice of retransmittal. The first retransmitting party shall, on the date telephone notice of the retransmittal is given, notify the purchaser originating the notice by telephone of the extended dates and immediately thereafter send, return receipt requested, a notice of extension of dates which shall contain the information specified in item (3) of subparagraph (C) below. Any party subsequently retransmitting such notice shall, on the date telephonic notice of the retransmittal is given, notify the purchaser originating the notice by telephone of such retransmittal, and immediately thereafter send a copy of the retransmittal notice to such originating purchaser.

(C) *Contents of Notices.* Written notices sent in accordance with the requirements of subparagraphs (A) or (B) above shall contain the following information:

(1) The notice of close-out required under subparagraph (A) above shall set forth:

(a) the name and address of the broker, dealer or municipal securities dealer originating the notice;

(b) the name and address of the broker, dealer or municipal securities dealer to whom the notice is being sent;

(c) the name of the person to whom the originator provided the required telephonic notice;

(d) the date of such telephonic notice;

(e) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;

(f) the trade date and settlement date of the transaction;

(g) the price and total dollar amount of the transaction;

(h) the date by which the securities must be received by the originating dealer;

(i) the date or dates during which the notice of close-out may be executed; and

(j) the name and telephone number of the person to contact concerning the close-out.

(2) The notice of retransmittal required under subparagraph (B) above shall set forth:

(a) the name and address of the broker, dealer or municipal securities dealer retransmitting the notice;

(b) the name and address of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(c) the name of the broker, dealer or municipal securities dealer originating the notice;

(d) the name of the person to whom the retransmitting party provided the required telephonic notice;

(e) the date of such telephonic notice;

(f) the par value and description of the securities involved in the transaction with respect to which the retransmittal notice is given;

(g) the trade date and settlement date of the transaction;

(h) the price and total dollar amount of the transaction;

(i) the date by which the securities must be received by the dealer originating the notice (as extended due to the retransmittal);

(j) the date or dates during which the notice of close-out may be executed (as extended due to the retransmittal); and

(k) the name and telephone number of the person to contact concerning the retransmittal.

(3) The notice of extension of dates required under subparagraph (B) above shall set forth:

(a) the name and address of the broker, dealer or municipal securities dealer originating the notice of close-out;

(b) the name and address of the broker, dealer or municipal securities dealer retransmitting the notice;

(c) the name of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(d) the name of the person to whom the retransmitting party provided the required telephonic notice of the extension of dates;

(e) the date of such telephonic notice;

(f) the par value and description of the securities involved in the transaction with respect to which the notice is given;

(g) the date specified by the originating dealer as the date by which delivery of such securities must be made;

(h) the date by which such delivery must be made, as extended due to the retransmittal;

(i) the effective date or dates for the notice of close-out, as extended due to the retransmittal; and

(j) the name and telephone number of the person to contact concerning the close-out.

(D) *Purchaser's Options.* If the securities described in the notice of close-out are not delivered to the originating purchaser by the date specified in the original notice, or the extended date resulting from a retransmittal, such purchaser may close out the transaction in accordance with the terms of the notice. To close out a transaction as provided herein the purchaser may, at its option, take one of the following actions:

(1) purchase ("buy-in") at the current market all or any part of the securities necessary to complete the transaction, for the account and liability of the seller;

(2) accept from the seller in satisfaction of the seller's obligation under the original contract (which shall be concurrently cancelled) the delivery of municipal securities which are comparable to those originally bought in quantity, quality, yield or price, and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller; or

(3) require the seller to repurchase the securities on terms which provide that the seller pay an amount which includes accrued interest and bear the burden of any change in market price or yield.

A purchaser executing a close-out shall, upon execution, notify the selling dealer for whose account and liability the transaction was closed out by telephone, stating the means of close-out utilized. The purchaser shall immediately thereafter confirm such notice in writing, sent return receipt requested, and forward a copy of the confirmation of the executed transaction. A retransmitting party shall give immediate notice of the execution of the close-out, in accordance with the procedure set forth herein, to the party to whom it retransmitted the notice. A close-out will operate to close out all transactions covered under retransmitted notices. Any moneys due on the transaction, or on the close-out of the transaction, shall be forwarded to the appropriate party within ten business days of the date of execution of the close-out notice. A buy-in may be executed from a long position in customers' accounts maintained with the party executing the buy-in or, with the agreement of the seller, from the purchaser's contra-party. In all cases, the purchaser must be prepared to defend the price at which the close-out is executed relative to market conditions at the time of the execution.

(E) *Close-Out Not Completed.* If a close-out pursuant to a notice of close-out is not completed in accordance with the terms of the notice and the provisions of this rule, the notice shall expire. Additional close-out notices may be issued, provided that a close-out procedure with respect to a transaction may not be initiated later than the ninetieth business day following the settlement date of such transaction, regardless of the number of close-out notices issued. Notwithstanding the foregoing, in the case of a transaction on which a delivery of securities has been

reclaimed pursuant to the provisions of subparagraphs (g)(iii)(C) or (g)(iii)(D) of this rule and which remains uncompleted, the purchaser may initiate one or more close-out procedures with respect to such transaction at any time during a period of fifteen business days following the date of reclamation. The first such procedure shall be considered an initial procedure for purposes of subparagraph (A) above.

(F) *Completion of Transaction.* If, at any time prior to the execution of a close-out pursuant to this paragraph (i), the seller, or any subsequent selling party to whom a notice has been retransmitted, can complete the transaction within two business days, such party shall give immediate notice to the purchaser originating the notice of close-out that the securities will be delivered within such time period. If the originating purchaser receives such notice, it shall not execute the close-out for two business days following the date of such notice; the period specified for the execution of the close-out shall be extended by two business days or, in the event that the notice is given on the last day specified for execution of the close-out, by three business days. Delivery of the securities in accordance with such notice shall cancel the close-out notice outstanding with respect to the transaction.

(G) *"Cash" Transactions.* The purchaser may close out transactions made for "cash" or made for or amended to include guaranteed delivery at the close of business on the day delivery is due.

(ii) *Close-Out by Seller.* If a seller makes good delivery according to the terms of the transaction and the requirements of this rule and the purchaser rejects delivery, the seller may close out the transaction in accordance with the following procedures:

(A) *Notice of Close-Out.* If the seller elects to close out a transaction in accordance with this paragraph (ii), the seller shall at any time not later than the close of business on the fifth business day following receipt by the seller of notice of the rejection, notify the purchaser by telephone of the seller's intention to close out the transaction. The seller shall state that unless the transaction is completed by a specified date and time, which shall not be earlier than the close of the business day following the date the telephonic notice is given, the transaction may be closed out in accordance with this section. The seller shall immediately thereafter send, return receipt requested, a written notice of close-out to the purchaser. Such notice shall contain the information specified in subparagraph (B) below, and shall be accompanied by a copy of the purchaser's confirmation of the transaction to be closed out or other written evidence of the contract between the parties.

(B) *Content of Notice.* The written notice sent in accordance with the requirements of subparagraph (A) above shall set forth:

(1) the name and address of the broker, dealer or municipal securities dealer originating the notice;

(2) the name and address of the broker, dealer or municipal securities dealer to whom the notice is being sent;

(3) the name of the person to whom the originator provided the required telephonic notice;

(4) the date of such telephonic notice;

(5) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;

(6) the trade date and settlement date of the transaction;

(7) the price and total dollar amount of the transaction;

(8) the date of improper rejection of the delivery;

(9) the date by which the delivery of the securities must be accepted; and

(10) the name and telephone number of the person to contact regarding the close-out.

(C) *Execution of Close-Out.* Not earlier than the close of the business day following the date telephonic notice of close-out is given to the purchaser, the seller may sell out the transaction at the current market for the account and liability of the purchaser. A seller executing a close-out shall, upon execution, notify the purchaser for whose account and liability the transaction was closed out by telephone. The seller shall immediately thereafter confirm such notice in writing, sent return receipt requested, and forward a copy of the confirmation of the executed transaction. Any moneys due on the close-out of the transaction shall be forwarded to the appropriate party within ten business days of the date of execution of the close-out notice.

(D) *Acceptance of Delivery.* In the event the transaction is completed by the date and time specified in the notice of close-out, the seller shall be entitled, upon written demand made to the purchaser, to recover from the purchaser all actual and necessary expenses incurred by the seller by reason of the purchaser's rejection of delivery.

(iii) *Close-Out Under Special Rulings.* Nothing herein contained shall be construed to prevent brokers, dealers or municipal securities dealers from closing out transactions as directed by a ruling of a national securities exchange, a reg-

istered securities association or an appropriate regulatory agency issued in connection with the liquidation of a broker, dealer or municipal securities dealer.

(iv) *Procedures Optional.* Nothing herein contained shall be construed to require the parties to follow the close-out procedures herein specified if they otherwise agree.

(i) *Good Faith Deposits.* Good faith deposits shall be returned by the manager of a syndicate or similar account formed for the purchase of securities from an issuer, to the members of the syndicate or account within two business days following the date of settlement with the issuer, or, in the event the syndicate or account is not successful in purchasing the issue, within two business days following the return of the deposit from the issuer.

(j) *Settlement of Syndicate or Similar Account.* Final settlement of a syndicate or similar account formed for the purchase of securities shall be made within 60 days following the date all securities have been delivered by the syndicate or account manager to the syndicate or account members.

(k) Any credit designated by a customer in connection with the purchase of securities as due to a member of a syndicate or similar account shall be distributed to such member by the broker, dealer or municipal securities dealer handling such order within 30 calendar days following the date the issuer delivers the securities to the syndicate.

(l) *Interest Payment Claims.* A broker, dealer or municipal securities dealer seeking to claim an interest payment on a municipal security from another broker, dealer or municipal securities dealer may claim such interest payment in accordance with this section. A broker, dealer or municipal securities dealer receiving a claim made under this section shall send to the claimant a draft or bank check for the amount of the interest payment or a statement of its basis for denying the claim no later than 10 business days after the date of receipt of the written notice of the claim or 20 business days in the case of a claim involving an interest payment scheduled to be made more than 60 days prior to the date of the claim.

(i) *Determining Party to Receive Claim.* A claimant making an interest payment claim under this section shall direct such claim to the party described in this paragraph (i).

(A) *Previously Delivered Registered Securities.* An interest payment claim made with respect to a registered security previously delivered to the claimant which is registered in the name of a broker, dealer or municipal securities dealer at the time of delivery shall be directed to such broker, dealer, or municipal securities dealer. A claim made with respect to a previously delivered registered security not registered in the name of a broker, dealer or municipal securities dealer guaranteeing the signature of the registered owner or, if neither the registered owner nor its signature guarantor is a broker, dealer or municipal securities dealer, to the broker, dealer or municipal securities dealer that first placed a signature guarantee on any assignment or power of substitution accompanying the security.

(B) *Previously Delivered Bearer Securities.* An interest payment claim made with respect to a bearer security previously delivered to the claimant shall be directed to the broker, dealer or municipal securities dealer that previously delivered the security.

(C) *Securities Delivered by Claimant.* An interest payment claim made with respect to a security previously delivered by the claimant shall be directed to the broker, dealer or municipal securities dealer that received the securities.

(D) *Deliveries by Book-Entry.* An interest payment claim arising out of a transaction with a contractual settlement date before, and settled by book-entry on or after, the interest payment date of the security shall be directed to the broker, dealer or municipal securities dealer that made the delivery.

(ii) *Content of Claim Notice.* A claimant seeking to claim an interest payment under this section shall send to the broker, dealer or municipal securities dealer against which the claim is made a written notice of claim including, at minimum:

(A) the name and address of the broker, dealer or municipal securities dealer making the claim;

(B) the name of the broker, dealer or municipal securities dealer against which the claim is made;

(C) the amount of the interest payment which is the subject of the claim;

(D) the date on which such interest payment was scheduled to be made (and, in the case of an interest payment on securities which are in default, the original interest payment date);

(E) a description of the security (including any CUSIP number assigned) on which such interest payment was made;

(F) a statement of the basis of the claim for the interest payment;

(G) if the claim is based on the delivery of a registered security, the certificate numbers of each security on which the claim is based and a photocopy of the certificate(s) on which the claim is based or (in lieu of such a photocopy) a written statement from the paying agent identifying the party that received the interest payment which is the subject of the claim; and,

(H) if the claim is made against the broker, dealer or municipal securities dealer that previously delivered the security on which the claim is based, or the broker, dealer or municipal securities dealer that received such security, the delivery date or settlement date of the transaction.

## BACKGROUND

The rule covers the following matters:

(1) establishment of uniform settlement dates for transactions in municipal securities;

(2) exchange and comparison of dealer confirmations;

(3) procedures for resolving discrepancies in confirmations which result in unrecognized transactions;

(4) establishment of uniform requirements for good delivery of municipal securities;

(5) procedures for rejection and reclamation of municipal securities;

(6) close-out procedures for transactions in municipal securities; and

(7) the time periods within which good faith deposits must be returned, syndicate accounts settled, and credits from designated orders distributed.

Except for the provisions relating to dealer confirmations, the return of good faith deposits, the settlement of syndicate accounts, and the distribution of credits from designated orders, the requirements of rule G-12 may be altered by agreement between the parties.

Several provisions of rule G-12 are designed to facilitate transactions in municipal securities and to make clear that procedures which may result in increased efficiency in processing municipal securities transactions are encouraged by the Board. In this regard, the rule requires municipal securities brokers and municipal securities dealers to include CUSIP numbers, if assigned, on inter-dealer confirmations and delivery tickets, as a means of uniform identification of the securities involved. In order to minimize the impact of this requirement on municipal securities dealers who process transactions on a manual basis, the Board has delayed the requirement to use CUSIP numbers until January 1, 1979. The Board also is considering making available to members of the municipal securities industry a service by which such members can readily obtain without charge information with regard to specific CUSIP numbers upon request to the Board's office.

Rule G-12 specifies the content of certain notices used in connection with the processing and clearance of municipal securities transactions but the rule does not require the use of specific forms. However, uniform forms currently in general use in the securities industry may be used to comply with the rule. Although the Board believes it may be burdensome to many municipal securities professionals for the Board to mandate the use of specific forms, the Board encourages the use of uniform forms to promote efficiencies in processing municipal securities transactions.

NOTE: A *Manual on Close-Out Procedures*, explaining the close–out procedures of rule G-12(h) in detail, and including suggested forms for the various close–out notices, is available from the Board's office, telephone (703) 797-6600.

## MSRB INTERPRETATIONS

### NOTICE CONCERNING CALENDAR OF PROCEDURES UNDER RULE G-12 ON UNIFORM PRACTICE

Revised: October 1981

For the convenience of municipal securities brokers and municipal securities dealers, this notice sets forth a calendar for certain procedures under Board rule G-12 on uniform practice. Rule G-12 covers such matters as uniform settlement dates, inter-dealer confirmations, procedures for resolving unrecognized transactions, procedures for reclamations, close-out procedures, and the time periods within which good faith deposits must be returned and syndicate accounts settled. Rule G-12 applies only to transactions between brokers, dealers and municipal securities dealers, and not to transactions with customers. Confirmation of transactions with customers is the subject of Board rule G-15.

The calendar set forth below is divided into the following sections:

I. CONFIRMATIONS, COMPARISON AND VERIFICATION (rule G-12(d))

II. RECLAMATIONS (rule G-12(g))

III. CLOSE-OUT BY PURCHASING DEALERS (rule G-12(h))

The following abbreviations are used in the calendar:

"D" means delivery date.

"R" means receipt of confirmation or other notice.

"S" means settlement date.

"T" means trade date.

Numerical references are to number of business days.

## I. CONFIRMATIONS, COMPARISON AND VERIFICATION

| *Date by Which Action Must be Taken* | *Action to be Taken by Purchasing Dealer*[1] | *Action to be Taken by Selling Dealer*[1] |
|---|---|---|
| T + 1 | Send dealer confirmation. | Send dealer confirmation. |
| R | Compare confirmation from selling dealer to determine whether discrepancies in trade information exist. If discrepancies discovered, communicate promptly with selling dealer and seek to resolve. | Compare confirmation from purchasing dealer to determine whether discrepancies in trade information exist. If discrepancies discovered, communicate promptly with selling dealer and seek to resolve. |
| Resolution of discrepancies + 1 | Send corrected confirmation, if purchasing dealer is party in error. | Send corrected confirmation, if selling dealer is party in error. |
| S | If no discrepancies, transaction settles.<br>May accept deliver even though discrepancies not resolved. | If no discrepancies, transactions settles. |
| S + 1 | If delivery has been accepted even though discrepancies not resolved, send corrected confirmation. | If delivery has been accepted even though discrepancies not resolved, send corrected confirmation. |

**The following procedures (A and B) apply in the event one of the parties to a trade does not send a confirmation, or discrepancies in trade information cannot be resolved.**[2]

*Procedure A* (Rule G-12(d)(ii))

| *Date by Which Action Must be Taken* | *Action to be Taken by Confirming Dealer* | *Action to be Taken by Non-Confirming Dealer* |
|---|---|---|
| T + 1 | Send dealer confirmation. | |
| R (receipt of confirmation) | | Promptly attempt to determine whether trade occurred. Immediately notify confirming dealer by telephone of results of determination. |
| R + 1 | | Send confirmation or nonrecognition (DK) notice. |
| R (receipt of non-recognition (DK) notice) | Promptly upon receipt of nonrecognition (DK) notice, attempt to verify whether trade occurred. If trade did not occur, send cancellation notice. | |
| R + 2 | If after verification, confirming dealer believes that trade did occur, but material differences with non-confirming dealer cannot be resolved, confirming dealer may send cancellation notice on or after this date. | |

*Procedure B* (Rule G-12(d)(iii))

| *Date by Which Action Must be Taken* | *Action to be Taken by Confirming Dealer* | *Action to be Taken by Non-Confirming Dealer* |
|---|---|---|
| T + 4 | In event of failure to receive confirmation or nonrecognition (DK) notice, promptly verify whether trade occurred and immediately notify non-confirming dealer by telephone. | Promptly upon receipt of telephone notice from confirming dealer, seek to determine whether trade occurred. Immediately notify confirming dealer by telephone of results of determination. Such notification may be made on T+5 if determination cannot be made before then. |
| T + 5 | Send written notice of failure to confirm. | Send written confirmation or nonrecognition (DK) notice. |
| T + 6 | If material differences with non-confirming dealer cannot be resolved, or non-confirming dealer does not respond to telephone notice of failure to confirm, confirming dealer may send cancellation notice on or after this date. | |

## II. RECLAMATIONS

| *Date by Which Action Must be Taken* | *Reasons for Action* |
|---|---|
| D + 1 | — Improper coupon or interest check in lieu of coupon missing. |
| | — Certificate or coupon mutilated. |
| | — Legal opinion or other legal documentation missing. |
| R (receipt of notice of dishonor) + 3 | — Interest check not honored. |
| D + 18 months | — Irregularity in deliver (*e.g.*, wrong securities delivered, duplicate delivery, etc.). |
| | — Refusal to transfer or deregister because of lack of required documentation. |
| | — Misdescription of securities (misstatement of information, omission of required information). |
| No time limit | — Missing, stolen, fraudulent or counterfeit securities. |
| | — Called certificate delivered, but not specified at time of trade. |

## III. CLOSE-OUT BY PURCHASING DEALER

| *Date by Which Action Must be Taken* | *Action to be Taken by Purchasing Dealer* | *Action to be Taken by Selling Dealer* |
|---|---|---|
| S + 5 | May give close-out notice on or after this date. Notice must be by telephone and confirmed in writing within one business day. Notice must specify delivery deadline date, execution date(s). Deliver deadline cannot be earlier than tenth business day following date notice was give (S + 15). | |
| Telephone notice + 1 | | If selling dealer intends to retransmit to a dealer failing to deliver to it the securities which are the subject of the close-out, the selling dealer must do so by telephone on this date. If the selling dealer does retransmit, this extends the delivery deadline and execution date(s) by five business days. Selling dealer must send written notice of retransmittal, and written notice of the extension of dates, within one business day. |
| Telephone notice + 10 | Earliest day which can be specified as delivery deadline (if no retransmittals). | |
| Telephone notice + 11-15 | Earliest day(s) which can be specified as execution date(s) (if no retransmittals). | |
| S + 90 | Last day on which purchasing dealer can initiate a close-out. | |

**NOTE: *A Manual on Close-Out Procedures*, explaining the close-out procedures of rule G-12(h) in detail, and including suggested forms for the various close-out notices, is available from the Board's office, telephone (703) 797-6600.**

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[1] For ease of reference, the term "dealer" refers to brokers, dealers and municipal securities dealers.

[2] The procedures set forth in (B) need not be followed if the procedures in (A) have been used. Similarly, the procedures in (A) need not be followed, if the procedures in (B) have been used.

## Notice Concerning "Immediate" Close-outs

August 19, 1981

The Municipal Securities Rulemaking Board has recently received inquiries concerning the provisions of rule G-12(h)(iii) regarding close-out procedures in the event of a firm's liquidation. The Board has been advised that a SIPC trustee has been appointed in connection with the liquidation of a general securities firm with which certain municipal securities brokers and dealers have uncompleted transactions in municipal securities, and that the New York Stock Exchange and the National Association of Securities Dealers, Inc., have notified their respective members that they may institute "immediate" close-out procedures on open transactions with the firm in liquidation. In accordance with a previous understanding between the Board and the NASD, the NASD has also advised municipal securities brokers and dealers that, pursuant to rule G-12(h)(iii), they may execute "immediate" close-outs on open transactions in municipal securities.

Rule G-12(h)(iii) provides:

> Nothing herein contained shall be construed to prevent brokers, dealers or municipal securities dealers from closing out transactions as directed by a ruling of a national securities exchange, a registered securities by a ruling of a national securities exchange, a registered securities association or an appropriate regulatory agency issued in connection with the liquidation of a broker, dealer or municipal securities dealer.

Therefore, in the event that a national securities exchange or registered securities association makes a ruling that close-outs may be effected "immediately" on transactions with a firm in liquidation, municipal securities brokers and dealers may take such action. In these circumstances, a purchasing dealer seeking to execute such a close-out need not follow the procedures for initiation of a close-out procedure, nor is the dealer required to wait the prescribed time periods prior to executing the close-out notice. Similarly, a selling dealer need not attempt delivery prior to using the procedure for close-outs by sellers. In both cases dealers may proceed to execute the close-out immediately—that is, the purchasing dealer may immediately "buy in" the securities in question for the account and liability of the firm in liquidation (or utilize one of the other options available for execution of the close-out), and a selling dealer may immediately "sell out" the subject securities. Notification of the execution of the close-out should be provided in accordance with the normal procedure.

Dealers executing close-outs in these circumstances should advise the trustee of the firm in liquidation of their actions in closing out these transactions. If proceeds from the close-out execution are due to the firm in liquidation, they should be remitted to the trustee. Requests for payment of amounts due on close-out executions should also be sent to the trustee; the trustee will resolve these claims in the course of the liquidation.

The Board also notes that dealers having open transactions with a firm in liquidation may, but are not required to, execute "immediate" close-outs in these circumstances. If individual dealers wish to attempt some other means of completing these transactions, such as seeking to complete a transaction with the liquidated firm's other contra-side, they may do so.

## Application of the Board's Rules to Trades in Misdescribed or Non-Existent Securities

January 12, 1984

From time to time, industry members have asked the Board for guidance in situations in which municipal securities dealers have traded securities which either are different from those described ("misdescribed") or do not exist as described ("non-existent") and the parties involved were unaware of this fact at the time of trade. A sale of a misdescribed security may occur, for example, when a minor characteristic of the issue is misstated. A sale of a non-existent security may result, for example, from the sale of a "when, as and if issued" security which is never authorized or issued.

The Board has responded to these inquiries by advising that its rules do not address the resolution of any underlying contractual dispute arising from trades in such misdescribed or non-existent securities, and that the parties involved in the trade should work out an appropriate resolution. Board rule G-12(g) does permit reclamation of an inter-dealer delivery in certain instances in which information required to be included on a confirmation by rule G-12(c)(v)(E)[1] is omitted or erroneously noted on the confirmation or where other material information is erroneously noted on the confirmation. Rule G-12(g)(v) and (vi), however, make clear that a reclamation only reverses the act of delivery and reinstates the open contract on the terms and conditions of the original contract, requiring the parties to work out an appropriate resolution of the transaction.

The Board wishes to emphasize that general principles of fair dealing would seem to require that a seller of non-existent or misdescribed securities make particular effort to reach an agreement on some disposition of the open trade with the purchaser. The Board believes that this obligation arises since it is usually the seller's responsibility to determine the status of the municipal securities it is offering for sale. The extent to which the seller bears this responsibility, of course, may vary, depending on the facts of a trade.

The Board notes that the status of the underlying contract claim for trades in non-existent or misdescribed securities ultimately is a matter of state law, and each fact situation must be dealt with under applicable state law, and each fact situation must be dealt with under applicable contract principles. The Board believes that the position set forth above is consistent with general contract principles, which commonly hold that a seller is responsible to the purchaser in most instances for failing to deliver goods as identified in the contract, or for negligently contracting for goods which do not exist if the purchaser relied in good faith on the seller's representation that the goods existed.

Parties to trades in misdescribed or non-existent securities should attempt to work out an appropriate resolution of the contractual agreement. If no agreement is reached, the Board's close-out and arbitration procedures may be available.

[1] Rule G-12(c)(v)(E) requires that confirmations contain a description of the securities, including at a minimum the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities and in the case of any securities, if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown.

## Notice Concerning Documentation on Rejection and Reclamation of Deliveries

March 5, 1982

The Municipal Securities Rulemaking Board has recently received complaints from certain municipal securities brokers and municipal securities dealers concerning problems with the documentation provided on rejections or reclamations of deliveries on municipal securities transactions. These brokers and dealers have alleged that other organizations, when rejecting or reclaiming deliveries, have failed to provide the requisite information regarding the return of the securities, thereby making it very difficult to accomplish prompt resolution of any delivery problems. In particular, these dealers indicate, notices of rejection or reclamation have

often failed to state a reason for the rejection or reclamation, or to name a person who can be contacted regarding the delivery problem.

Rule G-12(g)(iv) requires that a dealer rejecting or reclaiming a delivery of securities must provide a notice or other document with the rejected or reclaimed securities, which notice shall include the following information:

(A) the name of the party rejecting or reclaiming the securities;

(B) the name of the party to whom the securities are being rejected or reclaimed;

(C) a description of the securities;

(D) the date the securities were delivered;

(E) the date of rejection or reclamation;

(F) the par value of the securities which are being rejected or reclaimed;

(G) in the case of a reclamation, the amount of money the securities are reclaimed for;

(H) the reason for rejection or reclamation; and

(I) the name and telephone number of the person to contact concerning the rejection or reclamation.

The Uniform Reclamation Form may be used for this purpose.

The Board believes that the required information is the minimum necessary to permit prompt resolution of the problem, and does not view the requirement to provide this information as burdensome. The Board is concerned that failure to provide this information may contribute to inefficiencies in the clearance process, and strongly urges municipal securities brokers and dealers to take steps to ensure that the requirements of the rule are complied with. The Board notes that, in the case of reclaimed securities, failure to provide this information may result in, at minimum, a refusal on the part of the receiving party to honor the reclamation.

## NOTICE OF INTERPRETATION OF RULES G-12(e) AND G-15(c) ON DELIVERIES OF CALLED SECURITIES—DEFINITION OF "PUBLICATION DATE"

October 20, 1986

Rules G-12(e)(x) and G-15(c)(viii) on deliveries of called securities provide that a certificate for which a notice of partial call has been published does not constitute good delivery unless it was identified as called at the time of trade. The rules also provide that, if a notice of call affecting an entire issue has been published on or prior to the trade date, called securities do not constitute good delivery unless identified as such at the time of trade.[1] Thus, a dealer, in some instances, must determine the date that a notice of call is published (the "publication date") to determine whether delivery of a called certificate constitutes good delivery for a particular transaction. The Board has adopted the following interpretation of rules G-12(e)(x) and G-15(e)(viii) to assist the industry in determining the publication date of a notice of a call. The Board understands this interpretation to be consistent with the procedure currently being used by certain depositories in allocating the results of partial calls.

In general, the publication date of a notice of call is the date of the edition of the publication in which the issuer, the issuer's agent or the trustee publishes the notice. To qualify as a notice of call under the rules, a notice must contain the date of the early redemption, and, for partial calls, must contain information that specifically identifies the certificates being called. If a notice of call is published on more than one date, the earliest date of publication constitutes the publication date for purposes of the rules.

If a notice of call for a registered security is not published, but is sent to registered owners, the publication date is the date shown on the notice. If no date is shown on the notice, the issuer, the trustee or the appropriate agent of the issuer should be contacted to determine the date of the notice of call.

If a notice of call of a registered security is published and also is sent directly to registered owners, the publication date is the earlier of the actual publication date or the date shown on the notice sent to registered owners. For bearer securities, the first date of publication always constitutes the publication date, even if another date is shown on the notice.

[1] An inter-dealer delivery that does not meet these requirements may be rejected or reclaimed under rule G-12(g).

## NOTICE ON DETERMINING WHETHER TRANSACTIONS ARE INTER-DEALER OR CUSTOMER TRANSACTIONS: RULES G-12 AND G-15

May 1988

In December 1984, the Board published a notice providing guidance to dealers in determining whether certain transactions are inter-dealer or customer transactions for purposes of Board rules. Since the publication of this notice, the Board has continued to receive reports that inter-dealer transactions sometimes are erroneously submitted to automated confirmation/affirmation systems for customer transactions. This practice reduces the efficiencies of automated clearance since these transactions fail to compare in the initial comparison cycle. The Board is re-publishing the notice to remind dealers of the need to submit inter-dealer and customer transactions to the correct automated clearance systems.

The Board recently has been advised that some members of the municipal securities industry are experiencing difficulties in determining the proper classification of a contra-party as a dealer or customer for purposes of automated comparison and confirmation. In particular, questions have arisen about the status of banks purchasing for their trust departments and dealers buying securities to be deposited in accumulation accounts for unit investment trusts. Because a misclassification of a contra-party can cause significant difficulty to persons seeking to comply with the automated clearance requirements of rules G-12, and G-15, the Board believes that guidance concerning the appropriate classification of contra-parties in certain transactions would be helpful to the municipal securities industry.

### Background

Rule G-12(f)(i) requires dealers to submit an inter-dealer transaction for automated comparison if the transaction is eligible for automated comparison.... Rule G-15(d)(ii) requires dealers to use an automated confirmation/affirmation service for delivery versus payment or receipt versus payment (DVP/RVP) customer transactions if the [transactions are eligible for automated confirmation and acknowledgement].

The systems available for the automated comparison of inter-dealer transactions and automated confirmation/affirmation of customer transactions are separate and distinct. As a result, misclassification of a contra-party may frustrate efficient use of the systems. For example, a selling dealer in an inter-dealer transaction may misclassify the contra-party as a customer, and submit the trade for confirmation/affirmation through the automated system for customer transactions while the purchaser (correctly considering itself to be a dealer) seeks to compare the transaction through the inter-dealer comparison system. Since, the automated systems for inter-dealer and customer transactions are entirely separate, the transaction will not be successfully compared or acknowledged through either automated system.

### Transactions Effected by Banks

The Board has received certain questions about the proper classifica-

tion of contra-parties in the context of transactions effected by banks. A bank may be the purchaser or seller of municipal securities either as a dealer or as a customer. For example, a dealer may sell municipal securities to a bank's trust department for various trust accounts. Such purchases by a bank in a fiduciary capacity would not constitute "municipal securities dealer activities" under the Board's rules[1] and are properly classified and confirmed as customer transactions. A second type of transaction by a bank is the purchase or sale of securities for the dealer trading account of a dealer bank. The bank in this instance clearly is acting in its capacity as a municipal securities dealer and the transaction should be compared as an inter-dealer transaction.

A dealer effecting a transaction with a dealer bank may not know whether the bank is acting in its capacity as a dealer or as a customer. The Board is of the view that, in such a case, the dealer should ascertain the appropriate classification of the bank at the time of trade to ensure that the transaction can be compared or confirmed appropriately. The Board anticipates that dealer banks will assist in this process by informing contra-parties whether the bank is acting as a dealer or customer in transactions in which the bank's role may be unclear to the contra-party.

**Transactions by Dealer Purchasing Municipal Securities for UIT Accumulation Accounts**

The Board has also received several inquiries concerning the appropriate classification of a dealer who purchases municipal securities to be deposited into an accumulation account for ultimate transfer to a unit investment trust (UIT). The dealer buying securities for a UIT accumulation account may purchase and hold the securities over a period of several days before depositing them with the trustee of the UIT in exchange for all of the units of the trust; during this time the dealer is exposed to potential market risk on these securities positions. The subsequent deposit of the securities with the trustee of the UIT in exchange for the units of the trust may be viewed as a separate, customer transaction between the dealer buying the accumulation account and the trust. The original purchase of the securities by the dealer for the account then must be considered an inter-dealer transaction since the dealer is purchasing for its own account ultimately to execute a customer transaction. The Board notes that the SEC has taken this approach in applying its net capital and customer protection rules to such transactions.

The Board is of the view that, for purposes of its automated comparison requirements, transactions involving dealers purchasing for UIT accumulation accounts should be considered inter-dealer transactions. The Board also notes the distinction between this situation, in which a dealer purchases for ultimate transfer to a trust or fund, and situations where purchases or sales of municipal securities are made directly by the fund, as is the case with purchases or sales by some open-end mutual funds. These latter transactions should be considered as customer transactions and confirmed accordingly.

**Other Inter-Dealer Transactions**

In addition to questions on the status of a dealer bank and dealers purchasing for accumulation accounts, the Board has received information that a few large firms are sometimes subtracting trades with regional securities dealers into the customer confirmation system. The Board is aware that these firms may classify transactions with regional dealers or bank dealers as "customer" transactions for purposes of internal accounting and compensation systems. The Board reminds industry members that transactions with other municipal securities dealers will always be inter-dealer transactions and should be compared in the inter-dealer automated comparison system without regard to how the transactions are classified internally within a dealer's accounting systems. The Board believes it is incumbent upon those firms who misclassify transactions in this fashion to promptly make the necessary alterations to their internal systems to ensure that this practice of misclassifying transactions is corrected.

[1] Section 3(a)(30) of the Securities Exchange Act of 1934 defines a bank to be a municipal securities dealers if it "is engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity." For purposes of the Board's rule G-1, defining a separately identifiable department or division of a bank dealer, the purchase and sale of municipal securities by a trust department would not be considered to be "municipal securities dealer activities."

**Note: Revised to reflect subsequent amendments.**

## NOTICE CONCERNING USE OF PEX SYSTEM FOR CLOSE-OUTS: RULE G-12

March 31, 1993

The Depository Trust Company (DTC) recently announced that, as of April 19, 1993, it will offer the use of its Participant Terminal System (PTS) for the transmittal of municipal securities close-out messages through the Participant Exchange Service (PEX) system. The Board has determined to permit dealers to use this system to send the written close-out notices, required under the Board's close-out procedures, to dealers who are participating in the system.

Under rule G-12(h), a dealer taking action in a close-out must provide telephonic notice to the appropriate party, followed no later than the next business day with a written notice.[1] The rule, generally requires written notices to be sent "return receipt requested."[2] The Board previously has interpreted this provision to allow the use of certified mail, registered mail and messenger services that obtain acknowledgements of delivery from the recipient and make those acknowledgements accessible to the sender.[3] The Board has concluded that the PEX system also will meet the purposes of the rule by providing efficient transmission of written close-out notices and acknowledgements of receipt to the senders. Based on a review of the preformatted PEX message screens for municipal securities close-out notices, the Board believes that, if completed correctly, these screens would meet the information requirements of rule G-12(h).[4]

DTC will publish a list of PEX participants in its "Eligible Municipal Securities" directory. A listed PEX participant (at its own option) may use the PEX system to send a written close-out notice in lieu of sending the notice by "return receipt requested" mail. A dealer listed as a PEX participant is required to accept a notice sent through the system and may not demand a notice in paper form. A dealer that transmits a written notice to a recipient via the PEX system thereafter must use the PEX system for all written notices required to be sent to that recipient on that close-out. These steps will help to ensure that close-out messages sent through the PEX system are properly monitored and acknowledged by dealers participating in the program.

The Board emphasizes that rule G-12(h) will continue to govern all aspects of the municipal securities close-outs on which the PEX system is used. In particular, the Board reminds dealers that the telephonic notices required under rule G-12(h) must continue to be used and that any questions about a closeout should be resolved at that time and not delayed until the sending of the written notice. A dealer receiving a municipal securities close-out notice via the PEX system must acknowledge it through the system, providing the sending dealer with confirmation that the message was received. This acknowledgment is equivalent, under the rule, to signing for a letter received "return receipt requested." If a deficient notice or a notice on an unrecognized transaction is received through the system, the receiving dealer must acknowledge the notice and call the sending dealer to resolve the problem.[5] This should be an infrequent occurrence, since the written notices merely confirm previously made telephone calls.

[1] Telephone and written notices are required when dealers (i) originate a close-out; (ii) retransmit a close-out; (iii) extend delivery dates; and (iv) execute a close-out. The Board's Manual on Close-Out Procedures contains a detailed explanation of the procedures required by rule G-12(h).

[2] There is one exception to the general rule requiring notices to be sent "return receipt

requested." After a notice of close-out has been retransmitted once, copies of second and subsequent retransmittals of the notice must be sent to the originator. Rule G-12(h) does not require these to be sent "return receipt requested."

[3] MSRB Manual on Close-Out Procedures, Question and Answer 16, on page 8.

[4] The PEX screens for municipal securities close-outs do not require dealers to include the addresses of the parties to the close-out, as does rule G-12(h). The Board has concluded that this information is not necessary on PEX notices because the system will be limited to DTC members, who will use DTC identification numbers.

[5] This is identical to the procedure used for receipt of a written notice by "return receipt requested" mail. Under rule G-12(h), a dealer may not refuse to accept a written notice of close-out. MSRB Manual on Close-Out Procedures, Question and Answer 25, on page 11. The failure of a dealer to acknowledge a close-out notice actually received through the PEX system would be tantamount to a refusal to accept a notice.

## USE OF FACSIMILE TRANSMISSIONS FOR CLOSE-OUTS: RULE G-12(h)

December 20, 1996

Rule G-12(h) on close-outs requires that a dealer taking action in a close-out must provide telephonic notice to the appropriate party, followed no later than the next business day with a written notice.[1] The rule further requires that written notices be sent "return receipt requested." The Board previously has interpreted this provision to allow the use of certified mail, registered mail, messenger mail, messenger services, and Depository Trust Company's Participant Exchange Service (PEX) system. Use of these procedures allows the sender to obtain acknowledgement of delivery of the notice from the recipient.

Dealers have asked whether the use of a facsimile transmission would satisfy the requirement in the rule that written notices be sent "return receipt requested." The Board has determined that the requirements of the rule would be satisfied by the facsimile transmission of written notices as long as the facsimile transmission provides the sender with an acknowledgment of successful delivery of the notice. The Board emphasizes that, prior to the sending of written notices, dealers are required to notify the appropriate parties by telephone of their intention to take action under Board rule G-12(h) on close-outs.

[1] Telephone and written notices are required when dealers (i) originate a close-out; (ii) retransmit a close-out; (iii) extend delivery dates; and (iv) execute a close-out. The Board's Manual on Close-Out Procedures contains a detailed explanation of the procedures required by rule G-12(h).

## LOCKED-IN TRANSACTIONS

March 1, 2001

The Securities and Exchange Commission has approved the National Securities Clearing Corporation's ("NSCC") proposed rule change (SR-NSCC-00-13) regarding the submission of trade data for comparison of fixed income inter-dealer transactions.[1] NSCC proposes to offer its members the ability to submit their fixed income transaction information "locked-in" through Qualified Special Representatives ("QSR") for trades executed via an Alternative Trading System ("ATS"). Locked-in QSR trade data submission currently is only available for transactions in equity securities. The Municipal Securities Rulemaking Board ("MSRB") is publishing this notice to clarify the requirements of MSRB rules G-12(f) and G-14 as they pertain to the submission of locked-in transactions.

To accomplish a locked-in QSR submission, NSCC members on each side of a trade must have executed, or clear for a firm that executed, their trade through an ATS and previously authorized a specific NSCC-authorized QSR to submit locked-in trades to NSCC on their behalf. The locked-in transaction records are not compared in the traditional manner through the two-sided NSCC comparison process. Instead, the QSR itself takes responsibility to ensure that the trade data is correct and the parties have agreed to the trade according to the stated terms. Once NSCC receives a locked-in trade, it treats it as compared so that the transaction can proceed to netting or other automated settlement procedures.

MSRB rule G-12(f) on inter-dealer comparison and rule G-14 on Transaction Reporting Procedures each refer to the NSCC comparison process for inter-dealer transactions in municipal securities. These rules require dealers to submit their inter-dealer trade data to NSCC for purposes of comparison and for forwarding to the MSRB for trade-reporting purposes. Questions may arise as to whether the submission of trade data already locked-in by a QSR complies with these rules.

NSCC's proposal requires that a QSR must obtain authorization to submit locked-in transactions both from NSCC as well as from the NSCC members who wish to use the QSR for locked-in trade submission. Given this fact, and the fact that both rules G-12(f) and G-14 specifically contemplate the use of intermediaries in submitting data to NSCC and to the MSRB, locked-in trades submitted under NSCC's program will comply both with rule G-12(f) and rule G-14.

[1] *See* Securities Exchange Act Release No. 43949 (Feb. 9, 2001), 66 FR 10765 (Feb. 16, 2001).

## INTERPRETATION ON THE APPLICATION OF RULES G-8, G-12 AND G-14 TO SPECIFIC ELECTRONIC TRADING SYSTEMS

March 26, 2001

The Municipal Securities Rulemaking Board (the "MSRB") understands that, over time, the advent of new trading systems will present novel situations in applying MSRB uniform practice rules. The MSRB is prepared to provide interpretative guidance in these situations as they arise, and, if necessary, implement formal rule interpretations or rule changes to provide clarity or prevent unintended results in novel situations. The MSRB has been asked to provide guidance on the application of certain of its rules to transactions effected on a proposed electronic trading system with features similar to those described below.

### Description of System

The system is an electronic trading system offering a variety of trading services and operated by an entity registered as a dealer under the Securities Exchange Act of 1934. The system is qualified as an alternative trading system under Regulation ATS. Trading in the system is limited to brokers, dealers and municipal securities dealers ("dealers"). Purchase and sale contracts are created in the system through various types of electronic communications via the system, including acceptance of priced offers, a bid-wanted process, and through negotiation by system participants with each other. System rules govern how the bid/offer process is conducted and otherwise govern how contracts are formed between buyers and sellers.

Participants are, or may be, anonymous during the bid/offer/negotiation process. After a sales contract is formed, the system immediately sends an electronic communication to the buyer and seller, noting the transaction details as well as the identity of the contra-party. The transaction is then sent by the buyer and seller to a registered securities clearing agency for comparison and is settled without involvement of the system operator.

The system operator does not take a position in the securities traded on the system, even for clearance purposes. Dealers trading on the system are required by system rules to clear and settle transactions directly with each other even though the parties do not know each other at the time the sale contract is formed. If a dealer using the system does not wish to do business with another specific contra-party using the system, it may direct the system operator to adjust the system so that contracts with that contra-party cannot be formed through the system.

### Application of Certain Uniform Practice Rules to System

It appears to the MSRB that the dealer operating the system is effecting agency transactions for dealer clients.[1] The system operator does not have a role in clearing the transactions and is not taking principal posi-

tions in the securities being traded. However, the system operator is participating in the transactions at key points by providing anonymity to buyers and sellers during the formation of contracts and by setting system rules for the formation of contracts. Consequently, all MSRB rules generally applicable to inter-dealer transactions would apply except to the extent that such rules explicitly, or by context, are limited to principal transactions.

### Automated Comparison

One issue raised by the description of the system above is the planned method of clearance and settlement. Rule G-12(f)(i) requires that inter-dealer transactions be compared in an automated comparison system operated by a clearing corporation registered with the Securities and Exchange Commission. The purpose of rule G-12(f)(i) is to facilitate clearance and settlement of inter-dealer transactions. In this case, the system operator: (i) electronically communicates the transaction details to the buyer and seller; (ii) requires the buyer and seller to compare the transaction directly with each other in a registered securities clearing corporation; and (iii) is not otherwise involved in clearing or settling the transaction. The MSRB believes that under these circumstances, it is unnecessary for the system operator to obtain a separate comparison of its agency transactions with the buyer and seller.

Although automated comparison is not required between the system operator and the buyer and seller, the transaction details sent to each party by the system must conform to the information requirements for inter-dealer confirmations contained in rule G-12(c). Since system participants implicitly agree to receive this information in electronic form by participating in the system, a paper confirmation is not necessary. Also, the system operator may have an agreement with its participants that participants are not required to confirm the transactions back to the system operator, which normally would be required by rule G-12(c).

The system operator, which is subject to Regulation ATS, will be governed by the recordkeeping requirements of Regulation ATS for purposes of transaction records, including municipal securities transactions. However, the system operator also must comply with any applicable recordkeeping requirements in rule G-8(f), which relate to records specific to effecting municipal securities transactions. With respect to recordkeeping by dealers using the system, the specific procedures associated with this system require that transactions be recorded as principal transactions directly between buyer and seller, with notations of the fact that the transactions were effected through the system.

### Transaction Reporting

Rule G-14 requires inter-dealer transactions to be reported to the MSRB for the purposes of price transparency, market surveillance and fee assessment. The mechanism for reporting inter-dealer transactions is through National Securities Clearing Corporation ("NSCC"). In the system described above, the buyer and seller clear and settle transactions directly as principals with each other, and without the involvement of the dealer operating the system. The buyer and seller therefore will report transactions directly to NSCC. No transaction or pricing information will be lost if the system operator does not report the transaction. Consequently, it is not necessary for the system operator separately to report the transactions to the MSRB.

## NOTICE ON REPORTING AND COMPARISON OF CERTAIN TRANSACTIONS EFFECTED BY INVESTMENT ADVISORS: RULES G-12(f) AND G-14

May 23, 2003

In recent months, the MSRB has received a number of questions relating to certain kinds of transactions in which independent investment advisors instruct selling dealers to make deliveries to other dealers. This notice addresses questions that have been raised relating to Rule G-12(f)(i), on automated comparison, and Rule G-14, on transaction reporting. It describes existing requirements that follow from the language of the rules and does not set forth any new policies or procedures.

An independent investment advisor purchasing securities from one dealer sometimes instructs that dealer to make delivery of the securities to other dealers where the investment advisor's clients have accounts. The identities of individual account holders typically are not given.[1] The dealers receiving the deliveries in these cases generally are providing "wrap fee" or similar types of accounts that allow investors to use independent investment advisors to manage their municipal securities portfolios. In these kinds of arrangements, the investment advisor chosen by the account holder may be picked from a list of advisors approved by the dealer; however, dealers offering these accounts have indicated that the investment advisor acts independently in effecting transactions for the client's municipal securities portfolio.

The following example illustrates the situation. An Investment Advisor purchases a $1 million block of municipal bonds from the Selling Dealer and instructs the Selling Dealer to deliver $300,000 of the bonds to Dealer X and $700,000 to Dealer Y. The Investment Advisor does not give the Selling Dealer the individual client accounts at Dealer X and Dealer Y to which the bonds will be allocated and there is no contact between the Selling Dealer and Dealers X and Y at the time of trade. The Investment Advisor, however, later informs Dealer X and Dealer Y to expect the delivery from the Selling Dealer, and gives the identity and quantity of securities that will be delivered, the final monies, and the individual account allocations. For example, the Investment Advisor may instruct Dealer X to allocate its $300,000 delivery by placing $100,000 in John Doe's account and $200,000 in Mary Smith's account.

With respect to transaction reporting requirements in this situation, the Selling Dealer should report a $1 million sale to a customer. No other dealer should report a transaction. The comparison system should not be used for the inter-dealer transfers between the Selling Dealer and Dealers X and Y because this would cause them to be reported as inter-dealer trades.

### Frequently Asked Questions

One frequently asked question in the context of the above example is whether the transfers of the $300,000 and $700,000 blocks by the Selling Dealer to Dealer X and Dealer Y should be reported as inter-dealer transactions. Another question is whether these transfers may be accomplished by submitting them to the automated comparison system for inter-dealer transactions. Based on the information that has been provided to the MSRB, these transfers do not appear to represent inter-dealer trades and thus should not be reported under Rule G-14 or compared under Rule G-12(f)(i) using the current central comparison system.

One reason for the conclusion that no inter-dealer trade exists is that municipal securities professionals for firms in the roles of Dealer X and Y have stated that the Investment Advisor is acting independently and is not acting as their agent when effecting the trade with the Selling Dealer. In support of this assertion, they note that they often are not informed of the transaction or the deliveries that they should expect until well after the trade has been effected by the Investment Advisor. They also note that the actions of the Investment Advisor are not subject to their control or

[1] This situation can be contrasted with the typical broker's broker operation in which the broker's broker effects riskless principal transactions for dealer clients. The nature of the transactions as either agency or principal is governed for purposes of MSRB rules by whether a principal position is taken with respect to the security. "Riskless principal" transactions in this context are considered to be principal transactions in which a dealer has a firm order on one side at the time it executes a matching transaction on the contra-side. For purposes of the uniform practice rules, the MSRB considers broker's broker transactions to be riskless principal transactions even though the broker's broker may be acting for one party and may have agency or fiduciary obligations toward that party.

supervision. Thus, the $300,000 and $700,000 inter-dealer transfers in the above example appear to be simply deliveries made in accordance with a contract made by, and the instructions given by, the Investment Advisor. The inter-dealer transfers thus do not constitute inter-dealer transactions.

Because Rule G-14 transaction reporting of inter-dealer trades is accomplished through the central comparison system, any dealer submitting the $300,000 and $700,000 inter-dealer transfers to the comparison system is in effect reporting inter-dealer transactions that did not occur. In addition, this practice tends to drive down comparison rates and the overall performance of dealers in the automated comparison system. As noted above, the trading desks of Dealer X and Dealer Y generally do not know about the Investment Advisor's transaction at the time of trade. They consequently cannot submit comparison information to the system unless the Investment Advisor provides them with the trade details in a timely, accurate and complete manner. Since the Investment Advisor is acting independently and is not supervised by municipal securities professionals at Dealer X and Dealer Y, there is no means for the municipal securities professionals at Dealer X and Dealer Y to ensure that this happens.

Questions also have been received on whether the individual allocations to investor accounts (e.g., the $100,000 and $200,000 allocations to the accounts of John Doe and Mary Smith in the example above) should be reported under Rule G-14 as customer transactions. Even though the dealer housing these accounts obviously has important obligations to the investor with respect to receiving deliveries, paying the Selling Dealer for the securities, and processing the allocations under the instructions of the Investment Advisor, it does not appear that the dealer entered into a purchase or sale contract with the investor and thus nothing is reportable under Rule G-14. This conclusion again is based upon statements by dealers providing the "wrap fee" and similar accounts, who indicate that the investment advisor acts independently and not as the dealer's agent when it effects the original block transaction and when it makes allocation decisions.

For purposes of price transparency, the only transaction to be reported in the above example is a single $1 million sale to a customer. This is appropriate because the only market price to be reported is the one set between the Selling Dealer and the Investment Advisor for the $1 million block of securities. It is appropriate that the $300,000 and $700,000 inter-dealer transfers, and the $100,000 or $200,000 investor allocations are not disseminated as transactions since they would have to be reported using the price for the $1 million block. This could be misleading in that market prices for $1 million round lots are often different than market prices for smaller transaction sizes.

[1] It should be noted that in this situation, the investment advisor itself is the customer and must be treated as such for recordkeeping and other regulatory purposes. For discussion of a similar situation, see "Interpretive Notice on Recordkeeping" dated July 29, 1977.

### TRANSACTION REPORTING OF MULTIPLE TRANSACTIONS BETWEEN DEALERS IN THE SAME ISSUE: RULES G-12(f) AND G-14

November 24, 2003

The MSRB has become aware of problems in transaction reporting as a result of dealers "bunching" certain inter-dealer transactions in the comparison system. Recently, some dealers have reported the sum of two trades as one transaction in instances when two dealers effected two trades with each other in the same issue and at the same price. When two transactions are effected, two transactions should be reflected in each dealer's books and records and two transactions are required to be reported to the MSRB. The time of trade for each transaction also must accurately reflect the time at which a contractual commitment was formed for each quantity of securities. For example, if Dealer A purchases $50,000 of a municipal issue at a price of par from Dealer B at 11:00 am and then purchases an additional $50,000 at par from Dealer B at 2:00 pm, two transactions are required to be reflected on each dealers' books and records and two transactions are required to be reported to the MSRB.

Since the same inter-dealer trade record submitted for automated comparison under Rule G-12(f) also is used to satisfy the requirements of Rule G-14, on transaction reporting, each inter-dealer transaction should be submitted for automated comparison separately in order to comply with Rule G-14's requirement to report all transactions. Failure to do so causes erroneous information concerning transaction size and time of trade to appear in the transparency reports published by the MSRB as well as in the audit trail used by regulators and enforcement agencies. To the extent that dealers use the records generated by the comparison system for purposes of complying with MSRB Rule G-8, on recordkeeping, it may also create erroneous information as to the size of transactions effected or time of trade execution.

See also:

**Rule G-11 Interpretation – Syndicate Settlement Practice Violations Noted,** July 1981.

**Rule G-15 Interpretations – Interpretive Notice on Rule G-12 on Uniform Practice and Rule G-15 on Customer Confirmations,** November 28, 1977.

**– Interpretive Notice on Confirmation Requirements,** March 25, 1980.

**– Interpretive Notice Concerning Confirmation Disclosure Requirements Applicable to Variable-Rate Municipal Securities,** December 10, 1980.

**– Notice Concerning "Zero Coupon" and "Stepped Coupon" Securities,** April 27, 1982.

**– Notice Concerning Pricing to Call,** December 10, 1980.

**– Notice Concerning Confirmation Disclosure Requirements for Callable Municipal Securities,** February 10, 1986.

**– Notice Concerning Confirmation, Delivery and Reclamation of Interchangeable Securities,** August 10, 1988.

**– Notice Concerning Stripped Coupon Municipal Securities,** March 13, 1989.

**Rule G-17 Interpretations – Notice Concerning the Application of Board Rules to Put Option Bonds,** September 30, 1985.

**– Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15,** September 21, 1987.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## *Interpretive Letters*

**Delivery requirements: partials.** I am writing to confirm the substance of our telephone conversation concerning the provision of rule G-12(e)(iv) on partial deliveries. In our discussion, you posed a specific example of a single purchase of securities in which half are of one maturity and half of another maturity and inquired whether or not delivery of only one of the maturities would constitute a "partial" under the terms of the rule.

As I stated to you, if the transaction is effected on an "all or none" basis, and your confirmation is marked "all or none" or "AON," this would suffice to indicate that the purchase of both maturities constitutes a single transac-

tion, and that both maturities must be delivered to effect good delivery. *MSRB interpretation of February 23, 1978.*

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**Delivery requirements: coupons and coupon checks.** This letter is to confirm the substance of conversations you had with the Board's staff concerning the application of certain provisions of rule G-12, the uniform practice rule, to deliveries of securities bearing past-due coupons. You inquire whether, in the case where a transaction is effected for a settlement date prior to the coupon payment date, a delivery of securities with this past-due coupon attached constitutes "good delivery" for purposes of the rule.

Rule G-12(e)(vii)(C) provides that a seller may, but is not required to, deliver a check in lieu of coupons if delivery is made within thirty calendar days prior to an interest payment date. Thus, in the circumstances you set forth, the seller would have the option to detach the coupons and provide a check, but is under no obligation to do so. A delivery with these coupons still attached would constitute "good delivery," and a rejection of the delivery for this reason would be an improper rejection. *MSRB interpretation of March 9, 1978.*

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**Delivery requirements: mutilated coupons.** I am writing in response to your recent letter concerning the provisions of Board rule G-12(e) with respect to inter-dealer deliveries of securities with mutilated coupons attached. You indicate that your firm recently became involved in a dispute with another firm's clearing agent concerning whether certain coupons attached to securities your firm had delivered to the agent were mutilated. You request guidance as to the standards set forth in rule G-12(e) for the identification of mutilated coupons.

As you are aware, rule G-12(e)(ix) indicates that a coupon will be considered to be mutilated if the coupon is damaged to the extent that any one of the following *cannot be ascertained* from the coupon:

(A) title of the issuer;

(B) certificate number;

(C) coupon number or payment date...;

or

(D) the fact that there is a signature...

(emphasis added)

The standard set forth in the rule (that the information "cannot be ascertained") was deliberately chosen to make clear that minimal damage to a coupon is not sufficient to cause that coupon to be considered mutilated. For example, if the certificate number imprinted on a coupon is partially torn, but a sufficient portion of the coupon remains to permit identification of the number, the coupon would not be considered to be mutilated under the standard set forth in the rule, and a rejection of the delivery due to the damage to the coupon would not be permitted. In the case of the damaged coupon shown on the sample certificate enclosed with your letter, it seems clear that the certificate number can be identified, and confusion with another number would not be possible; therefore, this coupon would not be considered to be mutilated under the rule, and a rejection of a delivery due to the damage to this coupon would not be in accordance with the rule's provisions.

Your letter also inquires as to the means by which dealers can obtain redress in the event that a delivery is rejected due to damaged coupons which are not, in their view, mutilated under the standard set forth in the rule. I note that rule G-12(h)(ii) sets forth a procedure for a close-out by a selling dealer in the event that a delivery is improperly rejected by the purchaser; this procedure could be used in the circumstances you describe to obtain redress in this situation. Further, the arbitration procedure... could also be used in the event that the dealer incurs additional costs as a result of such an improper rejection of a delivery. *MSRB interpretation of January 4, 1984.*

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**Delivery requirements: put option bonds.** In a previous telephone conversation [name omitted] of your office had inquired whether any or all of the following deliveries of securities which are subject to a put option could be rejected:

(1) Certain securities are the subject of a "one time only" put option, exercisable by delivery of the securities to a designated trustee on or before a stated expiration date. An inter-dealer transaction in the securities—described as "puttable" securities—is effected for settlement prior to the expiration date. Delivery on the transaction is not made, however, until after the expiration date, and the recipient is accordingly unable to exercise the option, since it cannot deliver the securities to the trustee by the expiration date.

(2) Certain securities are the subject of a "one time only" put option, exercisable by delivery of the securities to a designated trustee on or before a stated expiration date. An inter-dealer transaction in the securities—described as "puttable" securities—is effected for settlement prior to the expiration date. Delivery on the transaction is made prior to the expiration date, but too late to permit the recipient to satisfy the conditions under which it can exercise the option (*e.g.*, the trustee is located too far away for the recipient to be able to present the physical securities by the expiration date).

(3) Certain securities are the subject of a put option exercisable on a stated periodic basis (*e.g.*, annually). An inter-dealer transaction in the securities—described as "puttable" securities—is effected for settlement shortly before the annual exercise date on the option. Delivery on the transaction, however, is not made until after the annual exercise date, so that the recipient is unable to exercise the option at the time it anticipated being able to do so.

I am writing to confirm my previous advice to him regarding the Board's consideration of his inquiry.

As I informed him, his inquiry was referred to a Committee of the Board which has responsibility for interpreting the "delivery" provisions of the Board's rules; that Committee has authorized my sending this response. In considering the inquiry, the Committee took note of the provisions of Board rule G-12(g), under which an inter-dealer delivery may be reclaimed for a period of eighteen months following the delivery date in the event that

information pertaining to the description of the securities was inaccurate for either of the following reasons:

(i) information required by subparagraph (c)(v)(E) of this rule was omitted or erroneously noted on a confirmation, or

(ii) information material to the transaction but not required by subparagraph (c)(v)(E) of this rule was erroneously noted on a confirmation.

Under this provision, therefore, a delivery of securities described on the confirmation as being "puttable" securities could be reclaimed if the securities delivered are not, in fact, "puttable" securities.

The Committee is of the view that, in the first of the situations which he cited, the delivery could be rejected or reclaimed pursuant to the provisions of rule G-12(g). In this instance the securities were traded and described as being "puttable" securities; the securities delivered, however, are no longer "puttable" securities, since the put option has expired by the delivery date. Accordingly, the rule would permit rejection or reclamation of the delivery.

In the third case he put forth, however, this provision would not be applicable, since the securities delivered are as described. Accordingly, there would not be a basis under the rules to reject or reclaim this delivery, and a purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding or in the courts. This may also be the result in the second case he cited, depending on the facts and circumstances of the delivery. *MSRB interpretation of February 27, 1985.*

**Confirmation disclosure: put option bonds.** This will acknowledge receipt of your letter of March 17, 1981, with respect to "put option" or "tender option" features on certain new issues of municipal securities. In your letter you note that an increasing number of issues with "put option" features are being brought to market, and you inquire concerning the application of the Board's rules to these securities.

The issues of this type with which we are familiar have a "put option" or "tender option" feature permitting the holder of securities of an issue to sell the securities back to the trustee of the issue at par. The "put" or "tender option" privilege normally becomes available a stated number of years (*e.g.*, six years) after issuance, and is available on stated dates thereafter (*e.g.*, once annually, on an interest payment date). The holder of the securities must usually give several months prior notice to the trustee of his intention to exercise the "put option."

Most Board rules will, of course, apply to "put option" issues as they would to any other municipal security. As you recognize in your letter, the only requirements raising interpretive questions appear to be the requirements of rules G-12 and G-15 concerning confirmations. These present two interpretive issues: (1) does the existence of the "put option" have to be disclosed and if so, how, and (2) should the "put option" be used in the computation of yield and dollar price.

> Both rules require confirmations to set forth a
>
> description of the securities, including... if the securities are... subject to redemption prior to maturity..., an indication to such effect

Confirmations of transactions in "put option" securities would therefore have to indicate the existence of the "put option," much as confirmations concerning callable securities must indicate the existence of the call feature. The confirmation need not set forth the specific details of the "put option" feature.

The requirements of the rules differ with respect to disclosure of yields and dollar prices. Rule G-12, which governs inter-dealer confirmations, requires such confirmations to set forth the

> yield at which transaction was effected and resulting dollar price, except in the case of securities which are traded on the basis of dollar price or securities sold at par, in which event only dollar price need be shown (in cases in which securities are priced to premium call or to par option, this must be stated and the call or option date and price used in the calculation must be shown, and where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to premium call, price to par option, or price to maturity)

Rule G-15 requires customer confirmations to contain yield and dollar price as follows:

> (A) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to premium call, price to par option, or price to maturity. In cases in which the dollar price is calculated to premium call or par option, this must be stated, and the call or option date and price used in the calculation must be shown.
> (B) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to premium call, yield to par option, or yield to maturity shall be shown; provided, however, that yield information for transactions in callable securities effected at a dollar price in excess of par, other than transactions in securities which have been called or prerefunded, is not required to be shown until October 1, 1981.
>
> (C) for transactions at par, the dollar price shall be shown[.]

Therefore, with respect to transactions in "put option" securities effected on the basis of dollar price, rule G-12 requires that confirmations simply set forth the dollar price. Rule G-15 requires that confirmations of such transactions set forth the dollar price and the yield to maturity resulting from such dollar price. With respect to transactions effected on the basis of yield, both rules require that the confirmations set forth the yield at which the transaction was effected and the resulting dollar price. Unless the parties otherwise agree, the yield should be computed to the maturity date when deriving the dollar price. If the parties explicitly agree that the transaction is effected at a yield to the "put option" date, then such yield may be shown on the confirmation, together with a statement that it is a "yield to the [date] put option," and an indication of the date the option first becomes available to the holder.

Since the exercise of the "put option" is at the discretion of the holder of the securities, and not, as in the case of a call feature, at the discretion of someone other than the holder, the Board concludes that the presentation of a yield to maturity on the confirmation, and the computation of yield prices to the maturity date, is appropriate, and accords with the goal of advising the purchaser of the minimum assured yield on the transaction. The Board further believes that the ability of the two parties to a transaction to agree to price the transaction to the "put option" date, should they so desire, provides sufficient additional flexibility in applying the rules to transactions in "put option" securities. MSRB *interpretation of April 24, 1981.*

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**Confirmation disclosure: put option bonds.** This will acknowledge receipt of your letter of May 6, 1981, requesting further clarification of the application of Board rules to municipal securities with "put option" or "tender option" features. In your letter you note that I had previously indicated that, in some circumstances, Board rules would require inter-dealer and customer confirmations to set forth a yield to the "put option" date, designated as such. You suggest that presentation of this information on confirmations would require reprogramming of many computerized confirmation-processing systems, and you inquire whether the Board intends that

> dealers should possess the capability to "price to the put" and [to] indicate the appropriate yield in their confirmation systems[.]

In my previous letter of April 24, 1981 I advised that Board rules G-12(c), on inter-dealer confirmations, and G-15, on customer confirmations, would require the following with respect to transactions in securities with "put option" features:

(1) If the transaction is effected on the basis of a yield price, the confirmation must state the yield at which the transaction was effected and the resulting dollar price. The dollar price must be computed to the maturity date, since, in most instances, these securities will not have call features. If the securities do have a refunding call feature, the requirement for pricing to the lowest of the premium call, par option, or maturity would obtain.

(2) If the transaction is effected on the basis of a dollar price, the confirmation must state the dollar price, and, in the case of a customer confirmation, the resulting yield to maturity. If the securities have a call feature, the customer confirmation would state the yield to premium call or the yield to par option in lieu of the yield to maturity, if either is lower than the yield to maturity.

In neither case does the rule require the presentation of a yield or a dollar price computed to the "put option" date as a part of the standard confirmation processing. Further, the Board does not at this time plan to adopt any requirement for a calculation of yield or dollar price to the lower of the put option or maturity dates, comparable to the calculation requirement involving call features. I would therefore have to respond to your inquiry by stating that the Board does not at this time intend to require, as an aspect of standard confirmation processing, that dealers have the capability to "price to the put."

In your May 6 letter you quote a paragraph from my previous correspondence, which stated the following:

> If the parties explicitly agree that the transaction is effected at a yield to the "put option" date, then such yield may be shown on the confirmation, together with a statement that it is a yield to the (date) put option, and an indication of the date the option first becomes available to the holder.

As this paragraph indicates, in some circumstances the parties to a particular transaction may agree between themselves that the transaction is effected on the basis of a yield to the "put option" date, and that the dollar price will be computed in that fashion. In such circumstances, the yield to the "put option" date is the "yield at which [the] transaction was effected" and must be disclosed as such; it must also be identified in order to evidence the agreement of the parties that the transaction is priced in this fashion. However, since the sale of securities on the basis of a yield to the "put option" is at the discretion of the parties to the transaction, and is a special circumstance requiring a mutual agreement of such parties, I suggest that the reprogramming you mention would be necessary only if your bank elects to treat securities with "put option" features in this special fashion. Further, given the fact that these would be exceptional transactions, and would require special handling at the time of trade itself (*viz.*, the conclusion of the mutual agreement concerning the pricing), I suggest that manual processing of these transactions on an "exception" basis appears to be a viable alternative to the reprogramming. *MSRB interpretation of May 11, 1981.*

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**Confirmation disclosure: advance refunded securities.** I am writing in response to your recent letter concerning the confirmation description requirements of Board rules applicable to transactions in securities which have been advance refunded. In particular, you note that certain issues of securities have been advance refunded by specific certificate number, with securities of certain designated certificate numbers refunded to one redemption date and price and other securities of the same issue refunded to a different redemption date and price. You inquire whether a confirmation of a transaction in such securities should identify the securities as being advance refunded by certificate number.

Rules G-12(c)(vi)(C)[*] and G-15(a)(iii)(C)[†] require that confirmations include

> if the securities [involved in the transaction] are "called" or "prerefunded," a designation to such effect, the date of maturity which has been fixed by the call notice, and the amount of the call price. . .

The rules therefore require, with respect to a transaction in securities which have been advance refunded by certificate number, that the confirmation state that the securities have been advance refunded, and the refunding redemption date and price. The rules do not require that the fact that only certain specific certificate numbers of the issue were advance refunded to that redemption date and price be stated on the confirmation. *MSRB interpretation of January 4, 1984.*

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[*][Currently codified at rule G-12(c)(vi)(E).]

[†][Currently codified at rule G-15(a)(i)(C)(3)(a).]

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**Confirmation disclosure: tender option bonds with adjustable tender fees.** This is in response to your inquiry concerning the application of the Board's rules to certain tender option bonds with adjustable tender fees issued as part of a recent [name of bond deleted] issue. Apparently, there is some uncertainty as to the interest rate which should be shown on the confirmation, and the appropriate yield disclosure required by rule G-15 with respect to customer confirmations in transactions involving these securities.

The securities in question are tender option bonds with a 2005 maturity which may be tendered during an annual tender period for purchase on an annual purchase date each year until the 2005 maturity date. To retain this tender option for the first year after issuance, the option bond owner must pay a tender fee of $27.50 per $1,000 in principal amount of the bonds. Beginning in the second year, however, the tender fee may vary each year and will be in an amount determined by the company granting the option (the "Company"), in its discretion, and approved by the bank which issued a letter of credit securing the obligations of the Company. The tender fee must, however, be in an amount which, in the judgment of the Company based upon consultation with not less than five institutional buyers of short term securities, would under normal market conditions permit the bonds to be remarketed at not less than par. If at any time these fees are not paid, the trustee will pay the fee to the Company on behalf of the owner and deduct that amount from the next interest payment sent to the owner unless the owner tenders the bonds prior to the fee payment date. While a system has been set up to receive payment of these tender fees, we understand that the trustee of the issue is assuming that most of the tender fees will be paid through a deduction from the interest payment.

You have advised us that confirmations of the original syndicate transactions in these securities stated the interest rate on the securities as 7-1/8%, which is the current effective rate on the bonds taking into account the tender fees during the first year after issuance (*i.e.*, the 9-7/8% rate less the 2-6/8% fee) and which, because of the yearly tender fee adjustment, is fixed only for one year. The interest rate shown on the bond certificates, however, is the 9-7/8% total rate, and no reference is made to the 7-1/8% effective rate. In addition, the bonds are traded on a dollar price basis as fixed-rate securities and are sold as one year tender option bonds (although the 2005 maturity date is disclosed). The yield to the one year tender date is the only yield customer confirmations.

You inquire whether it is proper that the confirmation show the interest rate on these securities as 7-1/8% and whether the yield disclosure requirements of rule G-15 are met with the disclosure of the yield to the one year tender date. Your inquiry was referred to the Committee of the Board which has responsibility for interpreting the Board's confirmation rules. The Committee has authorized this reply.

Rules G-12(c)(v)(E) and G-15(a)(i)(E)[*] require that dealer and customer confirmations contain a description of the securities including, among, other things, the interest rate on the bonds. The Committee believes that the stated interest rate on these bonds of 9-7/8% should be shown as the interest rate in the securities description on confirmations to reduce the confusion that may arise when the bond certificates are delivered and to ensure that an outdated effective rate is not utilized. In order to fully describe the rate of return on these bonds, however, the Committee believes that immediately after the notation of the 9-7/8% rate on the confirmations, the following phrase must be added—"less fee for put." Thus, it will be the responsibility of the selling dealer to determine the current effective rate applicable to these bonds and to disclose this to purchasing dealers and customers at the time of trade.[1]

In regard to yield disclosure, rule G-15(a)(i)(I)[†] requires that the yield to maturity be disclosed because these securities are traded on the basis of a dollar price.[2] The Board has determined that, for purposes of making this computation, only "in whole" calls should be used. Thus, for these tender option bonds, the yield to maturity is required to be disclosed. It appears, however, that an accurate yield to maturity cannot be calculated for these securities. While it is possible to calculate a yield to maturity using the stated 9-7/8% interest rate, this figure might be misleading since the adjustable tender fees would not be taken into account. Similarly, a yield calculated from the current effective rate of return would not be meaningful since it would not reflect subsequent changes in the amounts of the tender fees deducted. In view of these difficulties, the Committee believes that confirmations of these securities need not disclose a "yield to maturi-

ty." The Committee is also of the view, however, that dealers must include the yield to the one year tender date on the confirmations as an alternative form of yield disclosure. *MSRB interpretation of October 3, 1984.*

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1 We understand that these tender option bonds are the first of a series of similar issues and on subsequent issues of this nature the phrase "Bond subject to the payment of tender fee" will be printed on the bond certificates next to the interest rate. This additional description on the bond certificates, although helpful, is not a substitute for complete confirmation disclosure and this interpretation applies to these subsequent issues as well.

2 Rule G-15(a)(i)(I)[†] requires that on customer confirmations

> for transactions effected on the basis of a dollar price... the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown.

[*][Currently codified at rule G-15(a)(i)(B)(4)(c).]

[†][Currently codified at rule G-15(a)(i)(A)(5)(b).]

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**Confirmation disclosure: tender option bonds with adjustable tender fees.** This is in response to your letter requesting a one year delay in the effective date of an October 3, 1984, interpretation of Board rules G-12 and G-15 concerning confirmation disclosure of tender option bonds with adjustable tender fees. In that interpretation, the Board stated that the interest rate shown on the confirmation for these bonds should be the interest rate noted on the bond certificate (the "stated interest rate") but that the confirmation also must include the phrase "less fee for put." The Board also stated that it is the responsibility of the selling dealer to determine the current effective interest rate applicable to these bonds taking into account the tender fee (the "net interest rate") and to disclose this to purchasers at the time of trade. In addition, the Board took the position that the yield to maturity disclosure requirement does not apply to these bonds since an accurate yield to maturity cannot be calculated for these securities because of the annual adjustments to the tender fee. Dealers must, however, include the yield to the tender option date as an alternative form of yield disclosure.

While you agree with the interpretation, you state that the automated systems currently in place are not capable of complying with the interpretation and thus you request a one year delay in the effective date of this interpretation in order for the industry to effect necessary system modifications. Your request was referred to the Committee of the Board which has responsibility for interpreting the Board's confirmation rules. The Committee has authorized this reply.

Apparently, a problem arises when dealers include the stated interest rate in the interest rate field on the confirmation. In computing the yield on the transaction, most computer systems automatically pick up the rate in that field as the interest rate. Thus, an overstated yield based on the stated interest rate, instead of a yield based on the net interest rate, is printed on confirmations. We have been informed that certain dealers have solved this problem by including the net interest rate in the interest rate field. In this way, the computer automatically picks up the correct interest rate needed to determine the accurate yield to the tender option date. In order to solve the interest rate disclosure problem, these dealers include elsewhere in the description field of the confirmation the stated interest rate with the phrase "less fee for put." The Board believes that this method of disclosure is consistent with the Board's confirmation disclosure requirements.

Since the Board believes that most dealers will be able to comply either with the original interpretation or this clarification utilizing their present computer systems, it has decided not to approve any delay in the effective date of this interpretation for system modifications. We note, however, that any dealer that believes its system cannot comply with this interpretation might consider requesting a no-action letter from the SEC until its system modifications are in place. *MSRB interpretation of March 5, 1985.*

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**Confirmation requirements for partially refunded securities.** This will respond to your letter of May 16, 1989. The Board reviewed your letter at its August 1989 meeting and authorized this response.

You ask what is the correct method of computing price from yield on certain types of "partially prerefunded" issues having a mandatory sinking fund redemption. The escrow agreement for the issues provides for a stated portion of the issue to be redeemed at a premium price on an optional, "in-whole," call date for the issue. The remainder of the issue is subject to a sinking fund redemption at par.[1] Unlike some issues that are prerefunded by certificate number, the certificates that will be called at a premium price on the optional call date are not identified and published in advance. Instead, they are selected by lottery 30 to 60 days before the redemption date for the premium call. Prior to this time, it is not known which certificates will be called at a premium price on the optional call date. In the particular issues you have described, the operation of the sinking fund redemption will retire the entire issue prior to the stated maturity date for the issue.

As you know, rules G-12(c) and G-15(a) govern inter-dealer and customer confirmations, respectively. Rules G-12(c)(v)(I) and G-15(a)(i)(1)[*] require the dollar price computed from yield and shown on the confirmation to be computed to the lower of call date or maturity. For purposes of computing price to call, only "in-whole" calls, of the type which may be exercised in the event of a refunding, are used.[2] Accordingly, the Board previously has concluded that the sinking fund redemption in the type of issue you have described should be ignored and the dollar price should be calculated to the lowest of the "in-whole" call date for the issue (*i.e.*, the redemption date of the prerefunding) or maturity. In addition, the stated maturity date must be used for the calculation of price to maturity rather than any "effective" maturity which results from the operation of the sinking fund redemption. Identical rules apply when calculating yield from dollar price. Of course, the parties to a transaction may agree to calculate price or yield to a specific date, *e.g.*, a date which takes into account a sinking fund redemption. If this is done, it should be noted on the confirmation.[3]

In our telephone conversations, you also asked what is the appropriate securities description for securities that are advance refunded in this manner. Rules G-12(c)(v)(E) and G-15(a)(i)(E)[†] require that confirmations of securities that are "prerefunded" include a notation of this fact along with the date of "maturity" that has been fixed by the advance refunding and the redemption price. The rules also state that securities that are redeemable prior to maturity must be described as "callable."[4] In addition, rules G-12(c)(vi)(I) and G-15(a)(iii)(J)[‡] state that confirmations must include information not specifically required by the rules if the information is necessary to ensure that the parties agree to the details of the transaction. Since, in this case, only a portion of the issue will be chosen by lot and redeemed at a premium price under the prerefunding, this fact must be noted on the confirmation. As an example, the issue could be described as "partially prerefunded to [redemption date] at [premium price] to be chosen by lot-callable." The notation of this fact must be included within the securities description shown on the front of the confirmation. *MSRB interpretation of August 15, 1989.*

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1 In some issues, a sinking fund redemption operates prior to the optional call date, while, in others, the sinking fund redemption does not begin until on or after that date.

2 See [Rule G-15 Interpretation –] Notice of December 10, 1980, Concerning Pricing to Call, MSRB Manual, paragraph 3571.

3 These rules on pricing partially prerefunded securities with sinking funds are set forth in [Rule G-15 Interpretive Letter – Disclosure of pricing: calculating the dollar price of partially prerefunded bonds,] MSRB interpretation of May 15, 1986, MSRB Manual, paragraph 3571.26.

4 The Board has published an interpretive notice providing specific guidance on the confirmation of advanced refunded securities that are callable pursuant to an optional call. See Application of Rules G-12(c) and G-15(a) on Confirmation Disclosure of Escrowed-to-Maturity Securities [in Rule G-17 Interpretation – Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15], MSRB Manual, paragraph 3581.

[*][Currently codified at rule G-15(a)(i)(A)(5)(c)(i).]
[†][Currently codified at rule G-15(a)(i)(C)(3)(a).]
[‡][Currently codified at rule G-15(a)(i)(A)(8).]

**Close-out procedures: mandatory repurchase.** You recently inquired concerning the use of the "mandatory repurchase" option provided under Board rule G-12(h)(i)(D) for execution of a close-out notice. In the situation you presented, a municipal securities dealer executing a notice was requiring, under the provisions of this option, a repurchase at the original contract price. Since the transaction was originally effected on the basis of a yield price, you inquired whether the repurchase should be effected at this yield price (with the dollar price computed to the settlement date of the repurchase transaction), or at the dollar price computed from this yield price at the time of the original transaction.

At the time of your telephone call I responded that, while the Board would have to consider this inquiry, the Board's response to somewhat similar inquiries in the past suggested that the dollar price of the original contract should be used. I am writing to advise you that the Board did not adopt this position. With respect to the specific circumstances presented in your inquiry, the Board has concluded that the purchasing dealer does have the right, in the appropriate circumstances, to execute a close-out by requiring the seller to repurchase the securities at the yield price of the original contract, with the resulting dollar price computed to the settlement date of the repurchase transaction. The Board notes that, in these circumstances, the selling dealer has failed to fulfill its contractual obligations, and believes that permitting the use of the yield price of the original contract, with the resulting dollar price computed to the settlement date of the repurchase transaction, will in the majority of cases most fairly compensate the purchaser for the time value of the investment for the period from the original execution to the mandatory repurchase.[1]

The Board also is generally of the view that purchasers executing mandatory repurchase transactions may require a mandatory repurchase at the yield basis of the original transaction, with the resulting dollar price computed to the settlement date of the repurchase transaction, except in the case where both parties to the transaction agree that the original transaction was, and the repurchase transaction should be, effected on the basis of a dollar price, or where the terms of the transaction and/or the trading characteristics of the security (*e.g.*, issues with an active sinking fund or tender program) suggest that dollar price rather than yield was the dominant consideration in the original transaction. *MSRB interpretation of March 4, 1982.*

[1] The Board notes, for example, that, in the case of a security purchased at a discount, the purchaser and the purchaser's customer would realize the accretion of the discount for the period the security was owned. In the case of a security purchased at a premium, the premium would be amortized for the period the purchaser owned the security.

**Close-out procedures: timing of payments on retransmittals.** I am writing in response to your letter of August 23, 1983 concerning certain problems in the settlement of money amounts due on close-out executions. You note in your letter that rule G-12(h)(i)(D) provides that

> the purchaser must be prepared to defend the price at which the close-out is executed relative to market conditions at the time of the execution...[,]

and also that

> [a]ny moneys due on the transaction, or on the close-out of the transaction, shall be forwarded to the appropriate party within ten business days of the date of execution of the close-out notice.

You inquire as to the relationship between these two provisions in the case of a close-out procedure involving several retransmittals. You also suggest a method of handling of moneys in situations where a dispute as to the fairness of the execution price occurs.

* * *

In the type of situation which is the subject of your inquiry, a municipal securities dealer ("dealer A") may issue a close-out notice to a second dealer ("dealer B") who is failing to deliver to him certain municipal securities. If dealer B has an offsetting fail-to-receive of such securities from a third dealer ("dealer C"), dealer B will retransmit the close-out notice (in accordance with the requirements of the rule) to dealer C. Similarly, dealer C may retransmit the notice to a fourth dealer ("dealer D") owing him the securities.[1] In the event of such retransmittals, the ultimate recipient of the retransmitted close-out (in this case, dealer D) is the party for whose account and liability any close-out would be executed, and who, therefore, would absorb any loss in the event of an adverse market movement. As a consequence, the ultimate recipient of the notice (dealer D) is most often the person who would require the purchaser originating the notice (dealer A, in our example) to defend the fairness of the close-out execution price.

When a close-out notice which has been retransmitted is executed, the money settlement is most frequently made by each party sending to the immediately preceding party (*i.e.*, in the event of a loss, dealer B sends to A, C sends to B, D sends to C) the differential between the close-out execution price and the original contract price. In your letter you inquire as to the responsibility of the intermediate dealers in the retransmittal sequence (dealer B and C, in our example) to send such payments of money amounts due in the event that the ultimate recipient of the notice (dealer D) challenges the execution price and refuses to make payment until the dispute is resolved.

Your question was referred to the Board for its consideration. The Board has authorized me to advise you that, in its view, the close-out rules would not require the intermediate dealers to forward full payment of the money amount due in the event that the ultimate recipient of the close-out notice and execution, for whose account and liability the close-out has been executed, disputes the fairness of the execution price and refuses to make payment until the dispute is resolved. In terms of the example, if dealer D disputes the execution price, dealers B and C would not be obliged to make full payment of the money amount due until the dispute is resolved; upon resolution of the dispute, of course, all parties must make the necessary payments promptly. The Board believes that this result is the most equitable to all parties, since otherwise one of the intermediate dealers would be obliged to defend the fairness of the execution price, rather than the dealer who originated and executed the close-out notice.

* * *

In your letter you also suggest that, in the event of a dispute as to the fairness of a close-out execution price, the parties involved in the close-out should make appropriate payments of the undisputed portion of the money amount due, with the disputed portion remaining unpaid until the dispute is resolved by mutual agreement or arbitration. The Board agrees that your proposal might be a desirable method of dealing with disputes regarding close-out execution prices. The Board notes, however, that the acceptance of a partial payment of the amount due might, in certain circumstances, be viewed as a waiver of any claim for the additional balance; further, this approach would seem to complicate the bookkeeping involved in accounting for the results of a close-out execution. If the parties to a particular close-out execution are satisfied that these problems are not significant, your suggested approach might be an appropriate procedure in the event a dispute as to the fairness of the execution price arises. *MSRB interpretation of September 23, 1983.*

[1] The retransmittal process can, of course, continue, if additional municipal securities dealers are involved in the particular transaction sequence.

**Close-out procedures: transactions involving introducing broker.** I am writing in response to your recent letter concerning the

use of the close-out provisions under Board rule G-12(h) with respect to a transaction in which one of the two parties "introduces" all transactions to a third, "clearing" dealer such as [name of clearing dealer deleted]. You indicate that [the clearing dealer] was recently involved in a situation in which a close-out notice was issued directly to a securities firm which uses [the clearing dealer] as its clearing dealer, introducing all of its transactions to [the clearing dealer]. Due to this firm's failure to notify [the clearing dealer] of the issuance of the close-out notice in a timely fashion [the clearing dealer] was unable to retransmit the notice to the dealer owing it the securities, and consequently was exposed to liability on the close-out. You express the view that [the clearing dealer's] inability to retransmit the notice was attributable to the fact that the notice was improperly directed to the introducing broker, rather than to [the clearing dealer]. You suggest that the Board's close-out rules should be amended to require that, in circumstances in which one party to an inter-dealer transaction introduces all trades to a clearing dealer, all communications with respect to a close-out of the transaction should be sent to the clearing dealer. I note that others have proposed that, in situations of this type, the clearing dealer should also have the authority to issue close-out notices on the transaction on behalf of the introducing broker.

The Board does not agree with your suggestion that a dealer purchasing securities from an introducing broker should be required to send all communications related to a close-out procedure to such broker's clearing dealer. In general, the Board has declined to include in the close-out rules requirements that certain specific persons or types of persons be contacted to handle aspects of the procedure; the Board believes that such requirements would inappropriately restrict dealers' flexibility in determining how best to handle close-out notices, and in establishing their own procedures for processing such notices.[1] In the specific case where the selling party in the transaction is an introducing broker, the Board is of the view that the adoption of your suggestion (which would have the effect of prohibiting the purchasing dealer from issuing a close-out notice directly to the introducing broker) inappropriately places on the purchasing dealer the burden of ensuring that a close-out notice is directed properly. Further, this approach improperly makes the purchasing dealer responsible for knowing the nature of the introducing broker's clearing arrangements (*i.e.*, that there is an "introducing" relationship, rather than simply a use of clearing services) and determining the proper way to proceed in light of those arrangements.

The responsibility for ensuring that a close-out notice is directed properly clearly rests and should rest with the introducing broker. In the situation you described the improper handling of the notice and the consequent exposure to [the clearing dealer] was the result of the introducing broker's failure to understand the significance of the notice and to respond appropriately. The Board continues to believe that it is incumbent upon municipal securities brokers and dealers, including introducing brokers, to ensure that their personnel understand the importance of prompt handling of close-out notices and know the procedure established by the dealer to accomplish this.

With respect to the issuance of a close-out notice by a clearing dealer acting on behalf of an introducing broker, the Board is of the view that (1) if the clearing dealer confirms inter-dealer transactions on behalf of the introducing broker, with the confirmation identifying both entities, (2) if all communications related to the close-out issued by the clearing dealer indicate that the clearing dealer is acting on behalf of the introducing broker, and (3) if the clearing dealer takes all responsibility for the issuance of notices, with the introducing broker not involving itself in the close-out procedure at any time, then the clearing dealer may issue close-out notices on the introducing broker's behalf. I note that the ability of the clearing dealer to issue notices on the introducing broker's behalf is also contingent upon the existence of the "introducing" relationship; a party acting solely as a dealer's clearing agent, without the presence of an "introducing" relationship, would not be able to issue close-out notices on transactions effected by the dealer. *MSRB interpretation of March 5, 1984.*

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[1] See, for example, the discussion in Question 6 of the Board's Manual on Close-Out Procedures:

> Q: When you say "call the seller," what does that mean? Whom should I call?
>
> A: Every dealer has its own procedures to handle close-outs, so the Board doesn't require that a specific person, or a specific type of person, be contacted... A number of dealers have the trader who made the trade contact the person from whom he or she bought the bonds...
>
> While we're on this subject, remember that sometimes you will be the recipient of a close-out notice. People in your office should know who handles close-outs for you and that they're responsible for referring calls and notices on close-outs to these people. If a close-out is mishandled in your office and, due to this error, you inadvertently fail to meet certain requirements (for instance, not retransmissing the notice to another dealer on time), you will be exposed to some risk on the close-out.

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**Settlement of syndicate accounts.** Your letter dated September 25, 1978, regarding rule G-12 has been referred to me for reply. In your letter, you inquire as to whether the requirement in section (j) of rule G-12 to settle syndicate accounts within 60 days following the date all securities are delivered to syndicate members, applies in all circumstances. Specifically, you ask whether the time for settlement may be extended under the rule in the event that the syndicate has not received all expense bills prior to the expiration of that period.

There is no provision in rule G-12 for extending the 60-day period in the circumstances which you described. In adopting this requirement, the Board sought to achieve an equitable balance between the interests of syndicate members and syndicate managers in settling syndicate accounts. The Board believes that the 60-day period provides sufficient time to enable syndicate managers to settle on syndicate accounts and represents a reasonable time within which such accounts should be settled. It is therefore incumbent upon a syndicate manager to encourage persons to submit bills to the syndicate on a timely basis. The syndicate manager will otherwise have to settle the account within the prescribed time period and make adjustments subsequently when late bills are finally received. *MSRB interpretation of November 1, 1978.*

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**Settlement of syndicate accounts.** This is in response to your letter of July 28, 1981, suggesting that requirements analogous to those placed on syndicate managers in rule G-12(j) be imposed on syndicate members who must remit their share of syndicate losses to their syndicate managers. You state that syndicate members frequently do not remit their losses to the manager in a timely fashion and that such a requirement would establish an "equitable balance between the interests of syndicate members and syndicate managers."

Rule G-12(j) provides:

> Final settlement of a syndicate or similar account formed for the purchase of securities shall be made within 60 days following the date all securities have been delivered by the syndicate or account manager to the syndicate or account members.

The rule is not expressly limited to money payments by syndicate managers, but broadly requires that final settlement shall be made within 60 days following the date the manager delivers the securities to the syndicate members. Thus, the rule requires syndicate members to remit their share of syndicate losses to the syndicate manager within the 60-day period set forth in the rule. Since a syndicate member cannot remit his share of losses until he is apprised by the syndicate manager of the amount of his share, a member should remit his share of the losses to the manager within a reasonable period of time after receiving the syndicate accounting required by rule G-11(h). *MSRB interpretation of September 28, 1981.*

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**Confirmation: mailing of WAII confirmation.** I am writing to confirm my recent tele-

phone conversation with you regarding the requirements for mailing "when, as and if issued" confirmations of transactions in new issue municipal securities. Our recent conversation concerned your previous inquiry as to the time limit by which a municipal securities dealer must send out such confirmations in connection with allocations of securities to "pre-sale" orders, and the propriety of a dealer's sending out such confirmations prior to the award of the new issue.

As we discussed, rule G-12(c)(iii) requires that,

> [f]or transactions effected on a "when, as and if issued" basis, initial confirmations shall be sent within [one] business day following the trade date.

For purposes of this requirement the designation "trade date" should be understood to refer to, in the case of a competitive new issue, a date no earlier than the date of award of the new issue of municipal securities, and, in the case of a negotiated new issue, a date no earlier than the date of signing of the bond purchase agreement. Therefore, the rule would require that initial "when, as and if issued" confirmations reflecting the allocation of new issue securities to "pre-sale" orders be sent within [one] business day after the date of award or of signing of the bond purchase agreement. For example, if the bond purchase agreement on a negotiated new issue is signed on Monday, April 26, the initial "when, as and if issued" confirmations must be sent out not later than the close of business on [Tuesday], April [27], [one] business day later.

Further, the Board is of the view that its rules prohibit a municipal securities dealer from sending out initial "when, as and if issued" confirmations prior to the trade date. In reaching this conclusion the Board does not intend to call into question the validity of a "pre-sale" order received for a syndicate's securities or the practice of soliciting such orders. The Board recognizes that such orders are expressions of the purchasers' firm intent to buy the new issue securities in accordance with the stated terms, and that such orders may be filled and confirmed immediately upon the award of the issue or the execution of a bond purchase agreement. The Board is of the view, however, that such orders cannot be deemed to be executed until the time of the award of the new issue, or the execution of a bond purchase agreement on the new issue. Mailing of confirmations on such orders prior to this time, therefore, is a representation that the orders have been filled before this actually occurs, and, as such, may be deceptive or misleading to the purchasers. *MSRB interpretation of April 30, 1982.*

**Note: Revised to reflect subsequent amendments.**

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**Confirmation: mailing of WAII, "all or none" confirmation.** I understand that certain ... firms ... have raised questions concerning the application of a recent Board interpretive letter to certain types of municipal securities underwritings. I am writing to advise that these questions were recently reviewed by the Board which has authorized my sending you the following response.

The letter in question, reprinted in the Commerce Clearing House *Municipal Securities Rulemaking Board Manual* at ¶ 3556.55[*], discusses the timing of the mailing of initial "when, as and if issued" confirmations on "pre-sale" orders to which new issue municipal securities have been allocated. Among other matters, the letter states that such confirmations may not be sent out prior to the date of award of the new issue, in the case of an issue purchased at competitive bid, or the date of execution of a bond purchase agreement on the new issue, in the case of a negotiated issue. [Certain] ... firms have questioned whether this interpretation ... is intended to apply to "all or none" underwritings, in which confirmations have been, at times, sent out prior to the execution of a formal purchase agreement.

As the Board understands it, an "all or none" underwriting of a new issue of municipal securities is an underwriting in which the municipal securities dealer agrees to accept liability for the issue at a given price only under a stated contingency, usually that the entire issue is sold within a stated period. The dealer typically "presettles" with the purchasers of the securities, with the customers receiving confirmations and paying for the securities while the underwriting is taking place. Pursuant to SEC rule 15c2-4 all customer funds must be held in a special escrow account for the issue until such time as the contingency is met (*e.g.*, the entire issue is sold) and the funds are released to the issuer; if the contingency is not met, the funds are returned to the purchasers and the securities are not issued.[1]

The Board is of the view that an initial "when, as and if issued" confirmation of a transaction in a security which is the subject of an "all or none" underwriting may be sent out prior to the time a formal bond purchase agreement is executed. This would be permissible, however, only if two conditions are met: (1) that such confirmations clearly indicate the contingent nature of the transaction, through a statement that the securities are the subject of an "all or none" underwriting or otherwise; and (2) that the dealer has established, or has arranged to have established, the escrow account for the issue as required pursuant to rule 15c2-4. *MSRB interpretation of October 7, 1982.*

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[1] I note also that SEC rule 10b-9 sets forth certain conditions which must be met before a dealer is permitted to represent an underwriting as an "all or none" underwriting.

[*][See Rule G-12 Interpretive Letter – Confirmation: mailing of WAII confirmation, *MSRB interpretation of April 30, 1982.*]

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**Automated clearance: use of comparison systems.** I am writing to confirm the substance of our conversations with you at our meeting on October 3 to discuss certain of the issues that have arisen since the August 1 effective date of the requirements of rule G-12(f) for the use of automated comparison services on certain interdealer transactions in municipal securities. In our meeting you explained certain problems that have become apparent since the implementation of these requirements, and you inquired as to our views concerning the application of Board rules to these difficulties or appropriate procedures to remedy them. The essential points of our responses are summarized below.

In particular, you indicated that the use of the "as of" (or "demand as of") feature of the automated comparison system has, in some cases, caused inappropriate rejections of deliveries of securities. This occurs, you explained, because the comparison system is currently programmed to display an alternative settlement date of two business days following the date of successful comparison of the transaction, if such comparison is accomplished through use of the "as of" or "demand as of" feature.[1] As a result, in certain cases involving transactions compared on an "as of" basis dealers have attempted to make delivery on the transaction on the contractual settlement date, and have had those deliveries rejected, since the receiving party recognizes only the later "alternative settlement date" assigned to the transaction by the comparison system. You inquire whether such rejections of deliveries are in accordance with Board rules.

I note that this "alternative settlement date" has significance for clearance purposes only, and does not result in a recomputation of the dollar price or accrued interest on the transaction.

As we advised in our conversation, the receiving dealer clearly cannot reject a good delivery of securities made on or after the contractual settlement date on the basis that the delivery is made prior to the "alternative settlement date" displayed by the comparison system. Both dealers have a contract involving the purchase of securities as of a specified settlement date, and a delivery tendered on or after that date in "good delivery" form must be accepted. A dealer rejecting such a delivery on the basis that it has been made prior to the "alternative settlement date" would be subject to the procedures for a "close-out by seller" due to the improper rejection of a delivery, as set forth in Board rule G-12(h)(ii).[2]

* * *

You also advised that some dealers who are using the automated comparison system are using their own delivery tickets, rather than the delivery tickets generated by the system, at the time they make delivery on the transaction. As a result, you indicated, there have been rejections of these deliveries, since the receiving dealer is unable to correlate these deliveries with its records of transactions compared through the system. You suggested that the inclusion of the "control numbers" generated by the comparison system on these self-generated delivery tickets would help to eliminate these unnecessary rejections and facilitate the correlation of receipts and deliveries with records of transactions compared through the system. As I indicated in our conversation, the Board concurs with your suggestion. The Board strongly encourages dealers who choose to use their own delivery tickets for transactions compared through the automated system to display on those tickets the control number or other number identifying the transaction in the system.[3] This would ensure that the receiving dealer can verify that it knows the transaction being delivered and that it was successfully compared through the system.

* * *

You also noted that many municipal securities dealers have continued the practice of sending physical confirmations of transactions, in addition to submitting such transactions for comparison through the automated system. You advised that this is causing significant problems for certain dealers, since they are required to maintain a duplicate system in order to provide for the review of these physical confirmations.

The Board is aware that certain municipal securities dealers chose to maintain parallel confirmation systems following implementation of the automated comparison requirements on August 1 in order to ensure that they maintained adequate control over their activities, and recognizes that for many such dealers this was an appropriate and prudent course of action.[4] However, the Board wishes to emphasize that its rules do not require the sending of a physical confirmation on any transaction which has been submitted for comparison through the system. On the contrary, the continued use of unnecessary physical comparisons increases the risk of the duplication of trades and deliveries and substantially decreases the efficiencies and cost savings available from the use of the automated comparison system. The Board believes that all system participants must understand that the use of the automated comparison system is of primary importance. Accordingly, the Board strongly suggests that the mailing of unnecessary physical confirmations should be discontinued once a dealer is satisfied that it has adequate control over its comparison activities through the system.

You and others have suggested that it would be helpful if dealers which are unable to discontinue the mailing of physical confirmations would identify those transactions which have also been submitted for comparison through the system through some legend or stamp placed on the physical confirmation sent on the transaction. The Board concurs with your suggestion, and recommends that, during the short remaining interim when dealers are continuing to use duplicate physical confirmations, they include on physical confirmations of transactions submitted to the automated comparison system a stamp or legend in a prominent location which clearly indicates that the transaction has been submitted for automated comparison. *MSRB interpretation of January 2, 1985.*

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[1] For example, a transaction of trade date October 19 for settlement October 25 fails to compare through the normal comparison cycle. Due to this failure to compare, the transaction is dropped from the comparison system on October 23; however, due to a resolution of the dispute, both parties resubmit the trade on an "as of" basis on October 24, and it is successfully compared on that date. Due to the delay in the comparison of the transaction, the system will display an "alternative settlement date" on this transaction of October 26 on the system-generated delivery tickets.

[2] I understand that [Registered Clearing Agency] is taking steps to have the contractual settlement date reflected on delivery tickets produced with respect to transactions compared on an "as of" or "demand as of" basis. We believe that this will be most helpful in clarifying and receiving dealer's contractual obligation to accept a proper delivery made on or after the date.

[3] I understand that proper utilization of the comparison system control number is a reliable method for identifying and referring to transactions.

[4] The Board is also aware that on certain transactions dealers will need to send physical confirmations to document the terms of a specific agreement concluded at the time of trade (e.g., a specification of a rating). In such circumstances the Board anticipates that physical confirmations will continue to be sent.

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**Automated settlement involving multidepository participants.** This will respond to your letter concerning the requirements of rule G-12(f)(ii) applicable to transactions involving firms that are members of more than one registered securities depository. Your inquiry concerns situations in which a dealer that is a member of more than one depository executes a transaction with another dealer that is a member of one or more depositories. Your question is whether such dealers may specify the depository through which delivery must be made, either as a term of an individual transaction or with standing delivery instructions.

Your inquiry was referred to the Committee of the Board with the responsibility for interpreting the Board's automated clearance and settlement rules, which has authorized my sending this response.

... The rule does not specify which depository shall be used for settlement if the transaction is eligible for settlement at more than one depository.

The Board is of the view that, under rule G-12(f), parties to a transaction are free to agree, on a trade-by-trade basis or with standing delivery agreements, on the depository to be used for making book-entry deliveries. Absent such an agreement, a seller may effect good delivery under rule G-12(f) by delivering at any depository of which the receiving dealer is a member. *MSRB interpretation of November 18, 1985.*

**NOTE: Revised to reflect subsequent amendments.**

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See also:

**Rule G-15 Interpretive Letters – Callable securities: "catastrophe" calls,** *MSRB interpretation of November 7, 1977.*

**– Callable securities: disclosure,** *MSRB interpretation of August 23, 1982.*

**– Original issue discount, zero coupon securities: disclosure of, pricing to call feature,** *MSRB interpretation of June 30, 1982.*

**– Callable securities: pricing to call,** *MSRB interpretation of June 8, 1978.*

**– Callable securities: pricing to call,** *MSRB interpretation of March 9, 1979.*

**– Callable securities: pricing transactions on construction loan notes,** *MSRB interpretation of March 5, 1984.*

**– Calculation of price and yield on continuously callable securities,** *MSRB interpretation of August 15, 1989.*

**– Disclosure of pricing: calculating the dollar price of partially prerefunded bonds,** *MSRB interpretation of May 15, 1986.*

**– Securities description: revenue securities,** *MSRB interpretation of December 1, 1982.*

**– Securities description: securities backed by letters of credit,** *MSRB interpretation of December 2, 1982.*

**– Securities description: prerefunded securities,** *MSRB interpretation of February 17, 1998.*

**Rule G-17 Interpretive Letter – Put option bonds: safekeeping, pricing,** *MSRB interpretation of February 18, 1983.*

## Rule G-13: Quotations Relating to Municipal Securities

(a) *General.* The provisions of this rule shall apply to all quotations relating to municipal securities which are distributed or published, or caused to be distributed or published, by any broker, dealer or municipal securities dealer or any person associated with and acting on behalf of a broker, dealer or municipal securities dealer. For purposes of this rule, the term "quotation" shall mean any bid for, or offer of, municipal securities, or any request for bids for or offers of municipal securities, including indications of "bid wanted" or "offer wanted." The terms "distributed" or "published" shall mean the dissemination of quotations by any means of communication. Reference in this rule to a broker, dealer or municipal securities dealer shall be deemed to include reference to any person associated with a broker, dealer or municipal securities dealer.

(b) *Bona Fide Quotations.*

(i) Except as provided below, no broker, dealer or municipal securities dealer shall distribute or publish, or cause to be distributed or published, any quotation relating to municipal securities, unless the quotation represents a bona fide bid for, or offer of, municipal securities by such broker, dealer or municipal securities dealer, provided, however, that all quotations, unless otherwise indicated at the time made, shall be subject to prior purchase or sale and to subsequent change in price. If such broker, dealer or municipal securities dealer is distributing or publishing the quotation on behalf of another broker, dealer, or municipal securities dealer, such broker, dealer or municipal securities dealer shall have no reason to believe that such quotation does not represent a bona fide bid for, or offer of, municipal securities. Nothing in this paragraph shall be construed to prohibit requests for bids or offers, including indications of "bid wanted" or "offer wanted," or shall be construed to prohibit nominal quotations, if such quotations are, at the time made, clearly stated or indicated to be such. For purposes of this paragraph, a "nominal quotation" shall mean an indication of the price given solely for informational purposes.

(ii) No broker, dealer or municipal securities dealer shall distribute or publish, or cause to be distributed or published, any quotation relating to municipal securities, unless the price stated in the quotation is based on the best judgment of such broker, dealer or municipal securities dealer of the fair market value of the securities which are the subject of the quotation at the time the quotation is made. If a broker, dealer or municipal securities dealer is distributing or publishing a quotation on behalf of another broker, dealer, or municipal securities dealer, such broker, dealer or municipal securities dealer shall have no reason to believe that the price stated in the quotation is not based on the best judgment of the fair market value of the securities of the broker, dealer or municipal securities dealer on whose behalf such broker, dealer or municipal securities dealer is distributing or publishing the quotation.

(iii) For purposes of subparagraph (i), a quotation shall be deemed to represent a "bona fide bid for, or offer of, municipal securities" if the broker, dealer or municipal securities dealer making the quotation is prepared to purchase or sell the security which is the subject of the quotation at the price stated in the quotation and under such conditions, if any, as are specified at the time the quotation is made.

(iv) No broker, dealer or municipal securities dealer shall knowingly misrepresent a quotation relating to municipal securities made by any other broker, dealer, or municipal securities dealer.

(c) *Multiple Markets in the Same Securities.* No broker, dealer or municipal securities dealer participating in a joint account shall, together with one or more other participants in such account, distribute or publish, or cause to be distributed or published, quotations relating to the municipal securities which are the subject of such account if such quotations indicate more than one market for the same securities.

### *BACKGROUND*

On March 9, 1977, the Securities and Exchange Commission (the "Commission") approved the Municipal Securities Rulemaking Board's proposed rules on quotations and reports of sales or purchases of municipal securities, rule G-13 applies to all quotations with respect to municipal securities transactions, including transactions between professionals.

Rule G-13 prohibits the dissemination of a quotation relating to municipal securities unless the quotation represents a bona fide bid for, or offer of, securities. The term "quotation" is defined to mean any bid for, or offer of, municipal securities. A quotation is deemed to be "bona fide" if the firm on whose behalf the quotation is made is prepared to purchase or sell the municipal securities at the price stated in the quotation and under the conditions, if any, specified at the time the quotation is made. The rule does not prohibit requests for bids or offers or giving indications of price solely for informational purposes as long as clearly indicated to be for such purposes.

Rule G-13 also prohibits a firm from entering a quotation on behalf of another broker, dealer, or municipal securities dealer if the firm entering the quotation has any reason to believe that the quotation does not represent a bona fide bid for, or offer of, municipal securities. In addition, participants in a joint account are prohibited from entering quotations relating to municipal securities which are the subject of the joint account, if such quotations indicate more than one market for the same securities.

Under rule G-13, the price stated in a quotation for municipal securities has to be based on the best judgment of the person making the quotation as to the fair market value of such securities at the time the quotation is made. The rule does not require that the price stated in a quotation represent only the fair market value of the securities for which the quotation is made, but rather that the price stated have a reasonable relationship to the fair market value of the securities, taking into account all relevant circumstances, such as a firm's current inventory position, overall and in respect of a particular security, and a firm's anticipation of the direction of the movement of the market for the securities.

In a letter to the Commission staff, the Board presented the following three examples of how this provision would operate:

(1) Assume that a dealer submits a bid for bonds, knowing that they have been called by the issuer. The bonds are not general market bonds and the fact that they have been called is not widely known. While called bonds ordinarily trade at a premium, the dealer's bid is based on the value of the bonds as though they had not been called and is accepted by the dealer on the other side of the trade who is unaware of the called status of the bonds. In these circumstances, the bid clearly would not have been based upon the best judgment of the dealer making it as to the fair market value of the bonds.

(2) The provision would also apply to the situation in which a dealer submits a bid for bonds based on valuations obtained from independent sources, which in turn are based on mistaken assumptions concerning the nature of the securities in question. The circumstances indicate that the dealer submitting the bid knows that the securities have a substantially greater market value than the price bid, but the fact that independent valuations were obtained, albeit based on mistaken facts, clouds the dealer's culpability. The best judgment standard of rule G-13 would apply in this situation.

(3) The provision would also apply in the situation in which a dealer makes a bid for or offer of a security without any knowledge as to the value of the security or the value of comparable securities. While the Board does not intend that the best judgment of a dealer as to the fair market value of a security be second-guessed for purposes of the rule, the Board does intend that the dealer be required to act responsibly and to exercise some judgment in submitting a quotation. In other words, a quotation which has been "pulled out of the air" is not based on the best judgment of the dealer and, in the interests of promoting free and open markets in municipal securities, should not be encouraged.

Under rule G-13, any quotation, unless otherwise indicated at the time the quotation is made, is subject to prior purchase or sale and to change in price.

## MSRB INTERPRETATIONS

### NOTICE OF INTERPRETATION OF RULE G-13 ON PUBLISHED QUOTATIONS

April 21, 1988

The Board has received complaints regarding published quotations, such as those appearing in *The Blue List*. The complaints, which have been referred to the appropriate enforcement agency, state that municipal securities offerings published by dealers often do not reflect prices and amounts of securities that currently are being offered by the quoting dealer.

Board rule G-13, on quotations, prohibits the dissemination of a quotation relating to municipal securities unless the quotation represents a bona fide bid for, or offer of, municipal securities. The term quotation is defined to mean any bid for, or offer of, municipal securities. A quotation is deemed to be bona fide if the dealer on whose behalf the quotation is made is prepared to purchase or sell the municipal securities at the price stated and in the amount specified at the time the quotation is made.

Under rule G-13, the price stated in a quotation for municipal securities must be based on the best judgment of the dealer making the quotation as to the fair market value of such securities at the time the quotation is made. The Board has stated that the price must have a reasonable relationship to the fair market value of the securities, and may take into account relevant factors such as the dealer's current inventory position, overall and in respect to a particular security, and the dealer's anticipation of the direction of the market price for the securities.

Rule G-13 also prohibits a dealer from entering a quotation on behalf of another dealer if the dealer entering the quotation has any reason to believe that the quotation does not represent a bona fide bid for, or offer of, municipal securities. In addition, participants in a joint account are prohibited from entering quotations relating to municipal securities which are the subject of the joint account, if such quotations indicate more than one market for the same securities. Rule G-13 does not prohibit giving "nominal" bids or offers or giving indications of price solely for informational purposes as long as an indication of the price given is clearly shown to be for such purposes.

A dealer that publishes a quote in a daily or other listing must stand ready to purchase or sell the securities at the stated price and amount until the securities are sold or the dealer subsequently changes its price. If either of these events occur, the dealer must withdraw or update its published quotation in the next publication. Stale or invalid quotations violate rule G-13. Rule G-13 does permit a dealer to publish a quotation for a security it does not own if the dealer is prepared to sell the security at the price stated in the quotation. If the dealer knows that the security is not available in the market or is not prepared to sell the security at the stated price, the quotation would violate rule G-13.

See also:

**Rule G-17 Interpretations – Application of Board Rules to Transactions in Municipal Securities Subject to Secondary Market Insurance or Other Credit Enhancement Features,** March 6, 1984.

**– Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals,** April 30, 2002.

## Rule G-14: Reports of Sales or Purchases

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

(b) *Transaction Reporting Requirements.*

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

(ii) The information specified in the Transaction Reporting Procedures is critical to public reporting of prices for transparency purposes and to the compilation of an audit trail for regulatory purposes. All brokers, dealers and municipal securities dealers have an ongoing obligation to report this information promptly, accurately and completely. The broker, dealer or municipal securities dealer may employ an agent for the purpose of submitting customer transaction information; however, the primary responsibility for timely and accurate submission remains with the broker, dealer or municipal securities dealer that effected the transaction.

(iii) To identify its transactions for reporting purposes, each broker, dealer and municipal securities dealer shall obtain a unique executing broker symbol from the National Association of Securities Dealers, Inc.

### Rule G-14 Transaction Reporting Procedures

(a) Inter-Dealer Transactions.

(i) Except as described in paragraph (ii) of this section (a), each broker, dealer and municipal securities dealer shall report all transactions with other brokers, dealers or municipal securities dealers to the Board's designee for receiving such transaction information. The Board has designated National Securities Clearing Corporation (NSCC) for this purpose. A broker, dealer or municipal securities dealer shall report a transaction by submitting or causing to be submitted to NSCC information in such format and within such timeframe as required by NSCC to produce a compared trade for the transaction in the initial comparison cycle on the night of trade date in the automated comparison system operated by NSCC. Such transaction information may be submitted to NSCC directly or to another registered clearing agency linked for the purpose of automated comparison with NSCC.

The information submitted in accordance with this procedure shall include the time of trade execution and the identity of the brokers, dealers, or municipal securities dealers that execute the transaction in addition to the identity of the entities that clear the transaction. If clearing/introducing broker arrangements are used for transactions, the introducing brokers shall be identified as the "executing brokers." If the settlement date of a transaction is known by the broker, dealer or municipal securities dealer, the report made to NSCC also shall include a value for accrued interest in the format prescribed by NSCC.

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

(b) Customer Transactions

(i) Each broker, dealer and municipal securities dealer shall report to the Board all transactions with customers effected after March 1, 1998, except as described in paragraph (iii) of this section (b). A broker, dealer or municipal securities dealer shall report a transaction by submitting or causing to be submitted to the Board, by midnight of trade date, the customer transaction information specified in paragraph (ii) of this section (b) in such format and manner specified in the current *User's Manual for Customer Transaction Reporting.* The broker, dealer or municipal securities dealer shall promptly report cancellation of the trade or corrections to any required data items.

(ii) The information submitted in accordance with this procedure shall include: the CUSIP number of the security; the trade date; the time of trade execution; the executing broker symbol identifying the broker, dealer or municipal

securities dealer that effected the transaction; a symbol indicating the capacity of the broker, dealer or municipal securities dealer as buyer or seller in the transaction; the par value traded; the dollar price of the transaction, exclusive of any commission; the yield of the transaction; a symbol indicating the capacity of the broker, dealer or municipal securities dealer as agent for the customer or principal in the transaction; the commission, if any; the settlement date, if known to the broker, dealer or municipal securities dealer; a control number, determined by the broker, dealer or municipal securities dealer, identifying the transaction; and a symbol indicating whether the trade has previously been reported to the Board, and, if so, the control number used by the broker, dealer or municipal securities dealer for the previous report.

(iii) The following transactions shall not be required to be reported under this section (b):

(A) a transaction in a municipal security that is ineligible for assignment of a CUSIP number by the Board or its designee; and

(B) a transaction in a municipal fund security.

(iv) Each broker, dealer and municipal securities dealer effecting customer transactions in municipal securities, including introducing and clearing brokers, shall provide to the Board the name and telephone number of a person responsible for testing that firm's capabilities to report customer transaction information. Each broker, dealer or municipal securities dealer shall test such capabilities in a manner and according to the requirements specified in the current *User's Manual for Customer Transaction Reporting*. This paragraph (iv) shall take effect July 1, 1997.

## BACKGROUND

Rule G-14 requires a dealer which distributes or publishes a report of a sale or purchase of municipal securities to know or have reason to believe that the purchase or sale was actually effected and no reason to believe that the transaction is fictitious or in furtherance of any fraudulent, misleading or deceptive purpose. A report of a short sale is not prohibited by the rule.

Further, Rule G-14 requires each dealer to report every municipal security transaction to the Board or its designee. Such information collected by the Board will be used to make public reports of market activity and prices, and also will be made available to the Commission and the agencies charged with inspection for compliance with, and enforcement of, Board rules.

The associated Transaction Reporting Procedures define certain details of transaction reporting. Further information and specifications are contained in the *User's Manual* and in various notices, all of which are on the Board's web site (www.msrb.org).

## MSRB INTERPRETATIONS

### NOTICE CONCERNING EXECUTING BROKER SYMBOLS: RULE G-14

December 16, 1996

Board rule G-14 on Transaction Reporting requires that every dealer obtain an executing broker symbol, if one has not already been assigned, from the National Association of Securities Dealers (NASD). The NASD will assign executing broker symbols to all dealers including bank dealers that are not members of the NASD. NASDAQ Subscriber Services can be reached at (800) 777-5606. When calling the NASD for an executing broker symbol dealers should state that they need the symbol for use in reporting transactions in municipal securities to the Board. If dealers experience difficulties in obtaining executing broker symbols, please contact Joe Radzicki of NASDAQ at (203) 385-6306.

### RULE G-14 TRANSACTION REPORTING PROCEDURES— TIME OF TRADE REPORTING

August 1, 1996

***1. Q: When is the inter-dealer time of trade reporting requirement effective?***

A: The amendment to the rule G-14 transaction reporting procedures requiring the submission of time of trade execution for inter-dealer transactions became effective on July 1, 1996.

***2. Q: What is the purpose of submitting the time of trade to the Board?***

A: The Board's Transaction Reporting Program has two functions – public dissemination of price and volume information about frequently traded securities and the maintenance of a surveillance database to assist regulators in inspection for compliance with, and enforcement of, Board rules and securities laws. The surveillance database includes, among other things, the price and volume of each reported transaction, the trade date, the identification of the security traded, and the parties to the trade. The addition of the time of trade execution will enable the enforcement agencies to construct audit trails of inter-dealer transactions. When customer transactions are added to the system in 1998, these transaction records also will include time of trade. Time of trade will not be made public.

***3. Q: How is time of trade reported?***

A: Under rule G-14, inter-dealer transaction information is reported to the Municipal Securities Rulemaking Board using the same system used for automated comparison of inter-dealer transactions, operated by National Securities Clearing Corporation. Rule G-14 requires that the transaction information be submitted in the format specified by NSCC, and within such timeframe as required by NSCC to produce a compared trade for the transaction in the initial comparison cycle on the night of trade date. A broker, dealer or municipal securities dealer may employ an agent that is a member of NSCC or a registered clearing agency for the purpose of submitting transaction information. For example, the clearing broker generally reports transactions to the MSRB through NSCC when there is an introducing/clearing broker arrangement.

Under the new amendment to rule G-14, the transaction information submitted in accordance with the rule G-14 procedures must include the time of trade execution. NSCC has provided a space designated for this purpose in the standard format used for submitting trade data into the automated comparison system.

*4. Q: Which dealer in an inter-dealer transaction reports the time of trade?*

A: Under NSCC's automated comparison procedures, both sides of a transaction generally are required to submit transaction information. Therefore, time of trade will be reported by each side of the transaction in most cases. For "syndicate take-down" transactions, which are reported by only the seller, the time of trade is reported only by the seller.

*5. Q: If the time of trade that I submit does not agree with the time of trade that the contra party submits, will this cause the trade not to compare?*

A: No. The time of trade is not a match item in the automated comparison system.

*6. Q: Why do both sides to the transaction have to submit the time of trade?*

A: In some cases, even though both sides of a transaction are supposed to submit transaction information, the Board receives transaction information from only one party to a transaction. This may occur, for example, when a dealer "stamps an advisory" to create a compared trade. It therefore is necessary for each side of a transaction to report the time of trade to ensure that the surveillance data base has at least one report of the time of trade.

*7. Q: Does the time of trade reporting requirement apply only to secondary market transactions?*

A: No. The time of trade is required for all inter-dealer transactions including those in the primary market.

*8. Q: How does a dealer determine the time of trade for transactions?*

A: In general, this is the same time as the "time of execution," as currently required for recordkeeping purposes under rule G-8(a)(vi) and (vii).

*9. Q: What is the time of trade for syndicate allocations on new issues?*

A: First it should be noted that the "initial trade date" for an issue of municipal securities cannot precede the date of award (for competitive issues) or the date that the bond purchase agreement is signed (for negotiated issues). See rule G-34(a)(ii)(C)(2) and MSRB Interpretations of April 30, 1982, *MSRB Manual* and October 7, 1982, *MSRB Manual*. Similarly, the time of trade may not precede the time of award (for competitive issues) or the time that the bond purchase agreement is signed (for negotiated issues). In the typical case involving a competitive issue in which allocations are made after the date of award, the time of trade execution is the time that the allocation is made. If allocations have been "preassigned," prior to a competitive award, or prior to the signing of a bond purchase agreement, the time of award or signing of the bond purchase agreement should be entered as the "time of trade."

## Reminder Regarding MSRB Rule G-14 Transaction Reporting Requirements

March 3, 2003

The Municipal Securities Rulemaking Board ("MSRB") and NASD would like to remind brokers, dealers and municipal securities dealers (collectively "dealers") about the requirements of MSRB Rule G-14, on transaction reporting. This document also describes services provided by the MSRB designed to assist dealers in complying with Rule G-14.

Transactions reported to the MSRB under Rule G-14 are made available to the NASD and other regulators for their market surveillance and enforcement activities. The MSRB also makes public price information on municipal securities transactions using data reported by dealers. One product is the Daily Report of Frequently Traded Securities ("Daily Report") that is made available to subscribers each morning by 7:00 am. Currently, it includes details of transactions in municipal securities issues that were "frequently traded" the previous business day.[1] The Daily Report is one of the primary public sources of municipal securities price information and is used by a variety of industry participants to evaluate municipal securities.[2]

Dealers can monitor their municipal transaction reporting compliance in several ways. For customer and inter-dealer transaction reporting, the MSRB Dealer Feedback System ("DFS") provides monthly statistical information on transactions reported by a dealer to the MSRB and information about individual transactions reported by a dealer to the MSRB. For daily feedback on customer trades reported, the MSRB provides dealers a "customer report edit register" on the day after trades were submitted. This product indicates trades successfully submitted and those that contained errors or possible errors.[3] For inter-dealer transactions, National Securities Clearing Corporation ("NSCC") provides to its members daily files, sometimes called "contract sheets," that can be used to check the content and status of the transactions the member has submitted.

### Inter-Dealer Transactions

Even before Rule G-14 imposed requirements for transaction reporting, MSRB Rule G-12(f), on use of automated comparison, clearance and settlement systems, required dealers to submit data on their inter-dealer transactions in municipal securities to a registered clearing agency for automated comparison on trade date ("T"). NSCC provides the automated comparison services for transactions in municipal securities. The same inter-dealer trade record dealers submit to NSCC for comparison also is used to satisfy the requirements of MSRB Rule G-14 to report inter-dealer transactions to the MSRB. NSCC forwards the transaction data it receives from dealers to the MSRB so that dealers do not have to send a separate record to the MSRB. However, satisfying the requirements for successful trade comparison under Rule G-12(f) does not, by itself, necessarily satisfy a dealer's Rule G-14 transaction reporting requirements. In addition to the trade information necessary for a successful trade comparison, Rule G-14 requires dealers to submit accrued interest, time of trade (in military format) and the effecting brokers' (both buy and sell side) four-letter identifiers, also known as executing broker symbols ("EBS"). Failure to include accrued interest, time of trade and EBS when submitting transaction information to NSCC's automated comparison system is a violation of MSRB Rule G-14 on transaction reporting even though the trade may compare on T.

As noted above, the MSRB provides dealers with statistical measures of compliance with some important aspects of MSRB Rules G-12 and G-14 through its Dealer Feedback System.[4] The statistics available for inter-dealer trades include:

- **Late or Stamped** – The frequency with which a dealer causes an inter-dealer trade not to compare on trade date is reflected in the "late or stamped" statistic. Trades that do not compare on trade date are ineligible for the Daily Report. The statistic is an indication of how often a dealer submits a trade late or stamps its contra-party's advisory, and is expressed as a percentage of the dealer's total compared trades. Because this statistic includes both "when, as and if issued" and regular-way trades, it provides a comprehensive analysis of the timeliness with which a dealer reports its trades.

- **Invalid Time of Trade** – This statistic reflects the total number of trade records submitted by a dealer in which the time of trade is null or not within the hours of 0600 to 2100. Accurate times of trade are essential to regulatory surveillance because they provide an audit trail of trading activity.

- **Uncompared Input** – A high percentage of uncompared trades may indicate that a dealer is submitting duplicative trade information, inaccurate information, or is erroneously submitting buy-side reports against syndicate takedowns.[5] The uncompared input statistic reflects trade records that a dealer inputs for comparison that never compare and are expressed as a percentage of a dealer's total number of compared trades.

It is a violation of Rule G-14 to submit trade reports that do not accurately represent trades. Moreover, Rule G-12(f) requires that dealers follow-up on inter-dealer trade submissions that do not compare in the initial trade cycle by using the post-original comparison procedures at NSCC. Trade reports made to MSRB and NSCC that never compare are a concern because they either represent inaccurate trade input or indicate that the dealer is not following-up on uncompared trades using the post-original comparison procedures provided by NSCC.

- **Compared but Deleted or Withheld** – This statistic represents deleted or withheld trade records and is a percentage of all compared trade records. Compared trade records that are subsequently deleted or withheld are a concern because these trades may have previously appeared on the Daily Report. While it is sometimes necessary to correct erroneous trade submissions using delete or withhold procedures, this will be an infrequent occurrence if proper attention is paid to transaction reporting procedures. Dealers that have a high percentage of such trades should review their procedures to determine why transaction data is being entered inaccurately.

- **Executing Broker Symbol (EBS) Statistics** – These statistics indicate the percentage of trade submissions for which the field identifying the dealer that effected the trade is either empty or contains an invalid entry. These statistics are compiled for every member of NSCC.[6] It provides information on three types of EBS errors: 1) null EBS, where a dealer left the EBS field blank; 2) numeric EBS, where a dealer entered a number in the EBS field; and 3) unknown EBS, where a dealer populated the EBS field with a symbol that is not a valid NASD-assigned EBS. A large number of EBS errors may indicate that both clearing firm and correspondent dealer reporting procedures and/or software need to be reviewed to ensure that the EBS is entered correctly and does not "drop out" of the data during the submission process. The compatibility of correspondent dealer and clearing broker reporting systems also may need to be examined.

*Note on Stamped Advisories*

Firms often stamp advisories on T+1 after failing to submit accurate inter-dealer transaction information on trade date. A stamped advisory essentially is a message sent through the NSCC comparison system by the clearing firm on one side of a trade indicating that it agrees with the trade details submitted by the contra party.

A significant percentage of stamped advisories is a concern for two reasons. First, trades compared via a stamped advisory cannot be published in the Daily Report because they do not compare on trade date. Second, unless the dealer stamping the advisory verifies every data element submitted by the contra party (including accrued interest, time of trade and EBS) stamping the advisory may effectively confirm erroneous data about the trade, which will be included in the surveillance data provided to market regulators. With particular respect to EBS, both the MSRB and the NASD have observed that dealers do not always include accurate contra parties' EBSs in transaction reports. As a result, when a firm "stamps" a contra party's submission, its own EBS may not be correctly included in the transaction report sent to the MSRB.

In lieu of stamping an advisory, it is possible for a dealer to submit an "as of" trade record to match an advisory pending against it. This serves the same purpose as stamping an advisory but in addition allows the dealer to input its own EBS (and other data elements) and thus ensure the accuracy of the information about its side of the trade. While the trade will still be reported late, the data about the trade will be more likely to be correct.

*Note on Clearing Broker-Correspondent Issues*

While Rule G-14 notes that accurate and timely transaction reporting is primarily a responsibility of the firm that effected a trade, it also notes that a firm may use an agent or intermediary to submit trade information on its behalf. For inter-dealer trades, a direct member of NSCC must be used to input transaction data if the dealer effecting the transaction is not itself a direct member. This Rule G-14 requirement that a clearing broker and correspondent work together to submit transaction reporting data in a timely and accurate manner is the same as exists in Rule G-12(f) on inter-dealer comparison.

Where there is a clearing-correspondent relationship between dealers, timely and accurate submission of trade data to NSCC generally requires specific action by both the direct member of NSCC (who clears the trade) as well as the correspondent firm. The MSRB has noted that the responsibility for proper trade submission is shared between the correspondent and its clearing broker.[7] Clearing brokers, their correspondents and their contra-parties all have a responsibility to work together to resolve inaccurate or untimely information on transactions in municipal securities. A clearing firm's use of a large number of stamped advisories may indicate systemic problems with the clearing broker's procedures, the correspondents' procedures, or both.[8]

**Customer Transactions**

Dealers that engage in municipal securities transactions with customers also are required to submit accurate and complete trade information to the MSRB by midnight of trade date under Rule G-14. MSRB customer transaction reporting requirements include the reporting of time of trade and the dealer's EBS for each trade.

Dealers have flexibility in the way they report customer transactions to the MSRB Transaction Reporting System. The three options available allow dealers to: 1) transmit customer transaction data directly to NSCC, which, using its communications line with MSRB, forwards trade data to the MSRB the evening on which it is received; 2) send the data via an intermediary, such as a clearing broker or service bureau, to NSCC, which forwards the data to the MSRB; or 3) submit the data directly to the MSRB using a PC dial-up connection and software provided by the MSRB.

The MSRB Dealer Feedback System also provides dealers with performance statistics for customer trade reporting. These statistics include:

- **Ineligible** – This statistic reflects the percentage of a dealer's initial customer trade records that were ineligible for the Daily Report, because either the trade reports were submitted after trade date or they contained some other dealer error that caused it to be rejected by the MSRB Transaction Reporting System.

- **Late** – Initial customer trade records that were submitted after trade date are indicated in this statistic and are a subset of ineligible trades. This percentage is reported separately because late reporting is the most common reason for trade records to be ineligible for the Daily Report.

- **Cancelled** – This is the percentage of a dealer's initial customer trade records that were cancelled by the dealer after initial submission. Cancelled trades are a cause for concern because the data in the trade record submitted prior to cancellation may have already been included in the Daily Report.

- **Amended** – This is the percentage of a dealer's initial customer trade records that were amended by the dealer after initial submission. Amended trades are a cause for concern because the data in the trade record may have already been included in the Daily Report. While it is important that customer trades be immediately amended if any of the required information was incorrectly reported, dealers sometimes amend customer trade records unnecessarily. If trade details solely for internal dealer record-keeping or delivery are changed, the dealer should ensure that its processing systems do not automatically send MSRB an "amend" record. For example, if a transaction is reported correctly to the MSRB on trade date, the dealer should not amend the transaction (or cancel and resubmit another transaction record to the MSRB) simply because customer account numbers or allocation and delivery information is added or

changed in the dealer's own records.[9]

Amendments to change settlement dates for when-issued transaction also are generally unnecessary. Since MSRB monitors settlement dates for new issues through other sources, dealers should not send amended trade records merely because the settlement date becomes known. Dealers may find that their automated systems are sending amended trade records to the MSRB in these cases, even though amendments are unneeded.

Attention to these areas could greatly reduce the number of amendments sent to MSRB by some dealers.

- **Invalid Time of Trade** – This statistic reflects the total number of trade records submitted by a dealer in which the time of trade is null or not within the hours of 0600 to 2100. Accurate times of trade are essential to regulatory surveillance as they provide an audit trail of trading activity.

### Questions / Further Information

Questions about this notice may be directed to staff at either MSRB or NASD. At MSRB, contact P. John Baughman, Senior Data Analyst, or Justin R. Pica, Uniform Practice Specialist, at (703) 797-6600. At NASD's Department of Member Regulation, contact Malcolm Northam, Director, Fixed Income Securities, at (202) 728-8085, or Cynthia Friedlander, Regulatory Specialist, at (202) 728-8133. For more information on transaction reporting, including questions and answers and the customer transaction reporting system user guide, or to sign up for the Dealer Feedback System, we encourage dealers to visit the MSRB Web site at www.msrb.org, particularly the Municipal Price Reporting / Transaction Reporting System section.

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[1] The Daily Report is available by subscription at no cost. Currently, "frequently traded" securities are those that traded two or more times during a trading day. As noted below, inter-dealer transactions must be compared on trade date to be eligible for this report.

[2] The MSRB also publishes a "Daily Comprehensive Report," providing details of all municipal securities transactions that were effected during the trading day one week earlier. The Daily Comprehensive Report is available by subscription for $2,000 per year. Along with trades in issues that are not "frequently traded," this report includes transactions reported to the MSRB late, inter-dealer trades compared after trade date, and transaction data corrected by dealers after trade date.

[3] A dealer may call the MSRB at (703) 797-6600 and ask to speak with a Transaction Reporting Assistant who can check to see if its firm is signed up for this free service.

[4] A complete description of the service is available at www.msrb.org in the Municipal Price Reporting / Transaction Reporting System section. NASD also has informed dealers of this service in "Municipal Transaction Reporting Compliance Information," *Regulatory and Compliance Alert* (Summer 2002).

[5] Under NSCC procedures, no buy-side trade report should be submitted for comparison against a syndicate "takedown" trade submitted by the syndicate manager. Syndicate transactions are "one-sided submissions" and compare automatically after being submitted by the syndicate manager. Paragraph (a) (ii) of Rule G-14 Procedures thus requires that only the syndicate manager submit the trade.

[6] The EBS statistics reflect the aggregate number of such errors found in transaction data submitted by a particular NSCC member firm for itself and/or for its correspondents. This statistic cannot be generated individually for each correspondent because the EBS needed to identify the correspondent is itself missing or invalid. EBS statistics only measure the validity of the input the submitter provides to identify its own side of the trade and do not measure the accuracy with which a dealer uses EBSs to identify its contra-parties.

[7] In 1994, the MSRB stated that, "introducing brokers share the responsibility for complying with [Rule G-12(f)] with their clearing brokers. Introducing brokers who fail to submit transaction information in a timely and accurate manner could subject either or both parties to enforcement action for violating [Rule G-12(f)]." *See* "Enforcement Initiative," *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 35. NASD has since reiterated this policy; *see* the following articles in *Regulatory and Compliance Alert*: "Introducing Firm Responsibility When Reporting Municipal Trades Through Service Bureaus and Clearing Firms" (Winter 2000) and "Municipal Securities Transaction Reporting Compliance Information" (Spring 2001).

[8] As explained above, one of the problems often associated with stamped advisories is that the EBS on transaction records may be missing or inaccurate. Since a clearing broker may have many correspondents, stamping an advisory can make it impossible for market regulators to know which correspondent actually effected the trade.

[9] Of course, if the initial information reported to the MSRB, such as total par value, is changed, the trade record must be amended to make it correct.

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See also:

Rule G-12 Interpretation – Locked-In Transactions, March 1, 2001.

– Notice on Reporting and Comparison of Certain Transactions Effected by Investment Advisors, May 23, 2003.

– Transaction Reporting of Multiple Transactions Between Dealers in the Same Issue, November 24, 2003.

## Rule G-15: Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers

(a) *Customer Confirmations.*

(i) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation that complies with the requirements of this paragraph (i):

(A) Transaction information. The confirmation shall include information regarding the terms of the transaction as set forth in this subparagraph (A):

(1) The parties, their capacities, and any remuneration from other parties. The following information regarding the parties to the transaction and their relationship shall be included:

(a) name, address, and telephone number of the broker, dealer, or municipal securities dealer, provided, however, that the address and telephone number need not be stated on a confirmation sent through the automated confirmation facilities of a clearing agency registered with the Securities and Exchange Commission;

(b) name of customer;

(c) designation of whether the transaction was a purchase from or sale to the customer;

(d) the capacity in which the broker, dealer or municipal securities dealer effected the transaction, whether acting:

(i) as principal for its own account,

(ii) as agent for the customer,

(iii) as agent for a person other than the customer, or

(iv) as agent for both the customer and another person;

(e) if the broker, dealer or municipal securities dealer is effecting a transaction as agent for the customer or as agent for both the customer and another person, the confirmation shall include: (i) either (A) the name of the person from whom the securities were purchased or to whom the securities were sold for the customer, or (B) a statement that this information will be furnished upon the written request of the customer; and (ii) either (A) the source and amount of any remuneration received or to be received (shown in aggregate dollar amount) by the broker, dealer or municipal securities dealer in connection with the transaction from any person other than the customer, or (B) a statement indicating whether any such remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of the customer. In applying the terms of this subparagraph (A)(1)(e), if a security is acquired at a discount (*e.g.*, "net" price less concession) and is sold at a "net" price to a customer, the discount must be disclosed as remuneration received from the customer pursuant to subparagraph (A)(6)(f) of this paragraph rather than as remuneration received from "a person other than the customer."

(2) Trade date and time of execution. The trade date shall be shown. In addition, either (a) the time of execution, or (b) a statement that the time of execution will be furnished upon written request of the customer shall be shown.

(3) Par value. The par value of the securities shall be shown, with special requirements for the following securities:

(a) Zero coupon securities. For zero coupon securities, the maturity value of the securities must be shown if it differs from the par value.

(b) Municipal fund securities. For municipal fund securities, in place of par value, the confirmation shall show (i) in the case of a purchase of a municipal fund security by a customer, the total purchase price paid by the customer, exclusive of any commission, and (ii) in the case of a sale or tender for redemption of a municipal fund security by a customer, the total sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.

(4) Settlement date. The settlement date as defined in section (b) of this rule shall be shown.

(5) Yield and dollar price. Yields and dollar prices shall be computed and shown in the following manner, subject to the exceptions stated in subparagraph (A)(5)(d) of this paragraph:

(a) For transactions that are effected on the basis of a yield to maturity, yield to a call date, or yield to

a put date:

(i) The yield at which the transaction was effected shall be shown and, if that yield is to a call date or to a put date, this shall be noted, along with the date and dollar price of the call or put.

(ii) A dollar price shall be computed and shown in accordance with the rules in subparagraph (A)(5)(c) of this paragraph, and such dollar price shall be used in computations of extended principal and final monies shown on the confirmation.

(b) For transactions that are effected on the basis of a dollar price:

(i) The dollar price at which the transaction was effected shall be shown.

(ii) A yield shall be computed and shown in accordance with subparagraph (A)(5)(c) of this paragraph, unless the transaction was effected at "par."

(c) In computing yield and dollar price, the following rules shall be observed:

(i) The yield or dollar price computed and shown shall be computed to the lower of call or nominal maturity date, with the exceptions noted in this subparagraph (A)(5)(c).

(ii) For purposes of computing yield to call or dollar price to call, only those call features that represent "in whole calls" of the type that may be used by the issuer without restriction in a refunding ("pricing calls") shall be considered in computations made under this subparagraph (A)(5).

(iii) Yield computations shall take into account dollar price concessions granted to the customer, commissions charged to the customer and adjustable tender fees applicable to puttable securities, but shall not take into account incidental transaction fees or miscellaneous charges, provided, however, that as specified in subparagraph (A)(6)(e) of this paragraph, such fees or charges must be indicated on the confirmation.

(iv) With respect to the following specific situations, these additional rules shall be observed:

(A) Declining premium calls. For those securities subject to a series of pricing calls at declining premiums, the call date resulting in the lowest yield or dollar price shall be considered the yield to call or dollar price to call.

(B) Continuously callable securities. For those securities that, at the time of trade, are subject to a notice of a pricing call at any time, the yield to call or dollar price to call shall be computed based upon the assumption that a notice of call may be issued on the day after trade date or on any subsequent date.

(C) Mandatory tender dates. For those securities subject to a mandatory tender date, the mandatory tender date and dollar price of redemption shall be used in computations in lieu of nominal maturity date and maturity value.

(D) Securities sold on basis of yield to put. For those transactions effected on the basis of a yield to put date, the put date and dollar price of redemption shall be used in computations in lieu of maturity date and maturity value.

(E) Prerefunded or called securities. For those securities that are prerefunded or called to a call date prior to maturity, the date and dollar price of redemption set by the prerefunding shall be used in computations in lieu of maturity date and maturity value.

(v) Computations shall be made in accordance with the requirements of rule G-33.

(vi) If the computed yield or dollar price shown on the confirmation is not based upon the nominal maturity date, then the date used in the computation shall be identified and stated. If the computed yield or dollar price is not based upon a redemption value of par, the dollar price used in the computation shall be shown (*e.g.*, 5.00% yield to call on 1/1/99 at 103).

(vii) If the computed yield required by this paragraph (5) is different than the yield at which the transaction was effected, the computed yield must be shown in addition to the yield at which the transaction was effected.

(d) Notwithstanding the requirements noted in subparagraphs (A)(5)(a) through (c) of this paragraph above:

(i) Securities that prepay principal. For securities that prepay principal periodically, a yield computation and display of yield is not required, provided, however, that if a yield is displayed, there shall

be included a statement describing how the yield was computed.

(ii) Municipal Collateralized Mortgage Obligations. For municipal collateralized mortgage obligations, a yield computation and display of yield is not required, provided however, that if a yield is displayed, there shall be included a statement describing how the yield was computed.

(iii) Defaulted securities. For securities that have defaulted in the payment of interest or principal, a yield shall not be shown.

(iv) Variable rate securities. For municipal securities with a variable interest rate, a yield shall not be shown unless the transaction was effected on the basis of yield to put.

(v) Securities traded on a discounted basis. For securities traded on a discounted basis, a yield shall not be shown.

(vi) Municipal fund securities. For municipal fund securities, neither yield nor dollar price shall be shown.

(6) Final Monies. The following information relating to the calculation and display of final monies shall be shown:

(a) total dollar amount of transaction;

(b) amount of accrued interest, with special requirements for the following securities:

(i) Zero coupon securities. For zero coupon securities, no figure for accrued interest shall be shown;

(ii) Securities traded on discounted basis. For securities traded on a discounted basis (other than discounted securities traded on a yield-equivalent basis), no figure for accrued interest shall be shown;

(iii) Municipal fund securities. For municipal fund securities, no figure for accrued interest shall be shown;

(c) if the securities pay interest on a current basis but are traded without interest, a notation of "flat";

(d) extended principal amount, with special requirements for the following securities:

(i) Securities traded on discounted basis. For securities traded on a discounted basis (other than discounted securities sold on a yield-equivalent basis) total dollar amount of discount may be shown in lieu of the resulting dollar price and extended principal amount;

(ii) Municipal fund securities. For municipal fund securities, no extended principal amount shall be shown;

(e) the nature and amount of miscellaneous fees, such as special delivery arrangements or a "per transaction" fee, or if agreed to, any fees for converting registered certificates to or from bearer form;

(f) if the broker, dealer or municipal securities dealer is effecting the transaction as agent for the customer or as agent for both the customer and another person, the amount of any remuneration received or to be received (shown in aggregate dollar amount) by the broker, dealer or municipal securities dealer from the customer in connection with the transaction unless remuneration paid by the customer is determined, pursuant to a written agreement with the customer, other than on a transaction basis;

(g) the first interest payment date if other than semi-annual, but only if necessary for the calculation of final money;

(h) for callable zero coupon securities, if applicable, the percentage of the purchase price at risk due to the lowest possible call, which shall be calculated based upon the ration between (i) the difference between the price paid by the customer and the lowest possible call price, and (ii) the price paid to the customer.

(7) Delivery of securities. The following information regarding the delivery of securities shall be shown:

(a) Securities other than bonds or municipal fund securities. For securities other than bonds or municipal fund securities, denominations to be delivered;

(b) Bond certificates delivered in non-standard denominations. For bonds, denominations of certificates to be delivered shall be stated if:

(i) for bearer bonds, denominations are other than $1,000 or $5,000 in par value, and

(ii) for registered bonds, denominations are other than multiples of $1,000 par value, or exceed $100,000 par value;

(c) Municipal fund securities. For municipal fund securities, the purchase price, exclusive of commsion,

of each share or unit and the number of shares or units to be delivered;

(d) Delivery instructions. Instructions if available, regarding receipt or delivery of securities, and form of payment if other than as usual and customary between the parties.

(8) Additional information about the transaction. In addition to the transaction information required above, such other information as may be necessary to ensure that the parties agree to details of the transaction also shall be shown.

(B) Securities identification information. The confirmation shall include a securities identification which includes, at a minimum:

(1) the name of the issuer, with special requirements for the following securities:

(a) Stripped coupon securities. For stripped coupon securities, the trade name and series designation assigned to the stripped coupon municipal security by the broker, dealer or municipal securities dealer sponsoring the program must be shown;

(b) Municipal fund securities. For municipal fund securities, the name used by the issuer to identify such securities and, to the extent necessary to differentiate the securities from other municipal fund securities of the issuer, any separate program series, portfolio or fund designation for such securities must be shown;

(2) CUSIP number, if any, assigned to the securities;

(3) maturity date, if any, with special requirements for the following securities:

(a) Stripped coupon securities. For stripped coupon securities, the maturity date of the instrument must be shown in lieu of the maturity date of the underlying securities;

(b) Municipal fund securities. For municipal fund securities, no maturity date shall be shown;

(4) interest rate, if any, with special requirements for the following securities:

(a) Zero coupon securities. For zero coupon securities, the interest rate must be shown as 0%;

(b) Variable rate securities. For securities with a variable or floating interest rate, the interest rate must be shown as "variable;" provided however if the yield is computed to put date or to mandatory tender date, the interest rate used in that calculation shall be shown.

(c) Securities with adjustable tender fees. If the net interest rate paid on a tender option security is affected by an adjustable "tender fee," the stated interest rate must be shown as that of the underlying security with the phrase "less fee for put;"

(d) Stepped coupon securities. For stepped coupon securities, the interest rate currently being paid must be shown;

(e) Stripped coupon securities. For stripped coupon securities, the interest rate actually paid on the instrument must be shown in lieu of interest rate on underlying security;

(f) Municipal fund securities. For municipal fund securities, no interest rate shall be shown;

(5) the dated date if it affects the price or interest calculation, with special requirements for the following securities:

(a) Stripped coupon securities. For stripped coupon securities, the date that interest begins accruing to the custodian for payment to the beneficial owner shall be shown in lieu of the dated date of the underlying securities. This date, along with the first date that interest will be paid to the owner, must be stated on the confirmation whenever it is necessary for calculation of price or accrued interest.

(C) Securities descriptive information. The confirmation shall include descriptive information about the securities which includes, at a minimum:

(1) Credit backing. The following information, if applicable, regarding the credit backing of the security:

(a) Revenue securities. For revenue securities, a notation of that fact, and a notation of the primary source of revenue (*e.g.*, project name). This subparagraph will be satisfied if these designations appear on the confirmation in the formal title of the security or elsewhere in the securities description.

(b) Securities with additional credit backing. The name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown and, if a letter of credit is used, the identity of the bank issuing the letter of credit must be noted.

(2) Features of the securities. The following information, if applicable, regarding features of the securities:

(a) Callable securities. If the securities are subject to call prior to maturity through any means, a notation of "callable" shall be included. This shall not be required if the only call feature applicable to the securities is a "catastrophe" or "calamity" call feature, such as one relating to an event such as an act of God or eminent domain, and which event is beyond the control of the issuer of the securities. The date and price of the next pricing call shall be included and so designated. Other specific call features are not required to be listed unless required by subparagraph (A)(5)(c)(ii) of this paragraph on computation and display of price and yield. If any specific call feature is listed even though not required by this rule, it shall be identified. If there are any call features in addition to the next pricing call, disclosure must be made on the confirmation that "additional call features exist that may affect yield; complete information will be provided upon request;"

(b) Puttable securities. If the securities are puttable by the customer, a designation to that effect;

(c) Stepped coupon securities. If stepped coupon securities, a designation to that effect;

(d) Book-entry only securities. If the securities are available only in book entry form, a designation to that effect;

(e) Periodic interest payment. With respect to securities that pay interest on other than a semi-annual basis, a statement of the basis on which interest is paid;

(3) Information on status of securities. The following information, as applicable, regarding the status of the security shall be included:

(a) Prerefunded and called securities. If the securities are called or "prerefunded," a designation to such effect, the date of maturity which has been fixed by the call notice, and the amount of the call price.

(b) Escrowed to maturity securities. If the securities are advance refunded to maturity date and no call feature (with the exception of a sinking fund call) is explicitly reserved by the issuer, the securities must be described as "escrowed to maturity" and, if a sinking fund call is operable with respect to the securities, additionally described as "callable."

(c) Advanced refunded/callable securities. If advanced refunded securities have an explicitly reserved call feature other than a sinking fund call, the securities shall be described as "escrowed to [redemption date]—callable."

(d) Advanced refunded/stripped coupon securities. If the municipal securities underlying stripped coupon securities are advance-refunded, the stripped coupon securities shall be described as "escrowed-to-maturity," or "pre-refunded" as applicable.

(e) Securities in default. If the securities are in default as to the payment of interest or principal, they shall be described as "in default;"

(f) Unrated securities. If the security is unrated by a nationally recognized statistical rating organization, a disclosure to such effect.

(4) Tax information. The following information that may be related to the tax treatment of the security:

(a) Taxable securities. If the securities are identified by the issuer or sold by the underwriter as subject to federal taxation, a designation to that effect.

(b) Alternative minimum tax securities. If interest on the securities is identified by the issuer or underwriter as subject to the alternative minimum tax, a designation to that effect.

(c) Original issue discount securities. If the securities pay periodic interest and are sold by the underwriter as original issue discount securities, a designation that they are "original issue discount" securities and a statement of the initial public offering price of the securities, expressed as a dollar price.

(5) Municipal fund securities. For municipal fund securities, the information described in clauses (1) through (4) of this subparagraph (C) is not required to be shown.

(D) Disclosure statements:

(1) The confirmation for zero coupon securities shall include a statement to the effect that "No periodic payments," and, if applicable, "callable below maturity value," and, if callable and available in bearer form, "callable without notice by mail to holder unless registered."

(2) The confirmation for municipal collateralized mortgage obligations shall include a statement indicating that the actual yield of such security may vary according to the rate at which the underlying receivables or

other financial assets are prepaid and a statement that information concerning the factors that affect yield (including at a minimum estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon written request.

(3) The confirmation for securities for which a deferred commission or other charge is imposed upon redemption or as a condition for payment of principal or interest thereon shall include a statement that the customer may be required to make a payment of such deferred commission or other charge upon redemption of such securities or as a condition for payment of principal or interest thereon, as appropriate, and that information concerning such deferred commission or other charge will be furnished upon written request.

(E) Confirmation format. All requirements must be clearly and specifically indicated on the front of the confirmation, except that the following statements may be on the reverse side of the confirmation:

(1) The disclosure statements required in subparagraph (D)(1), (D)(2) or (D)(3) of this paragraph, provided that their specific applicability is noted on the front of the confirmation.

(2) The statement concerning the person from whom the securities were purchased or to whom the securities were sold that can be provided in satisfaction of subparagraph (A)(1)(e)(i) of this paragraph.

(3) The statement concerning time of execution that can be provided in satisfaction of subparagraph (A)(2) of this paragraph.

(ii) Separate confirmation for each transaction. Each broker, dealer or municipal securities dealer for each transaction in municipal securities shall give or send to the customer a separate written confirmation in accordance with the requirements of (i) above. Multiple confirmations may be printed on one page, provided that each transaction is clearly segregated and the information provided for each transaction complies with the requirements of (i) above; provided, however, that if multiple confirmations are printed in a continuous manner within a single document, it is permissible for the name and address of the broker, dealer or municipal securities dealer and the customer to appear once at the beginning of the document, rather than being included in the confirmation information for each transaction.

(iii) "When, as and if issued" transactions. A confirmation meeting the requirements of this rule shall be sent in all "when, as and if issued" transactions. In addition, a broker, dealer or municipal securities dealer may send a confirmation for a "when, as and if issued" transaction executed prior to determination of settlement date and may be required to do so for delivery vs. payment and receipt vs. payment ("DVP/RVP") accounts under paragraph (d)(i)(C) of this rule. If such a confirmation is sent, it shall include all information required by this section with the exception of settlement date, dollar price for transactions executed on a yield basis, yield for transactions executed on a dollar price, total monies, accrued interest, extended principal and delivery instructions.

(iv) Confirmations to customers who tender put option bonds or municipal fund securities. A broker, dealer, or municipal securities dealer that has an interest in put option bonds (including acting as remarketing agent) and accepts for tender put option bonds from a customer, or that has an interest in municipal fund securities (including acting as agent for the issuer thereof) and accepts for redemption municipal fund securities tendered by a customer, is engaging in a transaction in such municipal securities and shall send a confirmation under paragraph (i) of this section.

(v) Timing for providing information. Information requested by a customer pursuant to statements required on the confirmation shall be given or sent to the customer within five business days following the date of receipt of a request for such information; provided however, that in the case of information relating to a transaction executed more than 30 calendar days prior to the date of receipt of a request, the information shall be given or sent to the customer within 15 business days following the date of receipt of the request.

(vi) Definitions. For purposes of this rule, the following terms shall have the following meanings:

(A) Execution of a transaction. The term "the time of execution of a transaction" shall be the time of execution reflected in the records of the broker, dealer or municipal securities dealer pursuant to rule G-8 or Rule 17a-3 under the Act.

(B) Completion of transaction. The term "completion of transaction" shall have the same meaning as provided in Rule 15c1-1 under the Act.

(C) Stepped coupon securities. The term "stepped coupon securities" shall mean securities with the interest rate periodically changing on a pre-established schedule.

(D) Zero coupon securities. The term "zero coupon securities" shall mean securities maturing in more than two years and paying investment return solely at redemption.

(E) Stripped coupon securities. The term "stripped coupon securities" shall have the same meaning as in SEC staff letter dated January 19, 1989 (Stripped Coupon Municipal Securities, SEC No-Action Letter, Fed. Sec. L. Rep. (CCH) ¶ 78,949 (Jan. 19, 1989), reprinted in *MSRB Reports*, Vol. 9, No. 1 (March 1989) at 6-7.

(F) The term "pricing call" shall mean a call feature that represents "an in whole call" of the type that may be used by the issuer without restriction in a refunding.

(G) The term "periodic municipal fund security plan" shall mean any written authorization or arrangement for a broker, dealer or municipal securities dealer, acting as agent, to purchase, sell or redeem for a customer or group of customers one or more specific municipal fund securities, in specific amounts (calculated in security units or dollars), at specific time intervals and setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them).

(H) The term "non-periodic municipal fund security program" shall mean any written authorization or arrangement for a broker, dealer or municipal securities dealer, acting as agent, to purchase, sell or redeem for a customer or group of customers one or more specific municipal fund securities, setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them) and either (1) providing for the purchase, sale or redemption of such municipal fund securities at the direction of the customer or customers or (2) providing for the purchase, sale or redemption of such municipal fund securities at the direction of the customer or customers as well as authorizing the purchase, sale or redemption of such municipal fund securities in specific amounts (calculated in security units or dollars) at specific time intervals.

(vii) Price substituted for par value of municipal fund securities. For purposes of this rule, each reference to the term "par value," when applied to a municipal fund security, shall be substituted with (i) in the case of a purchase of a municipal fund security by a customer, the purchase price paid by the customer, exclusive of any commission, and (ii) in the case of a sale or tender for redemption of a municipal fund security by a customer, the sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.

(viii) Alternative periodic reporting for certain transactions in municipal fund securities. Notwithstanding any other provision of this section (a), a broker, dealer or municipal securities dealer may effect transactions in municipal fund securities with customers without giving or sending to such customer the written confirmation required by paragraph (i) of this section (a) at or before completion of each such transaction if:

(A) such transactions are effected pursuant to a periodic municipal fund security plan or a non-periodic municipal fund security program; and

(B) such broker, dealer or municipal securities dealer gives or sends to such customer within five business days after the end of each quarterly period, in the case of a customer participating in a periodic municipal fund security plan, or each monthly period, in the case of a customer participating in a non-periodic municipal fund security program, a written statement disclosing, for each purchase, sale or redemption effected for or with, and each payment of investment earnings credited to or reinvested for, the account of such customer during the reporting period, the information required to be disclosed to customers pursuant to subparagraphs (A) through (D) of paragraph (i) of this section (a), with the information regarding each transaction clearly segregated; provided that it is permissible:

(1) for the name and address of the broker, dealer or municipal securities dealer and the customer to appear once at the beginning of the periodic statement; and

(2) for information required to be included pursuant to subparagraph (A)(1)(d), (A)(2)(a) or (D)(3) of paragraph (i) of this section (a) to:

(a) appear once in the periodic statement if such information is identical for all transactions disclosed in such statement; or

(b) be omitted from the periodic statement, but only if such information previously has been delivered to the customer in writing and the periodic statement includes a statement indicating that such information has been provided to the customer and identifying the document in which such information appears; and

(C) in the case of a periodic municipal fund security plan that consists of an arrangement involving a group of two or more customers and contemplating periodic purchases of municipal fund securities by each customer through a person designated by the group, such broker, dealer or municipal securities dealer:

(1) gives or sends to the designated person, at or before the completion of the transaction for the purchase of such municipal fund securities, a written notification of the receipt of the total amount paid by the group;

(2) sends to anyone in the group who was a customer in the prior quarter and on whose behalf payment has not been received in the current quarter a quarterly written statement reflecting that a payment was not received on such customer's behalf; and

(3) advises each customer in the group if a payment is not received from the designated person on behalf of the group within 10 days of a date certain specified in the arrangement for delivery of that payment by the

designated person and either (a) thereafter sends to each customer the written confirmation described in paragraph (i) of this section (a) for the next three succeeding payments, or (b) includes in the quarterly statement referred to in subparagraph (B) of this paragraph (viii) each date certain specified in the arrangement for delivery of a payment by the designated person and each date on which a payment received from the designated person is applied to the purchase of municipal fund securities; and

(D) such customer is provided with prior notification in writing disclosing the intention to send the written information referred to in subparagraph (B) of this paragraph (viii) on a periodic basis in lieu of an immediate confirmation for each transaction; and

(E) such customer has consented in writing to receipt of the written information referred to in subparagraph (B) of this paragraph (viii) on a periodic basis in lieu of an immediate confirmation for each transaction; provided, however, that such customer consent shall not be required if:

(1) the customer is not a natural person;

(2) the customer is a natural person who participates in a periodic municipal fund security plan described in subparagraph (C) of this paragraph (viii); or

(3) the customer is a natural person who participates in a periodic municipal fund security plan (other than a plan described in subparagraph (C) of this paragraph (viii)) or a non-periodic municipal fund security program and the issuer has consented in writing to the use by the broker, dealer or municipal securities dealer of the periodic written information referred to in subparagraph (B) of this paragraph (viii) in lieu of an immediate confirmation for each transaction with each customer participating in such plan or program.

(b) *Settlement Dates.*

(i) Definitions. For purposes of this rule, the following terms shall have the following meanings:

(A) Settlement Date. The term "settlement date" shall mean the day used in price and interest computations, which shall also be the day delivery is due unless otherwise agreed by the parties.

(B) Business Day. The term "business day" shall mean a day recognized by the National Association of Securities Dealers, Inc. as a day on which securities transactions may be settled.

(ii) Settlement Dates. Settlement dates shall be as follows:

(A) for "cash" transactions, the trade date;

(B) for "regular way" transactions, the third business day following the trade date;

(C) for all other transactions, a date agreed upon by both parties; *provided, however*, that a broker, dealer or municipal securities dealer shall not effect or enter into a transaction for the purchase or sale of a municipal security (other than a "when, as and if issued" transaction) that provides for payment of funds and delivery of securities later than the third business day after the date of the transaction unless expressly agreed to by the parties, at the time of the transaction.

(c) *Deliveries to Customers.* Except as provided in section (d) below, a delivery of securities by a broker, dealer, or municipal securities dealer to a customer or to another person acting as agent for the customer shall, unless otherwise agreed by the parties or otherwise specified by the customer, be made in accordance with the following provisions:

(i) Securities Delivered.

(A) All securities delivered on a transaction shall be identical as to the applicable information set forth in section (a) of this rule. All securities delivered shall also be identical as to the call provisions and the dated date of such securities.

(B) CUSIP Numbers.

(1) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of section (a) of this rule; provided, however, that for purposes of this item (1), a security shall be deemed to have the same CUSIP number as that specified on the confirmation (a) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (b) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security.

(2) A new issue security delivered by an underwriter who is subject to the provisions of rule G-34 shall have the CUSIP number assigned to the security imprinted on or otherwise affixed to the security.

(ii) Delivery Ticket. A delivery ticket shall accompany the delivery of securities. Such ticket shall contain the information set forth in section (a) of this rule.

(iii) Units of Delivery. Delivery of bonds shall be made in the following denominations:

(A) for bearer bonds, in denominations of $1,000 or $5,000 par value; and

(B) for registered bonds, in denominations which are multiples of $1,000 par value, up to $100,000 par value.

Delivery of other municipal securities shall be made in the denominations specified on the confirmation as required pursuant to section (a) of this rule.

(iv) Form of Securities.

(A) Bearer and Registered Form. Delivery of securities which are issuable in both bearer and registered form may be in bearer form unless otherwise agreed by the parties; provided, however, that delivery of securities which are required to be in registered form in order for interest thereon to be exempted from Federal income taxation shall be in registered form.

(B) Book-Entry Form. Notwithstanding the other provisions of this section (c), a delivery of a book-entry form security shall be made only by a book-entry transfer of the ownership of the security to the purchasing customer or a person designated by the purchasing customer. For purposes of this subparagraph a "book-entry form" security shall mean a security which may be transferred only by bookkeeping entry, without the issuance or physical delivery of securities certificates, on books maintained for this purpose by a registered clearing agency or by the issuer or a person acting on behalf of the issuer.

(v) Mutilated Certificates. Delivery of a certificate which is damaged to the extent that any of the following is not ascertainable:

(A) name of issuer;

(B) par value;

(C) signature;

(D) coupon rate;

(E) maturity date;

(F) seal of the issuer; or

(G) certificate number

shall not constitute good delivery unless validated by the trustee, registrar, transfer agent, paying agent or issuer of the securities or by an authorized agent or official of the issuer.

(vi) Coupon Securities.

(A) Coupon securities shall have securely attached to the certificate in the correct sequence all appropriate coupons, including supplemental coupons if specified at the time of trade, which in the case of securities upon which interest is in default shall include all unpaid or partially paid coupons. All coupons attached to the certificates must have the same serial number as the certificate.

(B) Anything herein to the contrary notwithstanding, if securities are traded "and interest" and the settlement date is on or after the interest payment date, such securities shall be delivered without the coupon payable on such interest payment date.

(C) If delivery of securities is made on or after the thirtieth calendar day prior to an interest payment date, the seller may deliver to the purchaser a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, in an amount equal to the interest due, in lieu of the coupon.

(vii) Mutilated or Cancelled Coupons. Delivery of a certificate which bears a coupon which is damaged to the extent that any one of the following cannot be ascertained from the coupon:

(A) title of the issuer;

(B) certificate number;

(C) coupon number or payment date (if either the coupon number or the payment date is ascertainable from the coupon, the coupon will not be considered mutilated); or

(D) the fact that there is a signature;

or which coupon has been cancelled, shall not constitute good delivery unless the coupon is endorsed or guaranteed. In the case of damaged coupons, such endorsement or guarantee must be by the issuer or by a commercial bank. In the case of cancelled coupons, such endorsement or guarantee must be by the issuer or an authorized agent or official of the issuer,

or by the trustee or paying agent.

(viii) Delivery of Certificates Called for Redemption.

(A) A certificate for which a notice of call applicable to less than the entire issue of securities has been published on or prior to the delivery date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

(B) A certificate for which a notice of call applicable to the entire issue of securities has been published on or prior to the trade date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

(C) For purposes of this paragraph (viii) the term "entire issue of securities" shall mean securities of the same issuer having the same date of issue, maturity date and interest rate.

(ix) Delivery Without Legal Opinions or Other Documents. Delivery of certificates without legal opinions or other documents legally required to accompany the certificates shall not constitute good delivery unless identified as "ex legal" at the time of trade.

(x) Insured Securities. Delivery of certificates for securities traded as insured securities shall be accompanied by evidence of such insurance, either on the face of the certificate or in a document attached to the certificate.

(xi) Endorsements for Banking or Insurance Requirements. A security bearing an endorsement indicating that it was deposited in accordance with legal requirements applicable to banking institutions or insurance companies shall not constitute good delivery unless it bears a release acknowledged before an officer authorized to take such acknowledgments and was designated as a released endorsed security at the time of trade.

(xii) Delivery of Registered Securities.

(A) Delivery to the Customer. Registered securities delivered directly to a customer shall be registered in the customer's name or in such name as the customer shall direct.

(B) Delivery to an Agent of the Customer. Registered securities delivered to an agent of a customer may be registered in the customer's name or as otherwise directed by the customer. If such securities are not so registered, such securities shall be delivered in accordance with the following provisions:

(1) Assignments. Delivery of a certificate in registered form must be accompanied by an assignment on the certificate or on a separate bond power for such certificate, containing a signature or signatures which correspond in every particular with the name or names written upon the certificate, except that the following shall be interchangeable: "and" or "&"; "Company" or "Co."; "Incorporated" or "Inc."; and "Limited" or "Ltd."

(2) Detached Assignment Requirements. A detached assignment shall provide for the irrevocable appointment of an attorney, with power of substitution, a full description of the security, including the name of the issuer, the maturity date and interest date, the bond or note number, and the par value (expressed in words and numerals).

(3) Power of Substitution. When the name of an individual or firm has been inserted in an assignment as attorney, a power of substitution shall be executed in blank by such individual or firm. When the name of an individual or firm has been inserted in a power of substitution as a substitute attorney, a new power of substitution shall be executed in blank by such substitute attorney.

(4) Guarantee. Each assignment, endorsement, alteration and erasure shall bear a guarantee acceptable to the transfer agent or registrar.

(5) Form of Registration. Delivery of a certificate accompanied by the documentation required in this subparagraph (B) shall constitute good delivery if the certificate is registered in the name of:

(a) an individual or individuals;

(b) a nominee;

(c) a member of a national securities exchange whose specimen signature is on file with the transfer agent or any other broker, dealer or municipal securities dealer who has filed specimen signatures with the transfer agent and places a statement to this effect on the assignment; or

(d) an individual or individuals acting in a fiduciary capacity.

(6) Certificate in Legal Form. Good transfer of a security in legal form shall be determined only by the transfer agent for the security. Delivery of a certificate in legal form shall not constitute good delivery unless the certificate is identified as being in such form at the time of trade. A certificate shall be considered to be in legal

form if documentation in addition to that specified in this subparagraph (B) is required to complete a transfer of the securities.

(C) Payment of Interest. If a registered security is traded "and interest" and transfer of record ownership cannot be or has not been accomplished on or before the record date for the determination of registered holders for the payment of interest, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, for the amount of the interest.

(D) Registered Securities In Default. If a registered security is in default (i.e., is in default in the payment of principal or interest) and transfer of record ownership cannot be or has not been accomplished on or before the record date for the determination of registered holders for the payment of interest, an interest payment date having been established on or after the trade date, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, for the amount of the payment to be made by the issuer, unless the security is traded "ex-interest."

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

(i) No broker, dealer or municipal securities dealer shall execute a transaction with a customer pursuant to an arrangement whereby payment for securities received (RVP) or delivery against payment of securities sold (DVP) is to be made to or by an agent of the customer unless all of the following procedures are followed:

(A) the broker, dealer or municipal securities dealer shall have received from the customer prior to or at the time of accepting such order, the name and address of the agent and the name and account number of the customer on file with the agent;

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

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

(D) the broker, dealer or municipal securities dealer shall have obtained a representation from the customer (1) that the customer will furnish the agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly and in a manner to assure that settlement will occur on settlement date, and (2) that, with respect to a transaction subject to the provisions of paragraph (ii) below, the customer will furnish the agent such instructions in accordance with the rules of the registered clearing agency through whose facilities the transaction has been or will be confirmed.

(ii) Requirement for Confirmation/Acknowledgment.

(A) Use of Registered Clearing Agency or Qualified Vendor. Except as provided in this paragraph (ii) of rule G-15(d), 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 or Qualified Vendor 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:

(1) 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 Clearing Agency or Qualified Vendor;

(2) submit or cause to be submitted to a Clearing Agency or Qualified Vendor all information and instructions required by the Clearing Agency or Qualified Vendor for the production of a confirmation that can be acknowledged by the customer or the customer's clearing agent; and

(3) submit such transaction information to the automated confirmation/acknowledgment system on the date of execution of such transaction; provided that a transaction that is not eligible for automated confirmation and acknowledgment through the facilities of a Clearing Agency shall not be subject to this paragraph (ii).

(B) Definitions for Rule G-15(d)(ii).

(1) "Clearing Agency" shall mean a clearing agency as defined in Section 3(a)(23) of the Act that is registered with the Commission pursuant to Section 17A(b)(2) of the Act or has obtained from the Commission an exemption from registration granted specifically to allow the clearing agency to provide confirmation/acknowledgment services.

(2) "Qualified Vendor" shall mean a vendor of electronic confirmation and acknowledgment services that:

(a) for each transaction subject to this rule: (i) delivers a trade record to a Clearing Agency in the Clearing Agency's format; (ii) obtains a control number for the trade record from the Clearing Agency; (iii) cross-references the control number to the confirmation and subsequent acknowledgment of the trade; and (iv) electronically delivers any acknowledgment received on the trade to the Clearing Agency and includes the control number when delivering the acknowledgment of the trade to the Clearing Agency;

(b) certifies to its customers: (i) with respect to its electronic trade confirmation/acknowledgment system, that it has a capacity requirements evaluation and monitoring process that allows the vendor to formulate current and anticipated estimated capacity requirements; (ii) that its electronic trade confirmation/acknowledgment system has sufficient capacity to process the volume of data that it reasonably anticipates to be entered into its electronic trade confirmation/acknowledgment service during the upcoming year; (iii) that its electronic trade confirmation/acknowledgment system has formal contingency procedures, that the entity has followed a formal process for reviewing the likelihood of contingency occurrences, and that the contingency protocols are reviewed, tested, and updated on a regular basis; (iv) that its electronic confirmation/acknowledgment system has a process for preventing, detecting, and controlling any potential or actual systems or computer operations failures, including any failure to interface with a Clearing Agency as described in rule G-15(d)(ii)(B)(2)(a), above, and that its procedures designed to protect against security breaches are followed; and (v) that its current assets exceed its current liabilities by at least five hundred thousand dollars;

(c) when it begins providing such services, and annually thereafter, submits an Auditor's Report to the Commission staff which is not deemed unacceptable by the Commission staff. (An Auditor's Report will be deemed unacceptable if it contains any findings of material weakness.);

(d) notifies the Commission staff immediately in writing of any material change to its confirmation/affirmation systems. (For purposes of this subparagraph (d) "material change" means any changes to the vendor's systems that significantly affect or have the potential to significantly affect its electronic trade confirmation/acknowledgment systems, including: changes that: (i) affect or potentially affect the capacity or security of its electronic trade confirmation/acknowledgment system; (ii) rely on new or substantially different technology; (iii) provide a new service as part of the Qualified Vendor's electronic trade confirmation/acknowledgment system; or (iv) affect or have the potential to adversely affect the vendor's confirmation/acknowledgment system's interface with a Clearing Agency.);

(e) notifies the Commission staff in writing if it intends to cease providing services;

(f) provides the Board with copies of any submissions to the Commission staff made pursuant to subparagraphs (c), (d), and (e) of this rule G-15(d)(ii)(B)(2) within ten business days; and

(g) promptly supplies supplemental information regarding its confirmation/acknowledgment system when requested by the Commission staff or the Board.

(3) "Auditor's Report" shall mean a written report which is prepared by competent, independent, external audit personnel in accordance with the standards of the American Institute of Certified Public Accountants and the Information Systems Audit and Control Association and which:

(a) verifies the certifications described in subparagraph (d)(ii)(B)(2)(B) of this rule G-15;

(b) contains a risk analysis of all aspects of the entity's information technology systems including, computer operations, telecommunications, data security, systems development, capacity planning and testing, and contingency planning and testing; and

(c) contains the written response of the entity's management to the information provided pursuant to (a) and (b) of this subparagraph (d)(ii)(B)(3) of rule G-15.

(C) Disqualification of Vendor. A broker, dealer or municipal securities dealer using a Qualified Vendor that ceases to be qualified under the definition in rule G-15(d)(ii)(B)(2) shall not be deemed in violation of this rule G-15(d)(ii) if it ceases using such vendor promptly upon receiving notice that the vendor is no longer qualified.

(iii) Notwithstanding the provisions of section (c) of this rule, no broker, dealer or municipal securities dealer shall effect a delivery vs. payment or receipt vs. payment (DVP/RVP) customer transaction that is eligible for book-entry settlement in a depository registered with the Securities and Exchange Commission (depository) unless the transaction is settled through the facilities of a depository or through the interface between the two depositories. Each broker, dealer and municipal securities dealer settling such 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 settle transactions in a depository; and (B) submit or cause to be submitted to a depository all information and instructions required from the broker, dealer or municipal securities dealer by the depository for book-entry settlement of the transaction to occur; provided that, if a party to a

DVP/RVP customer transaction has made arrangements, through its clearing agent or otherwise, to use one or more depositories exclusively, a transaction by that party shall not be subject to the requirements of this paragraph (iii) if the transaction is ineligible for settlement at all such depositories with which such arrangements have been made; and further provided that purchases made by trustees or issuers to retire securities shall not be subject to this paragraph (iii).

(e) *Interest Payment Claims*. A broker, dealer or municipal securities dealer that receives from a customer a claim for the payment of interest due the customer on securities previously delivered to (or by) the customer shall respond to the claim no later than 10 business days following the date of the receipt of the claim or 20 business days in the case of a claim involving an interest payment scheduled to be made more than 60 days prior to the date of the claim.

(f) *Minimum Denominations*.

(i) Except as provided in this section (f), a broker, dealer or municipal securities dealer shall not effect a customer transaction in municipal securities issued after June 1, 2002 in an amount lower than the minimum denomination of the issue.

(ii) The prohibition in subsection (f)(i) of this rule shall not apply to the purchase of securities from a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the customer's position in the issue already is below the minimum denomination and that the entire position would be liquidated by the transaction. In determining whether this is the case, a broker, dealer or municipal securities dealer may rely either upon customer account information in its possession or upon a written statement by the customer as to its position in an issue.

(iii) The prohibition in subsection (f)(i) of this rule shall not apply to the sale of securities to a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the securities position being sold is the result of a customer liquidating a position below the minimum denomination, as described in subsection (f)(ii) of this rule. In determining whether this is the case, a broker, dealer or municipal securities dealer may rely upon customer account records in its possession or upon a written statement provided by the party from which the securities are purchased. A broker, dealer or municipal securities dealer effecting a sale to a customer under this subsection (iii) shall at or before the completion of the transaction, give or send to the customer a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. Such written statement may be included on the customer's confirmation or may be provided on a document separate from the confirmation.

(g) *Forwarding Official Communications*.

(i) If a broker, dealer or municipal securities dealer receives an official communication to beneficial owners applicable to an issue of municipal securities that the broker, dealer or municipal securities dealer has in safekeeping along with a request to forward such official communication to the applicable beneficial owners, the broker, dealer or municipal securities dealer shall use reasonable efforts to promptly retransmit the official communication to the parties for whom it is safekeeping the issue.

(ii) In determining whether reasonable efforts have been made to retransmit official communications, the following considerations are relevant:

(A) *CUSIP Numbers*. If CUSIP numbers are included on or with the official communication to beneficial owners, the broker, dealer or municipal securities dealer shall use such CUSIP numbers in determining the issue(s) to which the official communication applies. If CUSIP numbers are not included on or with the official communication, the broker, dealer or municipal securities dealer shall use reasonable efforts to determine the issue(s) to which the official communication applies; *provided however*, that it shall not be a violation of this rule if, after reasonable efforts are made, the issue(s) to which the official communication applies are not correctly identified by the broker, dealer or municipal securities dealer.

(B) *Compensation*. A broker, dealer or municipal securities dealer shall not be required by this rule to retransmit official communications without an offer of adequate compensation. If compensation is explicitly offered in or with the official communication, the broker, dealer or municipal securities dealer shall effect the retransmission and seek compensation concurrently; *provided, however*, that if total compensation would be more than $500.00, the broker, dealer or municipal securities dealer may, in lieu of this procedure, promptly contact the party offering compensation, inform it of the amount of compensation required, obtain specific agreement on the amount of compensation and wait for receipt of such compensation prior to proceeding with the retransmission. In determining whether compensation is adequate, the broker, dealer or municipal securities dealer shall make reference to the suggested rates for similar document transmission services found in "Suggested Rates

of Reimbursement" for expenses incurred in forwarding proxy material, annual reports, information statements and other material referenced in NASD Conduct Rule 2260(g), taking into account revisions or amendments to such suggested rates as may be made from time to time.

(C) *Sufficient Copies of Official Communications*. A broker, dealer or municipal securities dealer is not required to provide duplication services for official communications but may elect to do so. If sufficient copies of official communications are not received, and the broker, dealer or municipal securities dealer elects not to offer duplication services, the broker, dealer or municipal securities dealer shall promptly request from the party requesting the forwarding of the official communication the correct number of copies of the official communication.

(D) *Non-Objecting Beneficial Owners*. In lieu of retransmitting official communications to beneficial owners who have indicated in writing that they do not object to the disclosure of their names and security positions, a broker, dealer or municipal securities dealer may instead promptly provide a list of such non-objecting beneficial owners and their addresses.

(E) *Beneficial Owners Residing Outside of the United States*. A broker, dealer or municipal securities dealer shall not be required to send official communications to persons outside of the United States of America, although brokers, dealers and municipal securities dealers may voluntarily do so.

(F) *Investment Advisors*. A broker, dealer or municipal securities dealer shall send official communications to the investment advisor for a beneficial owner, rather than to the beneficial owner, when the broker, dealer or municipal securities dealer has on file a written authorization for such documents to be sent to the investment advisor in lieu of the beneficial owner.

(iii) *Definitions*.

(A) The terms "official communication to beneficial owners" and "official communication," as used in this section (g), mean any document or collection of documents pertaining to a specific issue or issues of municipal securities that both:

(1) is addressed to beneficial owners and was prepared or authorized by: (a) an issuer of municipal securities; (b) a trustee for an issue of municipal securities in its capacity as trustee; (c) a state or federal tax authority; or (d) a custody agent for a stripped coupon municipal securities program in its capacity as custody agent; and

(2) contains official information about such issue or issues including, but not limited to, notices concerning monetary or technical defaults, financial reports, material event notices, information statements, or status or review of status as to taxability.

## BACKGROUND

Rule G-15 requires that a customer be sent a written confirmation containing information concerning the identity of the parties to the transaction, a description of the securities, the trade date, the settlement date, yield to maturity or dollar price, the capacity in which the firm or bank is acting, and other specified information. The rule requires that information on the time of execution and contra party identity in agency transactions be furnished within specified time periods upon written request of the customer (in lieu of being included on the confirmation).

## MSRB INTERPRETATIONS

### INTERPRETIVE NOTICE ON RULE G-12 ON UNIFORM PRACTICE AND RULE G-15 ON CUSTOMER CONFIRMATIONS

November 28, 1977

This notice addresses several questions that have arisen concerning Board rules G-12 and G-15. Board rule G-12 establishes uniform industry procedures for the processing, clearance, and settlement of transactions in municipal securities. ... Board rule G-15 requires municipal securities professionals to send written confirmations of transactions to customers, and specifies the information required to be set forth on the confirmation.

**Settlement Dates**

In order to establish uniform settlement dates for "regular way" transactions in municipal securities, rule G-12(b)(i)(B) defines the term "business day" as "a day recognized by the National Association of Securities Dealers, Inc. [the "NASD"] as a day on which securities transactions may be settled." The practice of the NASD has been to exclude from the category of "business day," any day widely designated as a legal bank holiday, and to notify the NASD membership accordingly. Such notices set forth the NASD's trade and settlement date schedules for periods which include a legal holiday.

**"Catastrophe" Call Features**

Rules G-12 and G-15 require that confirmations of transactions set forth a "description of the securities, including at a minimum... if the securities are subject to redemption prior to maturity (callable)... an indication to such effect..." (paragraphs G-12(c)(v)(E) and G-15(a)(v)[*]). Both rules also require that in transactions in callable securities effected on a yield basis, dollar price must be shown and "the calculation of dollar price shall be to the lower of price to call or price to maturity" (paragraphs

G-12(c)(v)(I) and G-15(a)(viii)[†]).

The references to "callable" securities and pricing to call in rules G-12 and G-15 do not refer to "catastrophe" call features, such as those relating to acts of God or eminent domain, which are beyond the control of the issuer of the securities.

[*][Currently codified at rule G-15(a)(i)(C)(2)(a).]

[†][Currently codified at rule G-15(a)(i)(A)(5).]

## Interpretive Notice on Confirmation Requirements

March 25, 1980

Rule G-12(c)(v)(E) requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including "...in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities...."

Rule G-15(a)(v)[*] imposes the identical requirement with respect to customer confirmations. The Board has recently received an inquiry regarding whether these provisions require confirmations of transactions in Los Angeles Department of Water and Power bonds to distinguish between bonds secured by revenues of the electric power system and bonds secured by revenues of the waterworks system.

The Board is of the view that, if securities of a particular issuer are secured by separate sources of revenue, the source of revenue of the securities involved in a transaction is a material element of the description of the securities which should be set forth on customer and inter-dealer confirmations. Confirmations of transactions in Los Angeles Department of Water and Power bonds must therefore indicate whether the securities are "electric revenue" or "water revenue" bonds.

[*][Currently codified at rule G-15(a)(i)(C)(1)(a).]

## Interpretive Notice Concerning Confirmation Disclosure Requirements Applicable to Variable-Rate Municipal Securities

December 10, 1980

The Municipal Securities Rulemaking Board has recently received inquiries concerning the application of the Board's confirmation disclosure requirements, which are contained in Board rules G-12 and G-15, to municipal securities with variable or "floating" interest rates.

Rule G-12(c)(v)(E)[*] requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including the interest rate. Rule G-15(a)(i)(E)[*] imposes the same requirement with respect to customer confirmations. The Board is of the view that these provisions require that the security description appearing on customer and inter-dealer confirmations for securities with variable interest rates include a clear indication that the interest rates are variable or "floating."

The Board also notes that due to the variability of the interest rates on these securities, it is not possible to derive a yield to a future call or maturity date. Therefore, the Board has concluded that the provision of rule G-15 which requires that customer confirmations for transactions effected at a dollar price set forth the yield resulting from such dollar price is not applicable to transactions in variable-rate municipal securities.

[*][Currently codified at rule G-15(a)(i)(B)(4).]

## Notice Concerning "Zero Coupon" and "Stepped Coupon" Securities

April 27, 1982

The Municipal Securities Rulemaking Board has recently received inquiries concerning the application of the confirmation disclosure requirements of Board rules G-12 and G-15 to transactions in municipal securities with "zero coupons" or "stepped coupons." Certain recent new issues of municipal securities have had several maturities paying 0% interest; securities of these maturities are sold at deep discounts, with the investor's return received in the form of an accretion of this discount to par. Other issues have been sold which have "stepped coupons;" that is, all outstanding bonds pay the same interest rate each year, with the interest rate periodically rising, on a pre-established schedule, on all securities yet to be redeemed. Interested persons have inquired concerning how the description requirements of the rules apply to such securities, and whether the yield disclosure requirements of rule G-15 apply to confirmations of transactions in such securities for the accounts of customers.

Rule G-12(c)(v)(E) requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including the interest rate. Rule G-15(a)(i)(E)[*] imposes the same requirement with respect to customer confirmations. Further, rule G-15(a)(i)(I)(2)[†] requires that customer confirmations of transactions effected at dollar prices (except for transactions at par) state the lowest of the resulting yield to call, yield to par option, or yield to maturity.

A confirmation of a transaction in a "zero coupon" security must state that the interest rate on the security is "0%." A customer confirmation of such a transaction must state the lowest of the yield to call or yield to maturity resulting from the dollar price of the transaction.[1] The Board believes that the disclosure of the resulting yield is particularly important on such transactions, since it provides the only indication to the investor of the return he or she can expect from the investment.

A confirmation of a transaction in a "stepped coupon" security must state the interest rate currently being paid on the securities, and must identify the securities as "stepped coupon" securities. A customer confirmation of such a transaction must also state the lowest of the yield to call, yield to par option, or yield to maturity resulting from the dollar price of the transaction.[2] In view of the wide variation in the coupon interest rates that will be received over the life of a "stepped coupon" security, the Board believes that the disclosure of yield will assist customers in determining the actual return to be received on the investment.

In addition to the specific confirmation disclosure requirements of Board rules G-12 and G-15 discussed above, the Board is of the view that persons selling such securities to the public have an obligation to adequately disclose the special characteristics of such securities so as to comply with the Board's fair practice rules. For example, although the details of the increases to the interest rates on "stepped coupon" securities need not be provided on confirmations, such information is, of course, material information regarding the securities, and municipal securities dealers would be obliged to inform customers about this feature of the securities at or before the time of trade.

[1] The Board notes that, upon the effectiveness of Board rule G-33, such yield must be computed on a basis that presumes semi-annual compounding.

[2] In the case of both "zero coupon" and "stepped coupon" securities, if the transaction is effected in a yield basis, the confirmation must show the yield price and the resulting dollar price, computed to the lowest of price to premium call, price to par option, or price to maturity.

[*][Currently codified at rule G-15(a)(i)(B)(4).]

[†][Currently codified at rule G-15(a)(i)(A)(5).]

## Notice Concerning Pricing to Call

December 10, 1980

Board rules G-12 on uniform practice and G-15 on customer confirmations set forth certain requirements concerning the computations of

yields and dollar prices to premium call or par option features. Both rules currently require that, in the case of a transaction in callable securities effected on the basis of a yield price, the dollar price should be calculated to the lowest of the price to premium call, price to par option, or price to maturity. Further, confirmations of transactions on which the dollar price has been computed to a call or option feature must state the call date and price used in the computation. Amendments to rule G-15 which will become effective on October 1, 1981, generally require that confirmations of transactions in callable securities effected at a dollar price in excess of par must set forth the lowest of the yield to premium call, yield to par option, or yield to maturity resulting from such dollar price.[1]

Since the December 1977 effective dates of rule G-12 and G-15, the Board has received numerous inquiries concerning these provisions and their application to different issues of municipal securities. In view of the general interest in this subject, the Board is issuing this notice to provide guidance with respect to the general criteria to be used in selecting the appropriate call feature for yield or dollar price computations.

The requirement for the computation of dollar price to the lowest of price to premium call, par option, or maturity reflects the long-established practice of the industry in pricing transactions. This practice assures a customer that he or she will realize, at a minimum, the stated yield, even in the event that a call provision is exercised. The pending amendment to rule G-15, which requires the presentation of information concerning the lowest yield on confirmations of dollar price transactions, will provide investors with the equivalent information on these types of transactions.

In view of the variety of call provisions applicable to different kinds of municipal securities, there is often uncertainty concerning the selection of the appropriate call feature for use in the computation of yield or dollar price. Issues of municipal securities often have several different call features, ranging from calls associated with mandatory sinking fund requirements to optional calls from the proceeds of a refunding or funds in excess of debt service requirements. Certain issues have additional call provisions in the event that funds designated for specific purposes are not expended or obligations securing the issue are prepaid.[2] Most of the inquiries which the Board has received concerning the provisions of rules G-12 and G-15 focus on this question of selection of the call provisions to be used for computation purposes.

The Board is of the view that a distinction should be drawn between "in whole" call provisions, (*i.e.*, those under which all outstanding securities of a particular issue may be called) and "in part" call provisions (*i.e.*, those under which part of an issue, usually selected by lot or in inverse maturity or numerical order, may be called for redemption). The Board is of the view that for computation purposes only "in whole" calls should be used; sinking fund calls and other "in part" calls should not be used in making the computations required by rules G-12 and G-15.

Several inquiries have raised the question of which "in whole" call should be used in the case of issues which have more than one such call. The earlier call features of such issues are often subject to restrictions on the proceeds which may be used to redeem securities (*e.g.*, a restriction that only unexpended funds from the original issue may be used for redemption purposes). Since such call features operate as a practical matter as "in part" calls, the Board is of the view that the "in whole" call feature which would be exercised in the event of a refunding is the call feature which should generally be used for purposes of the computation of yields and dollar prices.

Other concerned persons have inquired regarding the application of the "pricing to call" requirements in the case of an issue with a sequence of call dates at gradually declining premiums. The Board believes that, as a general matter, a trial computation to the first date on which a security is callable "in whole" at a premium will be sufficient to determine whether the price to the premium call is the lowest dollar price. However, in the rare instance where the price to an intermediate premium call (*i.e.*, a call in the "middle" of a sequence of calls at declining premiums) is the lowest dollar price, such price should be used. The Board notes that, in such cases, the structure of the call schedule is sufficiently unusual (*e.g.*, with sharp declines in the premium amount over a very short period of time) that dealers should be alerted to the need to take the intermediate calls into consideration.

[1] Effective December 1, 1980, customer confirmations of transactions in callable securities effected at a dollar price less than par must set forth the yield to maturity resulting from such dollar price. Confirmations of dollar-price transactions in non-callable securities, or securities which have been called or prerefunded, must set forth the resulting yield to maturity (or to the date for redemption of the securities, in the case of called or prerefunded securities).

[2] Other issues are also callable in the event that the financed project is damaged or destroyed, or the tax exempt status of the issue is revoked. Since the possibility of such a call being exercised is extremely remote, and beyond the control of the issuer of the securities, the Board does not believe that these "catastrophe" calls need be considered for computation purposes.

## INTERPRETIVE NOTICE CONCERNING YIELD DISCLOSURE REQUIREMENTS FOR PURCHASES FROM CUSTOMERS

September 1, 1981

Certain amendments to Board rule G-15 on customer confirmations became effective on December 1, 1980. Among other matters, these amendments require that customer confirmations of transactions effected on the basis of dollar price, including confirmations of purchases from customers, set forth certain yield information concerning the transaction. Confirmations of dollar price transactions in non-callable securities, or in callable securities traded at prices below par, must set forth the yield to maturity resulting from the dollar price. Confirmations of dollar price transactions in securities which have been called or prerefunded must show the yield to the maturity date established by the call or prerefunding. Confirmations of transactions in callable securities traded at dollar prices in excess of par are exempt from yield disclosure requirements until October 1, 1981; after that date such confirmations must show the lowest of the yield to premium call, yield to par option, or yield to maturity resulting from such dollar price.[1]

Since the effective date of these amendments, the Board has received several inquiries as to whether all confirmations of purchases from customers, including purchases effected at a price derived from a yield price less a spread or concession, must show the yield resulting from the actual unit dollar price of the transaction.

The Board is of the view that all confirmations of purchasers from customers (except for purchases at par) must set forth the net or effective yield resulting from the actual unit dollar price of the transaction. The yield disclosure on confirmations of purchases from customers is intended to provide customers with a means of assessing the merits of alternative investment strategies (such as different possible reinvestment transactions) and the merits of the particular transaction being confirmed. The Board believes that the disclosure of the net or effective yield (*i.e.*, that derived from the actual unit dollar price of the transaction) best serves these purposes.

[1] Confirmations of transactions effected at a dollar price of par ("100") continue to be exempt from any yield disclosure requirements.

## SENDING CONFIRMATIONS TO CUSTOMERS WHO UTILIZE DEALERS TO TENDER PUT OPTION BONDS

September 30, 1985

The Board has received inquiries whether a municipal securities dealer must send a confirmation to a customer when the customer utilizes the dealer to tender bonds pursuant to a put option. Board rule G-15(a)(i)

requires dealers to send confirmations to customers at or before the completion of a transaction in municipal securities. The Board believes that whether a dealer that accepts for tender put bonds from a customer is engaging in "transactions in municipal securities" depends on whether the dealer has some interest in the put option bond.

In the situation in which a customer puts back a bond through a municipal securities dealer either because he purchased the bond from the dealer or he has an account with the dealer, and the dealer does not have an interest in the put option and has not been designated as the remarketing agent for the issue, there seems to be no "transaction in municipal securities" between the dealer and the tendering bondholder and no confirmation needs to be sent. The Board suggests, however, that it would be good industry practice to obtain written approval of the tender from the customer, give the customer a receipt for his bonds and promptly credit the customer's account. Of course, if the dealer actually purchases the security and places it in its trading account, even for an instant, prior to tendering the bond, a confirmation of this sale transaction should be sent.[1]

If a dealer has some interest in a put option bond which its customer has delivered to it for tendering, a confirmation must be sent to the customer. A dealer that is the issuer of a secondary market put option on a bond has an interest in the security and is deemed to be engaging in a municipal securities transaction if the bond is put back to it.

In addition, a remarketing agent, (*i.e.*, a dealer which, pursuant to an agreement with an issuer, is obligated to use its best efforts to resell bonds tendered by their owners pursuant to put options) who accepts put option bonds tendered by customers also is deemed to be engaging in a "transaction in municipal securities" with the customer for purposes of sending a confirmation to the customer because of the remarketing agent's interest in the bonds.[2] The Board's position on remarketing agents is based upon its understanding that remarketing agents sell the bonds that their customers submit for tendering, as well as other bonds tendered directly to the trustee or tender agent, pursuant to the put option. The customers and other bondholders, pursuant to the terms of the issue, usually are paid from the proceeds of the remarketing agents' sales activities.[3]

[1] This would apply equally in circumstances in which the dealer has an interest in the put option bond.

[2] Of course, remarketing agents also must send confirmations to those to whom they resell the bonds.

[3] If these funds are not sufficient to pay tendering bondholders, such bondholders usually are paid from certain funds set up under the issue's indenture or from advances under the letter of credit that usually backs the put option.

## NOTICE CONCERNING CONFIRMATION DISCLOSURE REQUIREMENTS FOR CALLABLE MUNICIPAL SECURITIES

February 20, 1986

Recently, the Board has received inquiries concerning the application of its inter-dealer and customer confirmation rules, rules G-12(c) and G-15(a) respectively, to municipal securities subject to call features. In particular, the Board has been made aware of instances in which dealers note one call date and price, usually the first in-whole call, on inter-dealer and customer confirmations without noting that the call information relates to the first in-whole call or that the bonds are otherwise callable.

> Rules G-12(c) and G-15(a) require that confirmations set forth a description of the securities, including... if the securities are... subject to redemption prior to maturity (callable)..., an indication to such effect...

Thus, municipal securities subject to in-whole or in-part calls must be described as callable. Rules G-12(c) and G-15(a) also require dealers, when securities transactions are effected on a yield basis, to set forth a dollar price that has been computed to the lowest of the price to call, price to par option, or price to maturity; rule G-15 requires that confirmations of customer transactions effected on a dollar price disclose a yield in a similar manner. These rules provide that when a price or yield is calculated to a call, this must be stated, and the call date and price used in the calculation must be shown.[1] These are the only instances in which specific call features must be identified on a confirmation.

The Board understands that confusion may arise when specific call features are noted on confirmations without an adequate description of such information. The Board has determined that confirmations that include specific call information not required to be included under the Board's confirmation rules also must include a notation that other call features exist and must provide clarifying information about the noted call, *e.g.* "first in-whole call." These disclosures should be sufficient to ensure that purchasing dealers and customers will be alerted to the need to obtain additional information.

The Board cautions dealers to ensure that confirmations of municipal securities with call features clearly describe the securities as "callable." If this information is erroneously noted on the confirmation, purchasing dealers have the right to reclaim the securities under rule G-12(g)(iii)(C)(3).

[1] In addition, rule G-15(a)(iii)(D) [currently codified at rule G-15(a)(i)(C)(2)(a)] requires a legend to be placed on customer confirmations of transactions in callable securities which notes that "[additional] call features ... exist ... [that may] affect yield; complete information will be provided upon request." **[NOTE: revised to reflect subsequent amendments.]**

## NOTICE CONCERNING CONFIRMATION, DELIVERY AND RECLAMATION OF INTERCHANGEABLE SECURITIES

August 10, 1988

In March 1988, the Securities and Exchange Commission approved amendments to rules G-12 and G-15 concerning municipal securities that may be issued in bearer or registered form (interchangeable securities).[1] These amendments will become effective for transactions executed on or after September 18, 1988. The amendments revise rules G-12(e) and G-15(c) to allow inter-dealer and customer deliveries of interchangeable securities to be either in bearer or registered form, ending the presumption in favor of bearer certificates for such deliveries. The amendments also delete the provision in rule G-12(g) that allows an inter-dealer delivery of interchangeable securities to be reclaimed within one day if the delivery is in registered form. In addition, the amendments remove the provisions in rules G-12(c) and G-15(a) that require dealers to disclose on inter-dealer and customer confirmations that securities are in registered form.

The Board has received inquiries on several matters concerning the amendments and is providing the following clarifications and interpretive guidance.

### Deliveries of Interchangeable Securities

Several dealers have asked whether the amendments apply to securities that can be converted from bearer to registered form, but that cannot then be converted back to bearer form. These securities are "interchangeable securities" because they originally were issuable in either bearer or registered form. Therefore, under the amendments, physical deliveries of these certificates may be made in either bearer or registered form, unless a contrary agreement has been made by the parties to the transaction.[2]

The Board also has been asked whether a mixed delivery of bearer and registered certificates is permissible under the amendments. Since the amendments provide that either bearer or registered certificates are acceptable for physical deliveries, a delivery consisting of bearer and registered certificates also is an acceptable delivery under the amendments.

### Fees for Conversion

Transfer agents for some interchangeable securities charge fees for conversion of registered certificates to bearer form. Dealers should be aware that these fees can be substantial and, in some cases, may be prohibitively expensive. Dealers, therefore, should ascertain the amount of the fee prior to agreeing to deliver bearer certificates. A dealer may pass on the costs of converting registered securities to bearer form to its customer. In such a case, the dealer must disclose the amount of the conversion fee to the customer at or prior to the time of trade, and the customer must agree to pay it.[3] In addition, rule G-15(a)(iii)(J)[*] requires that the dealer note such an agreement (including the amount of the conversion fee) on the confirmation.[4] The conversion fee, however, should not be included in the price when calculating the yield shown on the confirmation.[5] In collecting this fee, the dealer merely would be passing on the costs imposed by a third party, voluntarily assumed by the customer, relating to the form in which the securities are held. The conversion fee thus is not a necessary or intrinsic cost of the transaction for purposes of yield calculation.[6]

### Continued Application of the Board's Automated Clearance Rules

The Board's automated clearance rules, rules G-12(f) and G-15(d), require book-entry settlements of certain inter-dealer and customer transactions.[7] The amendments on interchangeable securities address only physical deliveries of certificates and, therefore, apply solely to transactions that are not required to be settled by book-entry under the automated clearance rules.

When a physical delivery is permitted under Board rules (*e.g.*, because the securities are not depository eligible), dealers may agree at the time of trade on the form of certificates to be delivered. When such an agreement is made, this special condition must be included on the confirmation, as required by rules G-12(c)(vi)(I) and G-15(a)(iii)(J).[8][*] Dealers, however, may not enter into an agreement providing for a physical delivery when book-entry settlement is required under the automated clearance rules, as this would result in a violation of the automated clearance rules.[9]

### Need for Education of Customers on Benefits of Registered Securities

Dealers should begin planning as soon as possible any internal or operational changes that may be needed to comply with the amendments. The Depository Trust Company (DTC) has announced plans for a full-scale program of converting interchangeable securities now held in bearer form to registered form beginning on September 18, 1988.[10] When possible, DTC plans to retain a small supply of bearer certificates in interchangeable issues to accommodate withdrawal requests for bearer certificates.[11] The general effect of the amendments and DTC's policy, however, will make it difficult for dealers, in certain cases, to ensure that their customers will receive bearer certificates. Dealers should educate customers who now prefer bearer certificates on the call notification and interest payment benefits offered by registered certificates and dealer safekeeping and advise them when it is unlikely that bearer certificates can be obtained in a particular transaction. Dealers safekeeping municipal securities through DTC on behalf of such customers also may wish to review with those customers DTC's new arrangements for interchangeable securities.

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[1] See SEC Release No. 34-25489 (March 18, 1988); MSRB Reports Vol. 8, no. 2 (March 1988), at 3.

[2] The amendments should substantially reduce delays in physical deliveries that result because of dealer questions about whether specific certificates should be in bearer form. This efficiency would be impossible if these "one-way" interchangeable securities were excluded from the amendments since dealers would be required to determine, for each physical delivery of registered securities, whether the securities are "one-way" interchangeable securities.

[3] Rule G-17, on fair dealing, requires dealers to disclose all material facts about a transaction to a customer at or before the time of trade. In many cases, the conversion fee is as much as $15 for each bearer certificate. The Board also has been made aware of some cases in which the transfer agent must obtain new printing plates or print new bearer certificates to effect a conversion. The conversion costs then may be in excess of several hundred or a thousand dollars. Therefore, it is important that the customer be aware of the amount of the conversion costs prior to agreeing to pay for them.

[4] This rule requires that, in addition to any other information required on the confirmation, the dealer must include "such other information as may be necessary to ensure that the parties agree on the details of the transaction."

[5] Rule G-15(a)(i)(I)[currently codified at rule G-15(a)(i)(A)(5)] requires the yield of a customer transaction to be shown on the confirmation.

[6] Some customers, for example, may ask dealers to convert registered securities to bearer form even though the customers also may be willing to accept registered certificates if this is more economical.

[7] Rule G-12(f)(ii) requires book-entry settlement of an inter-dealer municipal securities transaction if both dealers (or their clearing agents for the transaction) are members of a depository making the securities eligible and the transaction is compared through a registered securities clearing agency. Rule G-15(d)(iii) requires book-entry settlement of a customer transaction if the dealer grants delivery versus payment or receipt versus payment privileges on the transaction and both the dealer and the customer (or the clearing agents for the transaction) are members of a depository making the securities eligible.

[8] These rules require that, in addition to the other information required on inter-dealer and customer confirmation, confirmations must include "such other information as may be necessary to ensure that the parties agree to the details of the transaction."

[9] Of course, dealers may withdraw physical certificates from a depository once a book-entry delivery is accepted.

[10] DTC expects this conversion process to take approximately two years. Midwest Securities Trust Company and The Philadelphia Depository Trust Company have not yet announced their plans with regard to interchangeable securities.

[11] DTC Notice to Participants on Plans for Comprehensive Conversion of Interchangeable Municipal Bonds to the Registered Form (August 10, 1988).

[*][Currently codified at rule G-15(a)(i)(A)(8).]

## NOTICE CONCERNING STRIPPED COUPON MUNICIPAL SECURITIES

March 13, 1989

In 1986, several municipal securities dealers began selling ownership rights to discrete interest payments, principal payments or combinations of interest and principal payments on municipal securities. In 1987, the Board asked the Securities and Exchange Commission staff whether these "stripped coupon" instruments are municipal securities for purposes of the Securities Exchange Act and thus are subject to Board rules. On January 19, 1989, the staff of the Division of Market Regulation of the Commission issued a letter stating that, subject to certain conditions, these instruments are municipal securities for purposes of Board rules (SEC staff letter).

The Board is providing the following guidance on the application of its rules to transactions in stripped coupon instruments defined as municipal securities in the SEC staff letter (stripped coupon municipal securities). Questions whether other stripped coupon instruments are municipal securities and questions concerning the SEC staff letter should be directed to the Commission staff.

### Background

A dealer sponsoring a stripped coupon municipal securities program typically deposits municipal securities (the underlying securities) with a barred custodian. Pursuant to a custody agreement, the custodian separately records the ownership of the various interest payments, principal payments, or specified combinations of interest and principal payments. One combination of interest and principal payments sometimes offered is the "annual payment security," which represents one principal payment, with alternate semi-annual interest payments. This results in an annual interest rate equal to one-half the original interest rate on the securities.[1] Stripped coupon municipal securities are marketed under trade names such as Municipal Tax Exempt Investment Growth Receipts (Municipal TIGRs), Municipal Receipts (MRs), and Municipal Receipts of Accrual on Exempt Securities (MUNI RAES).

### Application of Board Rules

In general, the Board's rules apply to transactions in stripped coupon municipal securities in the same way as they apply to other municipal securities transactions. The Board's rules on professional qualifications and supervision, for example, apply to persons executing transactions in the securities the same as any other municipal security. The Board's rules on

recordkeeping, quotations, advertising and arbitration also apply to transactions in the securities. Dealers should be aware that rule G-19, on suitability of recommendations, and rule G-30, on fair pricing, apply to transactions in such instruments.

The Board emphasizes that its rule on fair dealing, rule G-17, requires dealers to disclose to customers purchasing stripped coupon municipal securities all material facts about the securities at or before the time of trade. Any facts concerning the underlying securities which materially affect the stripped coupon instruments, of course, must be disclosed to the customer. The Board understands that some stripped coupon municipal securities are sold without any credit enhancement to the underlying municipal securities. As pointed out in the SEC staff letter, dealers must be particularly careful in these cases to disclose all material facts relevant to the creditworthiness of the underlying issue.

**Confirmation Requirements**

Dealers generally should confirm transactions in stripped coupon municipal securities as they would transactions in other municipal securities that do not pay periodic interest or which pay interest annually.[2] A review of the Board's confirmation requirements applicable to the securities follows.

*Securities Descriptions.* Rules G-12(c)(v)(E) and G-15(a)(i)(E)[*] require a complete securities description to be included on inter-dealer and customer confirmations, respectively, including the name of the issuer, interest rate and maturity date.[3] In addition to the name of the issuer of the underlying municipal securities, the trade name and series designation assigned to the stripped coupon municipal security by the dealer sponsoring the program must be included on the confirmation.[4] Of course, the interest rate actually paid by the stripped coupon security (*e.g.*, zero percent or the actual, annual interest rate) must be stated on the confirmation rather than the interest rate on the underlying security.[†] Similarly, the maturity date listed on the confirmation must be the date of the final payment made by the stripped coupon municipal security rather than the maturity date of the underlying securities.[5]

*Credit Enhancement Information.* Rules G-12(c)(vi)(D) and G-15(a)(ii)(D)[‡] require confirmations of securities pre-refunded to a call date or escrowed to maturity to state this fact along with the date of maturity set by the advance refunding and the redemption price. If the underlying municipal securities are advance-refunded, confirmations of the stripped coupon municipal securities must note this. In addition, rules G-12(c)(v)(E) and G-15(c)(i)(E)[▫] require that the name of any company or other person, in addition to the issuer, obligated directly or indirectly with respect to debt service on the underlying issue or the stripped coupon security be included on confirmations.[6]

*Quantity of Securities and Denominations.* For securities that mature in more than two years and pay investment return only at maturity, rules G-12(c)(v) and G-15(a)(v)[**] require the maturity value to be stated on confirmations in lieu of par value. This requirement is applicable to transactions in stripped coupon municipal securities over two years in maturity that pay investment return only at maturity, *e.g.*, securities representing one interest payment or one principal payment. For securities that pay only principal and that are pre-refunded at a premium price, the principal amount may be stated as the transaction amount, but the maturity value must be clearly noted elsewhere on the confirmation. This will permit such securities to be sold in standard denominations and will facilitate the clearance and settlement of the securities.

Rules G-12(c)(vi)(F) and G-15(a)(iii)(G)[††] require confirmations of securities that are sold or that will be delivered in denominations other than the standard denominations specified in rules G-12(e)(v) and G-15(a)(iii)(G)[††] to state the denominations on the confirmation. The standard denominations are $1,000 or $5,000 for bearer securities, and for registered securities, increments of $1,000 up to a maximum of $100,000. If stripped coupon municipal securities are sold or will be delivered in any other denominations, the denomination of the security must be stated on the confirmation.

*Dated Date.* Rules G-12(c)(vi)(A) and G-15(a)(iii)(A)[***] require that confirmations state the dated date of a security if it affects price or interest calculations, and the first interest payment date if other than semi-annual. The dated date for purposes of an interest-paying stripped coupon municipal security is the date that interest begins accruing to the custodian for payment to the beneficial owner. This date, along with the first date that interest will be paid to the owner, must be stated on the confirmation whenever it is necessary for calculation of price or accrued interest.

*Original Issue Discount Disclosure.* Rules G-12(c)(vi)(G) and G-15(a)(iii)(H)[†††] require that confirmations identify securities that pay periodic interest and that are sold by an underwriter or designated by the issuer as "original issue discount." This alerts purchasers that the periodic interest received on the securities is not the only source of tax-exempt return on investment. Under federal tax law, the purchaser of stripped coupon municipal securities is assumed to have purchased the securities at an "original issue discount," which determines the amount of investment income that will be tax-exempt to the purchaser. Thus, dealers should include the designation of "original issue discount" on confirmations of stripped coupon municipal securities, such as annual payment securities, which pay periodic interest.

**Clearance and Settlement of Stripped Coupon Municipal Securities**

Under rules G-12(e)(vi)(B) and G-15(c)(iv)(B), delivery of securities transferable only on the books of a custodian can be made only by the bookkeeping entry of the custodian.[7] Many dealers sponsoring stripped coupon programs provide customers with "certificates of accrual" or "receipts," which evidence the type and amount of the stripped coupon municipal securities that are held by the custodian on behalf of the beneficial owner. Some of these documents, which generally are referred to as "custodial receipts," include "assignment forms," which allow the beneficial owner to instruct the custodian to transfer the ownership of the securities on its books. Physical delivery of a custodial receipt is not a good delivery under rules G-12(e) and G-15(a) unless the parties specifically have agreed to the delivery of a custodial receipt. If such an agreement is reached, it should be noted on the confirmation of the transaction, as required by rules G-12(c)(v)(N) and G-15(a)(i)(N)[****].

The Board understands that some stripped coupon municipal securities that are assigned CUSIP numbers and sold in denominations which are multiples of $1,000 are eligible for automated comparison and automated confirmation/affirmation and that some of these instruments also are eligible for book-entry delivery through registered securities depositories. The Board reminds dealers that transactions in stripped coupon municipal securities are subject to the automated clearance requirements of rules G-12(f) and G-15(d) if they are eligible in the automated clearance systems. Dealers sponsoring stripped coupon programs also should note that rule G-34(b)(ii) requires CUSIP numbers to be assigned to stripped coupon municipal securities prior to the initial sale of the securities to facilitate clearance and settlement.

**Written Disclosures in Connection with Sales of Stripped Coupon Municipal Securities**

Dealers sponsoring stripped coupon municipal securities programs generally prepare "offering circulars" or "offering memoranda" describing the securities that have been placed on deposit with the custodian, the custody agreement under which the securities are held, and the tax treatment of transactions in the securities. These documents generally are provided to all customers purchasing the securities during the initial offering of the instruments. The Board strongly encourages all dealers selling

stripped coupon municipal securities to provide these documents to their customers whether the securities are purchased during the initial distribution or at a later time.[8] Although the material information contained in these documents, under rule G-17, must be disclosed to customers orally if not provided in writing prior to the time of trade, the Board believes that the unusual nature of stripped coupon municipal securities and their tax treatment warrants special efforts to provide written disclosures. Moreover, if stripped coupon municipal securities are marketed during the underwriting period of the underlying issue, rule G-32 requires distribution of the official statement for the underlying issue prior to settlement of the transaction of the stripped coupon municipal securities.

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[1] The Board understands that other types of stripped coupon municipal securities also may be offered with combinations of interest and principal payments providing an interest rate different than the original interest rate of the securities.

[2] Thus, for stripped coupon municipal securities that do not pay periodic interest, rules G-12(c)(v) and G-15(a)(v) require confirmations to state the interest rate as zero and, for customer confirmations, the inclusion of a legend indicating that the customer will not receive periodic interest payments. [See current rule G-15(a)(vi)(D), G-15(a)(i)(B)(4)(a) and G-15(a)(i)(D)(1).] Rules G-12(c)(vi)(H) and G-15(a)(iii)(I) [currently codified at rule G-15(a)(i)(C)(2)(e)] require confirmations of securities paying annual interest to note this fact.

[3] The complete description consists of all of the following information:

the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities and in the case of any securities, if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement, "multiple obligors" may be shown.

[4] Trade name and series designation is required under rules G-12(c)(vi)(I) and G-15(a)(iii)(J) [currently codified at rule G-15(a)(i)(A)(8)], which state that confirmations, must include all information necessary to ensure that the parties agree to the details of the transaction. [See also current rule G-15(a)(i)(B)(1)(a).]

[5] Therefore, the maturity date of a stripped coupon municipal security representing one interest payment is the date of the interest payment. [See current rule G-15(a)(i)(B)(3)(a).]

[6] It should be noted that the SEC staff letter is limited to instruments in which "neither the custodian nor sponsor additionally will guarantee or otherwise enhance the creditworthiness of the underlying municipal security or the stripped coupon security."

[7] Under rules G-12(c)(vi)(B) and G-15(a)(iii)(B) [currently codified at rule G-15(a)(i)(C)(2)(d)] the book-entry-only nature of the securities also must be noted on the confirmation.

[8] The Board understands that these documents generally are available from the dealers sponsoring the stripped coupon municipal securities program.

[*][Currently codified at rule G-15(a)(i)(B).]

[†][Currently codified at rule G-15(a)(i)(B)(4)(e).]

[‡][Currently codified at rule G-15(a)(i)(C)(3)(c).]

[≠][Currently codified at rule G-15(a)(i)(C)(1)(b).]

[**] [Currently codified at rule G-15(a)(i)(A)(3).]

[††] [Currently codified at rule G-15(a)(i)(A)(7)(b).]

[***] [Currently codified at rule G-15(a)(i)(B)(5).]

[†††] [Currently codified at rule G-15(a)(i)(C)(4)(c).]

[****][Currently codified at rule G-15(a)(i)(A)(7)(c).]

## NOTICE CONCERNING CONFIRMATION DISCLOSURE OF MISCELLANEOUS TRANSACTION CHARGES

May 14, 1990

In recent months, several dealers have requested guidance from the Board on the appropriate confirmation treatment of miscellaneous charges added to customer transactions. These inquiries typically relate to small amounts which some dealers add to the combined extended principal and accrued interest of a transaction, prior to arriving at the final monies.[1] In some cases, the charges are levied for specific services provided as part of the transaction (*e.g.*, special delivery arrangements, delivery of physical securities, delivery vs. payment settlement). In other cases, dealers may charge a flat fee characterized simply as a "transaction fee." These miscellaneous fees differ from the commissions charged on agency transactions in that they are flat amounts and are not computed from the par value of the transaction.

Rule G-15(a)(iii)(J)[*] requires each customer confirmation to include, in addition to the specific items noted in G-15(a), "such other information as may be necessary to ensure that the parties agree to the details of the transaction." Accordingly, the nature and amount of miscellaneous charges must be noted on the confirmation.[2]

Questions have arisen whether miscellaneous transaction fees also should be reflected in the yield required to be disclosed on the confirmation under rule G-15(a)(i)(I).[3] The Board does not believe that it is appropriate for these fees to be incorporated in the stated yield. Because such fees are small, they generally will not significantly affect a customer's return on investment. To the extent that the minor miscellaneous fees charged in today's market may be relevant to the customer's investment decision, the Board believes that a clear disclosure of the nature and amount of the fee on the confirmation will provide customers with sufficient information. If the practice of charging that the fees routinely begin to represent significant factors in customers' return on investment, the Board may reconsider this interpretation in favor of placing the charges in the stated yield.

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[1] In purchases from customers, such transaction charges may be subtracted from the monies owed the customer.

[2] The Board also has considered questions relating to periodic charges, such as monthly charges for safekeeping. A dealer assessing periodic charges to customer accounts, of course, must reach agreement with the customer on the nature and extent of the charges and the services that will be provided in return. However, since periodic charges do not relate to a specific transaction and may change over time, a dealer's policy on periodic charges is not required on the confirmation as a "detail of the transaction."

[3] [Currently codified at rule G-15(a)(i)(A)(5).] Commissions charged on agency transactions must be included in the yield calculation. See [Rule G-15 Interpretive Letter – Agency transactions: yield disclosures,] MSRB interpretation of July 13, 1984, MSRB Manual 3571.33 at 4528. This has led dealers to ask whether miscellaneous transaction charges should be handled in a similar manner. As noted above, the Board does not believe that miscellaneous charges should be handled in the same manner as commissions.

[*][Currently codified at rule G-15(a)(i)(A)(8).]

## NOTICE CONCERNING TRANSACTIONS IN MUNICIPAL COLLATERALIZED MORTGAGE OBLIGATIONS: RULE G-15

April 8, 1992

The Board has become aware that some municipal issuers recently have issued securities that are structured as collateralized mortgage obligations (CMOs). Like the CMOs issued by non-municipal issuers, these securities represent interest in pools of mortgages and are partitioned into several classes (or tranches), which are serialized as to priority for redemption and payment of principal.

Since these "municipal CMOs" are being issued directly by political subdivisions, agencies or instrumentalities of state or local governments, it appears that they may be "municipal securities," as that term is defined under section 3(a)(29) of the Securities Exchange Act of 1934.[1] Although the interest paid on these instruments may be subject to federal taxation, the Board reminds dealers that transactions in municipal securities are subject to Board rules whether those securities are taxable or tax-exempt. Accordingly, dealers executing transactions in municipal CMOs should ensure that they are in compliance with all applicable Board rules. For example, dealers should ensure that all Board requirements regarding professional qualifications and recordkeeping are observed.[2]

Because the interest and principal payment features of municipal CMOs are very different from those of traditional municipal bonds, dealers should take care to ensure that all Board rules designed for the protec-

tion of customers are observed. This includes ensuring that: (i) all material facts about each transaction are disclosed to the customer, in compliance with rule G-17; (ii) each transaction recommended to a customer is suitable for the customer, in compliance with rule G-19; and (iii) the price of each customer transaction is fair and reasonable, in compliance with rule G-30. With respect to the material facts that should be disclosed to customers, dealers should ensure that customers are adequately informed of the likelihood of "prepayment" of principal on the securities and the likelihood of the securities being redeemed substantially prior to the stated maturity date. If the amount of principal that will be delivered to the customer differs from the "face" amount to be delivered, the customer also should be informed of this fact, along with the amount of the principal that will be delivered.

The Board also has reviewed the requirements of rule G-15(a)(i)(1)[*] with respect to confirmation disclosure of "yield to maturity" or "yield to call" on customer confirmations in these securities. Because CMOs typically pay principal to holders prior to maturity and because the actual duration of the securities often varies significantly from the stated maturity, the Board has interpreted rule G-15(a) not to require a statement of yield for transactions in municipal CMOs. A dealer that decides to voluntarily include a statement of "yield" on a confirmation for these securities must also disclose on the confirmation the method by which yield was computed. This will help to avoid the possibility of the customer misunderstanding the yield figure if he should use it to compare the merits of alternative investments.

The Board will be monitoring municipal CMOs and will adopt specific rules for the instruments in the future if this appears to be necessary.

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1 Of course, whether any instrument is a municipal security is a matter to be determined by the Securities and Exchange Commission.

2 In addition, as noted above, the interest paid on these instruments may be subject to federal taxation. If the securities are identified by the issuer or sold by the underwriter as subject to federal taxation, rules G-12(c) and G-15(a) require confirmations to contain a designation to that effect.

[*][Currently codified at rule G-15(a)(i)(A)(5).]

## NOTICE CONCERNING USE OF THE OASYS GLOBAL TRADE CONFIRMATION SYSTEM TO SATISFY RULE G-15(a)

June 6, 1994

Rule G-15(a) requires that, at or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer (dealers) shall give or send to the customer "a written confirmation of the transaction" containing specified information. Securities Exchange Act Rule 10b-10 states similar confirmation requirements for customer transactions in securities other than municipal securities. In December 1992, Thomson Financial Services, Inc. (Thomson) asked the Securities and Exchange Commission (Commission) to allow dealers to use Thomson's OASYS Global system for delivering confirmation under Rule 10b-10. In October 1993, the Commission staff provided Thomson with a "no-action" letter stating that, if OASYS Global system participants agree between themselves to use the system's electronic "contract confirmation messages" (CCMs) instead of hard-copy confirmations and if certain other requirements are met[1] the Commission staff would not recommend enforcement action to the Commission if broker-dealers rely on CCMs sent through the OASYS Global system to satisfy the requirements to confirm a transaction under Rule 10b-10.[2]

Thomson has asked the Board for an interpretation of rule G-15(a) that would allow dealers to use the OASYS Global system for municipal securities transactions to the same extent as dealers are allowed to use the system to comply with Rule 10b-10. The Board believes that the speed and efficiencies offered by electronic confirmation delivery are of benefit to the municipal securities industry, especially in light of the move to T+3 settlement. Therefore, the Board has interpreted the requirement in rule G-15(a) to provide customers with a written confirmation to be satisfied by a CCM sent through the OASYS Global system when the following conditions are met: (i) the customer and dealer have both agreed to use the OASYS Global system for purposes of confirmation delivery; (ii) the CCM includes all information required by rule G-15(a); and (iii) all other applicable requirements and conditions concerning the OASYS Global system expressed in the Commission's October 8, 1993 no-action letter concerning Securities Exchange Act Rule 10b-10 continue to be met.[3]

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1 The other requirements contained in the Commission's no-action letter are as follows: (i) that the CCMs can be printed or downloaded by the participants, (ii) that the recipient of a CCM must respond through the system affirming or rejecting the trade, (iii) that the CCMs will not be automatically deleted by the system, and (iv) that the use of the system by the participants ensures that both parties to the transaction have the capacity to receive the CCMs.

2 The Commission's October 8, 1993 no-action letter is reprinted in *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 38-39.

3 The Board understands that Thomson's OASYS Global system is not at this time a registered securities clearing agency and is not linked with other registered securities clearing agencies for purposes of automated confirmation/acknowledgement required under rule G-15(d). Thus, under these circumstances, use of the OASYS Global system will not constitute compliance with rule G-15(d) on automated confirmation/acknowledgement.

## NOTICE CONCERNING FLAT TRANSACTION FEES

June 13, 2001

The MSRB has received inquiries regarding an interpretation of rule G-15(a) from dealers who offer automated execution of transactions and charge a small, flat "transaction fee" per transaction. These dealers asked whether a $15.00 flat fee qualifies as a miscellaneous transaction charge.

Rule G-15(a) sets out confirmation requirements for transactions with customers and specifies that dealers include a yield on the confirmation. In computing yield, G-15(a)(i)(A)(5)(c)(iii) states that such "computations shall take into account ... commissions charged to the customer ... but shall not take into account incidental transaction fees or miscellaneous charges, provided, however, that ... such fees or charges [are] indicated on the confirmation."

In a May 14, 1990 Notice Concerning Confirmation Disclosure of Miscellaneous Transaction Charges,[1] the MSRB reminded dealers that clear disclosure of the nature and amount of miscellaneous fees is required. The notice stated that these fees should not be incorporated into the stated yield because they are small and do not significantly affect a customer's return on investment, as shown in the yield. The notice also stated that miscellaneous fees differ from commissions because they are flat amounts, and, unlike the common practice used in computing commissions for agency transactions, are not related to the par value of the transaction.

The dealers who contacted the MSRB will charge a flat transaction fee of $15.00 for trades executed through an automated trading system. Since this fee is relatively small and unrelated to the par value of the transaction, the MSRB believes that the transaction fee should be considered a miscellaneous transaction fee. Therefore the fee would not have to be incorporated into the stated yield, but would need to be separately disclosed on the confirmation.

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1 *See* Rule G-15 Interpretation - Notice Concerning Confirmation Disclosure of Miscellaneous Transaction Charges, May 14, 1990, MSRB *Rule Book* (January 1, 2001) at 108.

**See also:**

**Rule G-12 Interpretations – Notice of Interpretation of Rules G-12(e) and G-15(c) on Deliveries of Called Securities – Definition of "Publication Date"**, October 20, 1986.

**– Notice on Determining Whether Transactions Are Inter-Dealer or Customer Transactions: Rules G-12 and G-15**, May 1988.

Rule G-17 Interpretations – Altering the Settlement Date on Transactions in "When-Issued" Securities, February 26, 1985.

– Notice Concerning the Application of Board Rules to Put Option Bonds, September 30, 1985.

– Notice Concerning Disclosure of Call Information to Customers of Municipal Securities, March 4, 1986.

– Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15, September 21, 1987.

– Educational Notice on Bonds Subject to "Detachable" Call Features, May 13, 1993.

Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

## *Interpretive Letters*

**Callable securities: "catastrophe" calls.** This will acknowledge receipt of your letter dated October 20, 1977 which has been referred to me for reply. In your letter you request an interpretation of the provisions in rules G-12 and G-15 requiring that the dollar price for transactions in callable securities effected on a yield basis be priced to the lower of price to call or price to maturity. (See rules G-12(c)(v)(I) and G-15(a)(viii))[*].

At its meeting held October 25-26, 1977, the Board confirmed that the requirements in rules G-12 and G-15 relating to pricing to call do not include "catastrophe" calls, that is, calls which occur as a result of events specified in the bond indenture which are beyond the control of the issuer. *MSRB interpretation of November 7, 1977.*

[*][Currently codified at rule G-15(a)(i)(A)(5).]

**Callable securities: disclosure.** I am writing in response to your letter of August 17, 1982, concerning the requirements of Board rules G-12(c)(v)(E) and G-15(a)(v) concerning securities descriptions set forth on confirmations. In your letter you note that certain descriptive details are required to be disclosed on the confirmation only "if necessary for a materially complete description of the securities," and you inquire whether information as to a security's callability is one of these details.

Rules G-12(c)(v)(E) and G-15(a)(v)[*] require confirmations to set forth a

> description of the securities, including at a minimum the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable) or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, *if necessary for a materially complete description of the securities, and in the case of any securities, if necessary for a materially complete description of the securities*, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement 'multiple obligators' may be shown.
>
> (emphasis added)

As you can see, the phrase "if necessary for a materially complete description of the securities" modifies only the requirements for disclosure of "the type of revenue," or... disclosure of "the name of any company or other person obligated ... with respect to debt service...," and does not modify the requirements for disclosure of the other listed information. Both rules, therefore, deem information as to the "name of the issuer, interest rate, maturity date and if the securities are limited tax, subject to redemption prior to maturity (callable) or revenue bonds" to be necessarily material and subject to disclosure on the confirmation. In the specific case which you cite, that of a security with an "in-part" sinking fund call feature, the confirmation of a transaction in such security would be required to identify the security as "callable." *MSRB interpretation of August 23, 1982.*

[*][Currently codified at rules G-15(a)(i)(B) and G-15(a)(i)(C).]

**Callable securities: extraordinary mandatory redemption features.** I am writing in response to your letter of February 15, 1983 regarding the confirmation disclosure requirements applicable to municipal securities which are subject to extraordinary mandatory redemption features. In your letter you inquire whether such securities need be identified as "callable" securities on the confirmation. You also inquire as to the relationship between an extraordinary mandatory redemption feature and a "catastrophe call" feature, and the disclosure requirements applicable to the latter type of provision.

An extraordinary mandatory redemption feature, in my understanding, is a call provision under which an issuer of securities would be obliged to call all or a part of an issue if certain stated unexpected events occur. For example, many of the recent mortgage revenue issues have extraordinary mandatory redemption provisions under which securities would be called if a portion of the proceeds of the issue has not been used to acquire mortgages by a certain stated date, or if moneys received from principal prepayments have not been used to acquire new mortgages by a certain period following receipt of the prepayment. In general, securities which are subject to extraordinary mandatory redemption provisions must be identified as "callable" securities on any confirmation. Extraordinary redemption provisions would not, however, be used for purposes of computing a yield or dollar price.

One specific type of extraordinary mandatory redemption provision is what has been colloquially termed a "catastrophe" or "calamity" call provision. Under this type of provision the issuer of securities would be obliged to call all or part of an issue if the financed project is destroyed or damaged by some catastrophe (*e.g.*, by fire, flood, lightning or other act of God) or if the tax exempt status of the issue is negated. The Board has previously expressed the view that securities which are callable solely under this type of "catastrophe" call provision, and are not otherwise callable, need not be designated as "callable" securities on a confirmation.

In summary, therefore, securities which are subject to extraordinary mandatory redemption provisions other than "catastrophe" call provisions must be identified as "callable" securities on confirmations. *MSRB interpretation of February 18, 1983.*

**Original issue discount, zero coupon securities: disclosure of, pricing to call feature.** I am writing in response to your inquiry in our recent telephone conversation regarding the application of Board rules to the recent original issue discount and "zero coupon" new issues of municipal securities. In particular, you indicated that these types of securities are often subject to somewhat unusual call provisions, and you inquired as to the application to these types of securities of Board rules concerning the disclosure of call provisions and the use of such call provisions in dollar price and yield computations.

Subsequent to our conversation, I obtained several examples of these call provisions, which were provided to the Board in connection with your inquiry. In the first of these examples, involving an original issue discount security, the call provision commences ten years after issuance, with the redemption price initially set

at 90 and increasing by 2 points every three years, reaching a redemption price of 100 twenty-five years after issuance. In the second example, involving a "zero coupon" security, the call provision commences ten years after issuance; the redemption price is based on the compound accreted value of the security (plus a stated redemption premium for the first five years of the call provision), with certain of the securities initially redeemable at an approximate dollar price of 18.

As you know, the call provisions on "zero coupon" and original issue discount securities are one of the special characteristics of such securities, but are not, by any means, the sole special characteristic. The Board is of the view that municipal securities brokers and dealers selling such securities are obliged, under Board rule G-17 as well as under the anti-fraud rules under the Securities Exchange Act, to disclose to customers all material information regarding such special characteristics. As the Board stated in its April 27, 1982 "Notice Concerning 'Zero Coupon' and 'Stepped Coupon' Securities,"

> persons selling such securities to the public have an obligation to adequately disclose the special characteristics of such securities so as to comply with the Board's fair practice rules.

Therefore, in selling an original issue discount or "zero coupon" security to a customer, a dealer would be obliged to disclose, among other matters, any material information with respect to the call provisions of such securities.

I note also that Rule G-15 requires customer confirmations of transactions in callable securities to indicate that the securities are "callable," and to contain a legend stating, in part, that information concerning the call provisions of such securities will be made available upon the customer's request. Customer confirmations of transactions in callable original issue discount or "zero coupon" securities would have to contain such a legend, in addition to the designation "callable," and the details of the call provisions of such securities would have to be provided to the customer in writing upon the customer's request.

The requirement under rules G-12 and G-15 for the computation of dollar price and (under rule G-15) yield to a call or option feature would apply to a transaction in an original issue discount or "zero coupon" security. Therefore, if the dollar price to the call on a transaction in such securities is lower than the price to maturity, such dollar price should be used. In the case of customer confirmations, if the yield to call on a transaction in such securities is lower, such yield must be shown. As you noted in our conversation, in view of the redemption price structure of the call provisions on such securities, the price or yield to call on a particular transaction might be lower than the price or yield to maturity, even though the transaction is effected at a price below par. Since heretofore the industry has been accustomed to call provisions at prices at or above par, industry members may wish to pay particular attention to the processing of transactions in original issue discount or "zero coupon" securities with these unusual types of call provisions, to ensure that the dollar price or yield of such transactions is not inadvertently overstated due to a failure to check the price or yield to call. *MSRB interpretation of June 30, 1982.*

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**Callable securities: pricing to call.** Your letter dated May 1, 1978 concerning the pricing to call provisions of rules G-12 and G-15 has been referred to me for response. In your letter, you request clarification of the application of such provisions to a situation in which securities have been prerefunded and the escrow fund is to be held to the maturity date of the securities. We understand that the securities in question are part of a term issue, sold on a yield basis, and are subject to a mandatory sinking fund call beginning two years prior to maturity.

Under rules G-12 and G-15, the dollar price of a transaction effected on a yield basis must be calculated to the lowest of price to premium call price to par option or price to maturity. The calculation of dollar price to a premium call or par option date should be to that date at which the issuer may exercise an option to call the whole of a particular issue or, in the case of serial bonds, a particular maturity, and not to the date of a call in part.

Accordingly, the calculation of the dollar price of a transaction in the securities in your example should be made to the maturity date. The existence of the sinking fund call should, however, be disclosed on the confirmation by an indication that the securities are "callable." The fact that the securities are prerefunded should also be noted on the confirmation. *MSRB interpretation of June 8, 1978.*

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**Callable securities: pricing to call.** Your letter, dated January 25, 1979 has been referred to me for response. In your letter, you raise a question regarding pricing of callable securities under rules G-12 and G-15. Specifically, you inquire as to how the dollar price should be calculated for transactions in a particular issue of [Name of bond deleted] bonds. The terms of the issue provide in pertinent part that the securities are subject to redemption prior to maturity on or after October 1, 1984, at declining premiums, from the proceeds of prepayments of mortgage loans (the "1984 call feature").

As you know, Board rules G-12 and G-15 require that

> ...where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to premium call, price to par option, or price to maturity...

As an interpretive matter, the Board has adopted the position that the calculation of dollar price to a premium call or par option date should be to that date at which the issuer may exercise an option to call the whole of a particular issue or, in the case of serial bonds, a particular maturity, and not to the date of a call in part.

With respect to your question, the Board is of the view that the dollar price for transactions involving the securities in question should not be calculated to the 1984 call feature. The Board bases its conclusion on (1) the fact that it is extremely unlikely as a practical matter that the call would be exercised as to all or even a significant part of the issue (that is, it is much more likely to operate in practice as an "in part" call) and (2) the exercise of the 1984 call feature would depend on events which are not subject to the control of the issuer. I note that the Board cited this as the reason for not utilizing "catastrophe call" features for purposes of price calculation. *MSRB interpretation of March 9, 1979.*

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**Callable securities: pricing transactions on construction loan notes.** I am writing in response to your letter of February 3, 1984 concerning the application of certain of the confirmation requirements of Board rules G-12 and G-15 to transactions in construction loan notes. In your letter you note that both rules require that the confirmation of a transaction in callable securities effected on a yield basis set forth a dollar price that has been computed to the lowest of the price to the call, the price to the par option, or the price to maturity of the securities; rule G-15 requires that customer confirmations effected on a dollar price basis state the resulting yield computed to the lowest of the yield to call, to the par option, or to maturity. You inquire how these comparative calculation requirements would apply to a confirmation of a transaction in construction loan notes, which generally are callable "in whole" six months prior to the stated maturity date at par.

Your inquiry was referred to a committee of the Board which has responsibility for interpreting the Board's confirmation rules; that committee has authorized my sending you this response. The committee notes that a Board interpretive notice of December 1980, which discussed the types of call features which should be used for purposes of the comparative calculation requirements, stated clearly that these requirements would apply to a transaction in a callable security if the issue of which the security is a part is callable "in whole" and if there is no restriction on the source of the funds which may be used to exercise the call. Since the call feature applica-

ble to issues of construction loan notes is this type of "in whole" call feature, the committee is of the view that the comparative calculation requirements would apply. The confirmation of a transaction in a construction loan note effected on a yield basis, therefore, should state a dollar price computed to the lower of the price to this call feature or the price to maturity. Similarly, a customer confirmation of a transaction in these securities effected on a dollar price basis should set forth a yield to the lower of the yield to this call feature or a yield to maturity. MSRB *interpretation of March 5, 1984.*

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**Callable securities: pricing to call and extraordinary mandatory redemption features.** This is in response to your November 16, 1983, letter concerning the application of the Board's rules to sales of municipal securities that are subject to extraordinary redemption features.

As a general matter, rule G-17 of the Board's rules of fair practice requires municipal securities brokers and dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require, in connection with the purchase from or sale of a municipal security to a customer, that a dealer must disclose, at or before the time the transaction occurs, all material facts concerning the transaction and not omit any material facts which would render other statements misleading. The fact that a security may be redeemed "in whole," "in part," or in extraordinary circumstances prior to maturity is essential to a customer's investment decision about the security and is one of the facts a dealer must disclose prior to the transaction. It should be noted that the Board has determined that certain items of information must, because of their materiality, be disclosed on confirmations of transactions. However, a confirmation is not received by a customer until after a transaction is effected and is not meant to take the place of oral disclosure prior to the time the trade occurs.

You ask whether, for an issue which has more than one call feature, the disclosure requirements of MSRB rule G-15 would be better served by merely stating on the confirmation that the bonds are callable, instead of disclosing the terms of one call feature and not another. Board rule G-15, among other things, prescribes what items of information must be disclosed on confirmations of transactions with customers.[1] Rule G-15(a)(i)(E)[*] requires that customer confirmations contain a materially complete description of the securities and specifically identifies the fact that securities are subject to redemption prior to maturity as one item that must be specified. The Board is of the view that the fact that a security may be subject to an "in whole" or "in part" call is a material fact for an individual making an investment decision about the securities and has further required in rule G-15(a)(iii)(D)[†] that confirmations of transactions in callable securities must state that the resulting yield may be affected by the exercise of a call provision, and that information relating to call provisions is available upon request.[2]

With respect to the computation of yields and dollar prices, rule G-15(a)(i)(I)[‡] requires that the yield and dollar price for the transaction be disclosed as the price (if the transaction is done on a yield basis) or yield (if the transaction is done on the basis of a dollar price) calculated to the lowest price or yield to call, to par option, or to maturity. The provision also requires, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in whole" calls should be used.[3] This requirement reflects the longstanding practice of the municipal securities industry and advises a purchaser what amount of return he can expect to realize from the investment and the terms under which such return would be realized.

You also ask whether it is reasonable to infer from the discharge of one call feature that no other call features exist. As discussed above, the Board requires a customer confirmation to disclose, when applicable, that a security is subject to redemption prior to maturity and that the call feature may affect the security's yield. This requirement applies to securities subject to either "in whole" or "in part" calls. Moreover, as noted earlier, because information concerning call features is material information, principles of fair dealing embodied by rule G-17 require that these details be disclosed orally at the time of trade.

By contrast, identification of the first "in-whole" call date and its price must be made only when they are used to compute the yield or resulting dollar price for a transaction. This disclosure is designed only to advise an investor what information was used in computing the lowest of yield or price to call, to par option, or to maturity and is not meant to describe the only call features of the municipal security.

In addition, in the case of the sale of new issue securities during the underwriting period, Board rule G-32 requires that ... a copy of the final official statement, if any, must be provided to the customer.[4] While the official statement would describe all call features of an issue, it must be emphasized that delivery of this document does not relieve a dealer of its obligation to advise a customer of material characteristics and facts concerning the security at the time of trade.

Finally, you ask whether the omission of this or other call features on the confirmation is a material omission of the kind which would be actionable under SEC rule 10b-5. The Board is not empowered to interpret the Securities Exchange Act or rules thereunder; that responsibility has been delegated to the Securities and Exchange Commission. We note, however, that the failure to disclose the existence of a call feature would violate rule G-15 and, in egregious situations, also may violate rule G-17, the Board's fair dealing rule. MSRB *interpretation of February 10, 1984.*

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1 Similar requirements are specified in rule G-12 for confirmations of inter-dealer transactions.

2 The rule states that this requirement will be satisfied by placing in footnote or otherwise the statement:

> "[Additional] call features ... exist [that may] affect yield; complete information will be provided upon request."

3 See [Rule G-15 Interpretation – Notice Concerning Pricing to Call,] December 10, 1980 ... at ¶ 3571.

4 The term underwriting period is defined in rule G-11 as:

> the period commencing with the first submission to a syndicate of an order for the purchase of new issue municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending at such time as the issuer delivers the securities to the syndicate or the syndicate no longer retains an unsold balance of securities, whichever last occurs.

[*][Currently codified at rule G-15(a)(i)(C).]

[†][Currently codified at rule G-15(a)(i)(C)(2)(a).]

[‡][Currently codified at rule G-15(a)(i)(A)(5).]

**NOTE: Revised to reflect subsequent amendments.**

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**Calculation of price and yield on continuously callable securities.** This will respond to your letter of May 30, 1989, relating to the calculation of price and yield in transactions involving municipal securities which can be called by the issuer at any time after the first optional "in-whole" call date. The Board reviewed your letter at its August 1989 meeting and has authorized this response.

Rules G-12(c) and G-15(a) govern inter-dealer and customer confirmations, respectively. For transactions executed on a yield basis, rules G-12(c)(v)(I) and G-15(a)(v)(I)[*] require the dollar price computed from yield and shown on the confirmation to be computed to the lower of call or maturity. The rules also require the call date and price to be shown on the confirmation when securities are priced to a call date.

In computing price to call, only "in-whole" calls, of the type which may be exercised in the event of a refunding, should be used.[1] The "in-whole" call producing the lowest price must be used when computing price to call. If there is a series of "in-whole" call dates with declining premiums, a calculation to the first premium call date generally will produce the lowest price to call. However, in certain circumstances involving premiums which decline steeply over a short time, an "intermediate" call date—a date on

which a lower premium or par call becomes operative—may produce the lowest price. Dealers must calculate prices to intermediate call dates when this is the case.[2] Identical rules govern the computation and display of yield to call and yield to maturity, as required on customer confirmations under rule G-15(a).

The issues that you describe are callable at declining premiums, in part or in whole, at any time after the first optional call date. There is no restriction on the issuer in exercising a call after this date except for the requirement to give 30 to 60 days notice of the redemption. Since this "continuous" call provision is an "in-whole" call of the type which may be used for a refunding, it must be considered when calculating price or yield.

The procedure for calculating price to call for these issues is the same as for other securities with declining premium calls. Dealers must take the lowest price possible from the operation of an "in-whole" call feature, compare it to the price calculated to maturity and use the lower of the two figures on the confirmation. For settlement dates prior to the first "in-whole" call, it generally should be sufficient to check the first and intermediate call dates (including the par call), determine which produces the lowest price, and compare that price to the price calculated to maturity. For settlement dates occurring after the first "in-whole" call date, it must be assumed that a notice of call could be published on the day after trade date, which would result in the redemption of the issue 31 days after trade date.[3] The price calculated to this possible redemption date should be compared to prices calculated to subsequent intermediate call dates and the lowest of these prices used as the price to call. The price computed to call then can be compared to the price computed to maturity and the lower of the two included on the confirmation. If a price to call is used, the date and redemption price of the call must be stated. Identical procedures are used for computing yield from price for display on customer confirmations under rule G-15(a).

You also have asked for the Board's interpretation of two official statements which you believe have a continuous call feature and ask whether securities with continuous call features typically are called between the normal coupon dates. The Board's rulemaking authority does not extend to the interpretation of official statements and the Board does not collect information on issuer practices in calling securities. Therefore, the Board cannot assist you with these inquiries. *MSRB Interpretation of August 15, 1989.*

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[1] The parties to a transaction may agree at the time of trade to price securities to a date other than an "in-whole" call date or maturity. If such an agreement is reached, if must be noted on the confirmation.

[2] See [Rule G-15 Interpretation – ]Notice Concerning Pricing to Call, December 10, 1980, *MSRB Manual* paragraph 3571.

[3] If a notice of call for the entire issue occurs on or prior to the trade date, delivery cannot be made on the transaction and it must be worked out or arbitrated by the parties. See rules G-12(e)(x)(B) and G-15(c)(viii)(B).

[*][Currently codified at rule G-15(a)(i)(A)(5)(c).]

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**Callable securities: pricing to mandatory sinking fund calls.** This is in response to your February 21, 1986 letter concerning the application of rule G-15(a) regarding pricing to prerefunded bonds with mandatory sinking fund calls.

You give the following example:

Bonds, due 7/1/10, are prerefunded to 7/1/91 at 102. There are $17,605,000 of these bonds outstanding. However, there is a mandatory sinking fund which will operate to call $1,000,000 of these bonds at par every year from 7/1/86 to 7/1/91. The balance ($11,605,000) then will be redeemed 7/1/91 at 102. If this bond is priced to the 1991 prerefunded date in today's market at a 6.75 yield, the dollar price would be approximately 127.94. However, if this bond is called 7/1/86 at 100 and a customer paid the above price, his/her yield would be a minus 52 percent (-52%) on the called portion.

You state that the correct way to price the bond is to the 7/1/86 par call at a 5% level which equates to an approximate dollar price of 102.61. The subsequent yield to the 7/1/91 at 102 prerefunded date would be 12.33% if the bond survived all the mandatory calls to that date. You note that a June 8, 1978, MSRB interpretation states, "the calculation of dollar price to a premium call or par option date should be to that date at which the issuer may exercise an option to call the whole of a particular issue or, in the case of serial bonds, a particular maturity, and not to the date of a call in-part." You believe, however, that, as the rule is presently written, dealers are leaving themselves open for litigation from customers if bonds, which are trading at a premium, are not priced to the mandatory sinking fund call. You ask that the Board review this interpretation.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Rule G-15(a)(i)(I)[*1] requires that on customer confirmations the yield and dollar price for the transaction be disclosed as the price (if the transaction is done on a yield basis) or yield (if the transaction is done on the basis of the dollar price) calculated to the lowest price or yield to call, to par option, or to maturity. The provision also requires, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in-whole" calls should be used.[1] This requirement reflects the longstanding practice of the municipal securities industry that a price calculated to an "in-part" call, such as a sinking fund call, is not adequate because, depending on the probability of the call provision being exercised and the portion of the issue subject to the call provision, the effective yield based on the price to a sinking fund date may not bear any relation to the likely return on the investment.

Rule G-15(a)(i)(I) applies, however, only when the parties have not specified that the bonds are priced to a specific call date. In some circumstances, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to a particular date, *e.g.* put option date, and that the dollar price will be computed in this fashion. If that is the case, the yield to this agreed upon date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to that date, together with a statement that it is a "yield to [date]." In an August 1979 interpretive notice on pricing of callable securities, the Board stated that, under rule G-30, a dealer pricing securities on the basis of a yield to a specified call feature should take into account the possibility that the call feature may not be exercised.[2] Accordingly, the price to be paid by the customer should reflect this possibility, and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in such a manner may constitute a violation of rule G-30 since the price may not be "fair and reasonable" in the event the call feature is not exercised. The Board also noted that the fact that a customer in these circumstances may realize a yield in excess of the yield at which the transaction was effected does not relieve a municipal securities dealer of its responsibilities under rule G-30.

Accordingly, the calculation of the dollar price of a transaction in the securities in your example, unless the parties have agreed otherwise, should be made to the prerefunded date. Of course, under rule G-17 on fair dealing, dealers must explain to customers the existence of sinking fund calls at the time of trade. The sinking fund call, in addition, should be disclosed on the confirmation by an indication that the securities are "callable." The fact that the securities are prerefunded also should be noted on the confirmation. *MSRB Interpretation of April 30, 1986.*

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[1] See [Rule G-15 Interpretation – Notice Concerning Pricing to Call,] December 10, 1980 ... at ¶ 3571.

[2] See [Rule G-30 Interpretation – Interpretive Notice on Pricing of Callable Securities,] August 10, 1979 ... at ¶ 3646.

[*][Currently codified at rule G-15(a)(i)(A)(5).]

**Disclosure of pricing: calculating the dollar price of partially prerefunded bonds.** This is in response to your March 21, 1986 letter concerning the application of Board rules to the description of municipal securities provided at or prior to the time of trade and the application of rules G-12(c) and G-15(a) on calculating the dollar price of partially prerefunded bonds with mandatory sinking fund calls.

You describe an issue, due 10/1/13. Mandatory sinking fund calls for this issue begin 10/1/05 and end 10/1/13. Recently, a partial refunding took place which prerefunds the 2011, 2012 and 2013 mandatory sinking fund requirements totalling $11,195,000 (which is 43.6% of the issue) to 10/1/94 at 102. The certificate numbers for the partial prerefunding will not be chosen until 30 days prior to the prerefunded date. Thus, a large percentage of the bonds are prerefunded and all the bonds will be redeemed by 10/1/10 because the 2011, 2012, and 2013 maturities no longer exist.

You note that the bonds should be described as partially prerefunded to 10/1/94 with a 10/1/10 maturity. Also, you state that the price of these securities should be calculated to the cheapest call, in this case, the partial prerefunded date of 10/1/94 at 102. You add that there is a 9 ½ point difference in price between calculating to maturity and to the partially prerefunded date.

You note that the descriptions you have seen on various brokers' wires do not accurately describe these securities and a purchaser of these bonds would not know what they bought if the purchase was based on current descriptions. You ask the Board to address the description and calculation problems posed by this issue.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Board rule G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

In regard to inter-dealer transactions, the items of information that professionals must exchange at or prior to the time of trade are governed by principles of contract law and essentially are those items necessary adequately to describe the security that is the subject of the contract. As a general matter, these items of information do not encompass all material facts, but should be sufficient to distinguish the security from other similar issues. The Board has interpreted rule G-17 to require dealers to treat other dealers fairly and to hold them to the prevailing ethical standards of the industry.[1] The rule also prohibits dealers from knowingly misdescribing securities to another dealer.[2]

Board rules G-12(c) and G-15(a) require that

> where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity ...

In addition, for customer confirmations, rule G-15(a) requires that

> for transactions effected on the basis of dollar price,... the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown...

These provisions also require, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in-whole" calls should be used.[3] This requirement reflects the longstanding practice of the municipal securities industry that a price calculated to an "in-part" call, for example, a partial prerefunding date, is not adequate because, depending on the probability of the call provision being exercised and the portion of the issue subject to the call provision, the effective yield based on the price to a partial prerefunding date may not bear any relation to the likely return on the investment.

These provisions of Rules G-12(c) and G-15(a) apply, however, only when the parties have not specified that the bonds are priced to a specific call date. In some circumstances, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to a particular date, *e.g.*, a partial prerefunding date, and that the dollar price will be computed in this fashion. If that is the case, the yield to this agreed upon date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to that date, together with a statement that it is a "yield to [date]." In an August 1979 interpretive notice on pricing of callable securities, the Board stated that, under rule G-30, a dealer pricing securities sold to a customer on the basis of a yield to a specified call feature should take into account the possibility that the call feature may not be exercised.[4] Accordingly, the price to be paid by the customer should reflect this possibility, and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in such a manner may constitute a violation of rule G-30 since the price may not be "fair and reasonable" in the event the call feature is not exercised. The Board also noted that the fact that a customer in these circumstances may realize a yield in excess of the yield at which the transaction was effected does not relieve a municipal securities dealer of its responsibilities under rule G-30.

Accordingly, the calculation of the dollar price of a transaction in the securities you describe, unless the parties have agreed otherwise, should be made to the lowest of price to the first in-whole call, par option, or maturity. While the partial prerefunding effectively redeems the issue by 10/1/10, the stated maturity of the bond is 10/1/13 and, subject to the parties agreeing to price to 10/1/10, the stated maturity date should be used. *MSRB interpretation of May 15, 1986.*

[1] In addition, the Board has interpreted this rule to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision, including a complete description of the security, and not omit any material facts which would render other statements misleading.

[2] While the Board does not have any specific disclosure requirements applicable to dealers at the time of trade, a dealer is free to disclose any unique aspect of an issue. For example, in the issue described above, a dealer may decide to disclose the "effective" maturity date of 2010, as well as the stated maturity date of 2013.

[3] See [Rule G-15 Interpretation – Notice Concerning Pricing to Call,] December 10, 1980 ... at ¶ 3571.

[4] See [Rule G-30 Interpretation – Interpretive Notice on Pricing of Callable Securities,] August 10, 1979 ... at ¶ 3646.

**Disclosure of the investment of bond proceeds.** This is in response to your letter asking whether rule G-15(a), on customer confirmations, requires disclosure of the investment of bond proceeds.

Rule G-15(a)(i)(E)[*1] requires dealers to note on customer confirmations the description of the securities, including, at a minimum

> the name of the issuer, interest rate, maturity date and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities, and in the case of any securities, if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown.

The Board has not interpreted this provision as requiring disclosure of the investment of bond

proceeds.

Of course, rule G-17, on fair dealing, has been interpreted by the Board to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision and must not omit any material facts which would render other statements misleading. Thus, if information on the investment of bond proceeds of a particular issue is a material fact, Board rules require disclosure at the time of trade. *MSRB Interpretation of August 16, 1991.*

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[*][Currently codified at rules G-15(a)(i)(B) and G-15(a)(i)(C).]

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**Agency transactions: remuneration.** This will acknowledge receipt of your letter dated November 1, 1977 in which you request an interpretation concerning the provision in Board rule G-15(b)(ii)[*] which requires that "the source and amount of any commission or other remuneration" received by a municipal securities dealer in a transaction in which the municipal securities dealer is acting as agent for a customer be disclosed on the confirmation to the customer.

The reference to the "amount of any commission or other remuneration" requires that an aggregate dollar amount be shown, in a purchase transaction on behalf of an equivalent of the dealer concession, and, if applicable, any additional charge to the customer above the price paid to the seller of the securities. In a sale transaction on behalf of a customer, this would normally be the difference between the net price paid by the purchaser of the securities and the proceeds to the customer. If a percentage of par value or unit profit were shown it would be difficult for many customers to relate this information to the "total dollar amount of [the] transaction" required by rule G-15(a)(xi)[†] to be shown on the confirmation.

The reference in rule G-15(b)(ii)[*] to the "source" of remuneration would not require you to differentiate between the concession and any additional charge. Standard language could be included on the confirmation to indicate that your remuneration may include dealer concessions and other charges. *MSRB interpretation of November 10, 1977.*

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[*][Currently codified at rule G-15(a)(i)(A)(1)(e).]

[†][Currently codified at rule G-15(a)(i)(A)(6)(a).]

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**Agency transaction: pricing.** This will acknowledge receipt of your letter of March 17, 1981 concerning the appropriate method of disclosing remuneration on agency transactions. In your letter you indicate that the bank wishes to use one of the following two legends, as appropriate, in disclosing such remuneration:

1) "Commission: Agency Fee $... per $1,000 of par value included in/deducted from net price to customer;" or

2) "Commission: Concession received from broker/dealer $...per $1,000 of par value."

You inquire whether these legends, indicating the amount of remuneration on a "dollars per bond" basis, are satisfactory for purposes of rule G-15.

Rule G-15(b)[*] requires that

> [i]f the broker, dealer or municipal securities dealer is effecting a transaction as agent for the customer or as agent for both the customer and another person, the confirmation shall set forth... the source and amount of any commission or other remuneration received or to be received by the broker, dealer or municipal securities dealer in connection with the transaction.

As you are aware, the Board has previously interpreted this provision to require that an aggregate dollar amount be shown. The Board adopted this position due to its belief that many customers would find it difficult to interpret the meaning of a statement disclosing the remuneration as a percentage of par value or a unit profit per bond, or to relate this information to the "total dollar amount of [the] transaction" required to be shown under G-15(a)(xi)[†].

Accordingly, we are unable to conclude that disclosure of the remuneration in the manner in which you suggest would be satisfactory for purposes of the rule. The total dollar amount of the remuneration should be set forth on the confirmation. *MSRB interpretation of April 23, 1981.*

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[*][Currently codified at rule G-15(a)(i)(A)(1)(e).]

[†][Currently codified at rule G-15(a)(i)(A)(6)(a).]

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**Agency transaction: pricing.** Your letter of August 3, 1979 has been referred to me for response. In your letter you inquire as to the relationship between the requirements to show on customers confirmations the "yield at which transaction is effected" and the "resulting dollar price," particularly in the context of agency transactions where the professional receives a concession or other dealer reallowance as its remuneration.

Under rule G-15, the dollar price disclosed to a customer must be calculated on the basis of the yield at which the transaction was effected. This calculation is made without reference to any possible concession or other allowance which a municipal securities dealer may receive from another municipal securities professional. Accordingly, the dollar price shown on a customer confirmation will always be derived directly from the yield price.

For example, a municipal securities dealer seeking to purchase $100,000 fifteen-year bonds with a 5% coupon as agent for a customer would commonly purchase the securities from another professional at a yield price less a concession (*e.g.*, "5.60 ½"), and confirm to the customer at the net yield price ("5.60"), retaining the concession as its remuneration. In our example, the customer confirmation would be required to disclose the "yield at which transaction is effected" ("5.60"), the "resulting dollar price" ("93.96"), and the fact that the dealer received $500 as its remuneration in the form of a dealer concession. The dollar price is computed directly from the yield price, and is not net of the concession received.

The confusion may arise from comparing the confirmation sent to a customer to the confirmation sent to the professional on the other side of a transaction. On the inter-dealer confirmation, the "yield at which transaction is effected" will be shown, as well as the amount of the concession, but the unit dollar price may be expressed net of the concession (in our example, "93.46," being the gross dollar price of "93.96" less the ½ point reallowance). This may give the appearance of a difference in price between the purchase and sale confirmations, but in fact both transactions are being effected at the same yield price (in our example, "5.60"), and the dollar price disclosed to the customer is the result of this yield. *MSRB interpretation of September 20, 1979.*

**Note: The above letter refers to the text of rule G-15 as in effect prior to amendments effective on January 16, 1992.**

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**Agency transactions: yield disclosures.** I am writing in connection with your previous conversations with Christopher Taylor of the Board's staff concerning the application of the yield disclosure requirements of Board rule G-15 to certain types of transactions in municipal securities. In your conversations you noted that dealers occasionally effect transactions in municipal securities on an "agency" basis. In these transactions the customer's confirmation would typically show as the dollar price of the transaction the price paid by the dealer to the person from whom it acquired the securities; the dealer's remuneration, received in the form of a commission paid by the customer, is typically shown separately, as a charge included in the summing of the total dollar amount due from (or to) the customer in connection with the transaction. You inquired whether, in such a transaction, the yield to the customer disclosed on the confirmation should be derived from the price shown as the dollar price of the transaction or from the total dollar amount of the transaction (*i.e.*, whether the yield should show the effect of

the commission charged).

This will confirm Mr. Taylor's advice to you that the yield shown on the confirmation of such a transaction should be derived from the total dollar amount of the transaction, and therefore should show the effect of the commission charged to the customer on the transaction. As the Board has previously stated, the yield disclosure on customer confirmations is intended to provide customers with a means of assessing the merits of alternative investment strategies and the merits of the transaction being confirmed. The disclosure of the yield after giving effect to the commission charged the customer best serves these purposes. *MSRB interpretation of July 13, 1984.*

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**Disclosure of pricing: accrued interest.** This is in response to your request by telephone for an interpretation of Board rule G-15 which requires that a municipal securities dealer provide to his customer, at or prior to completion of a transaction, a written confirmation containing certain general information including the amount of accrued interest. Specifically, you have asked whether the rule permits a municipal securities dealer, in using one confirmation to confirm transactions in several different municipal securities of one issuer, to disclose the amount of accrued interest for the bonds as an aggregate figure. You have advised us that, typically, such a confirmation will show other items of information required by the rule such as yield and dollar price, separately for each issue.

Rule G-15 was adopted by the Board to assure that confirmations of municipal securities transactions provide investors with certain fundamental information concerning transactions. The Board believes that disclosure of accrued interest as an aggregate sum does not permit investors to determine easily from the confirmation the amount of accrued interest attributable to each security purchased, but rather necessitates the performance of several computations. It, thus, would be more difficult for an investor to determine whether the information concerning accrued interest is correct if the information is presented in aggregate form.

Such a result is inconsistent with the purposes of rule G-15. Accordingly, the Board has concluded that, under rule G-15, the amount of accrued interest must be shown for each issue of bonds to which the customer confirmation relates. *MSRB interpretation of July 27, 1981.*

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**Yield disclosures.** This letter is in response to your inquiry of April 14, 1981 concerning the application of the yield disclosure requirements of Board rule G-15 to a particular transaction effected by your firm. As I indicated to you in my letter of May 9, 1981, the Board was unable to consider your inquiry at its April meeting, and, accordingly, deferred the matter to its July meeting. At that meeting the Board took up your question and authorized my sending you this answer to your inquiry. While we realize that the matter is now moot with respect to the particular transaction about which you were writing, we assume that this question may arise again with respect to future transactions.

In your April 14 letter you inquired concerning a recent sale of new issue securities to a customer. You indicated that the firm had sold all twenty maturities of the new issue to a customer. This sale had been effected at the same premium dollar price for all maturities, and the customer had been advised of the average life of the issue and the yield to the average life. You inquired whether the final money confirmation of this sale should show "one dollar price ... and one yield to the average life," or the dollar price and each of the yields to the twenty different maturities of the issue.[1]

Rule G-15(a)(viii)(B)[*] requires that customer confirmations of transactions in noncallable securities effected on the basis of a dollar price set forth the dollar price and the resulting yield to maturity. In the situation you describe, it would be difficult to conclude that the rule would permit the confirmation to show only a "yield to the average life," omitting any yield to maturity information. Although the "yield to the average life" would provide the customer with some indication of the return on his or her investment, the customer could easily make the mistake of assuming that this would be the yield on all of the securities, and not realize that it is the result of differing yields, with lower yields on the short-term maturities and higher yields on the long-term ones. The Board believes that disclosure of each of the yields to the twenty maturities of the issue would provide the customer with much more accurate information concerning the return on his or her investments. Accordingly, the Board concludes that, in a transaction of this type, the final money confirmation(s) should set forth each of the yields. *MSRB interpretation of July 27, 1981.*

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[1] Although you did not indicate this, we assume that all of these securities are noncallable.

[*][Currently codified at rule G-15(a)(i)(A)(5)(b).]

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**Yield disclosures: transactions at par.** I am writing in response to your letter of April 2, 1982, concerning certain of the yield disclosure requirements of Board rule G-15 on customer confirmations. In your letter you note that item (C) of rule G-15(a)(viii)[*] requires that "for transactions at par, the dollar price shall be shown" on the confirmations of such transactions, and you inquire whether it is necessary to show a yield on such confirmations.

Please be advised that a confirmation of a transaction effected at par (*i.e.*, at a dollar price of "100") need show only the dollar price "100" and need not, under the terms of the rule, show the resulting yield.

I note, however, that a transaction effected on the basis of a yield price equal to the interest rate of the security which is the subject of the transaction would be considered, for purposes of the rule, to be a "transaction effected on a yield basis," and therefore would be subject to the requirements of item (A) of rule G-15(a)(viii)[†]. The confirmation of such transaction would therefore be required to state "the yield at which [the] transaction was effected and the resulting dollar price[.]" *MSRB interpretation of April 8, 1982.*

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[*][Currently codified at rule G-15(a)(i)(A)(5)(b)(ii).]

[†][Currently codified at rule G-15(a)(i)(A)(5)(a).]

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**Yield disclosures: yields to call on zero coupon bonds.** I am writing in response to your letter of October 18, 1983 concerning the appropriate method of disclosing on a confirmation a call price used in the computation of a dollar price or yield on a transaction in a zero coupon, compound interest, multiplier, or other similar type of security. In your letter you indicate that the call features on these types of securities often express the call prices in terms of a percentage of the compound accreted value of the security as of the call date.[1] You note that, in computing a price or yield to such a call feature, it is necessary for the computing dealer to convert such a call price into its equivalent in terms of a percentage of maturity value (*i.e.*, into a standard dollar price), and use this figure in the computation. You inquire whether, in circumstances where the confirmation of a transaction is required to disclose a yield or dollar price computed to such a call feature, the call price used in the calculation should be stated on the confirmation in terms of the percentage of the compound accreted value or in terms of the equivalent percentage of maturity value.

The requirement which is the subject of your inquiry is set forth in Board rule G-15(a)(i)(I)[*] as follows:

> In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated, and the call or option date and price used in the calculation must be shown...[2]

The Board is of the view that, in the case of a computation of a yield or dollar price to a call or option feature on a transaction in a zero coupon or similar security, the call price shown on the confirmation should be expressed in terms of a percentage of the security's maturity value. The Board believes that the disclosure of the call price in terms of the security's maturity value would provide more meaningful information to

the purchaser, since other confirmation disclosure on these types of securities are also expressed in terms of the security's maturity value. This form of disclosure therefore presents the information to a purchaser in a consistent format, thereby facilitating the purchaser's understanding of the information shown on the confirmation. The Board notes also that this form of disclosure is simpler and requires less confirmation space to present. *MSRB interpretation of January 4, 1984.*

[1] For example, the selected portions of an official statement describing one of these types of issues enclosed with your letter indicate that the security in question is callable on October 1, 1993 at 108% of the security's compound accreted value on that date (which is indicated elsewhere in the official statement to be $146.02 per $1,000 of maturity value).

[2] Comparable requirements with respect to inter-dealer confirmations are set forth in Board rule G-12(c)(v)(I).

[*][Currently codified at rule G-15(a)(i)(A)(5).]

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**Particularity of legend.** I refer to your recent letter in which you inquired regarding the appropriateness of using a particular legend to satisfy certain requirements of rule G-15 on customer confirmations. As you note in your letter, rule G-15 requires that information concerning time of execution of a transaction and the identity of the contra-side of an agency transaction be furnished to customers, at least upon request. You have requested advice as to whether the following legend satisfies the requirements of rule G-15 with respect to this information:

> "Other details about this trade may be obtained by written request to the above address."

We are of the opinion that the legend in question does not satisfy the requirements of rule G-15 because it is too general in nature. The legend does not sufficiently apprise customers of their right to obtain information pertaining to the time of execution of a transaction or the identity of the contra-party, as contemplated by rule G-15. A legend specifically alluding to the availability of such information is necessary to satisfy the rule.

The Board has not adopted a standardized form, nor approved particular language for use in compliance with the requirements of the rule. I believe, however, that [Name deleted] is a member of the Dealer Bank Association. I suggest that you refer to the Forms Book prepared by the Dealer Bank Association, which may be of help to you. *MSRB interpretation of March 6, 1979.*

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**Securities description: revenue securities.** I am writing in response to your letter of September 30, 1982 regarding the confirmation description of revenue securities. In your letter you note that the designation "revenue" is often not included in the title of the security, and you raise several questions concerning the method of deriving a proper confirmation description of revenue securities.

As you know, rule G-15(a)(v)[*1] requires that customer confirmations set forth a

> description of the securities [involved in the transaction] including at a minimum the name of the issuer, interest rate, maturity date and *if the securities are... revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities...*[1]
>
> [emphasis added]

The rule requires, therefore, that revenue securities be designated as such, regardless of whether or not such designation appears in the formal title of the security. The dealer preparing the confirmation is responsible for ensuring that the designation is included in the securities description. In circumstances in which standard sources of descriptive information (*e.g.*, official statements, rating agency and service bureau publications, and the like) do not include such a designation in the security title, therefore, the dealer must augment this title to include the requisite information.

In your letter you inquire as to who is responsible for providing this type of descriptive information to the facilities manager of the CUSIP system. Although the Board does not currently have any requirements concerning this matter, proposed rule G-34 will, when approved by the Securities and Exchange Commission, require that the managing underwriter of a new issue of municipal securities apply for the assignment of CUSIP numbers of such new issue if no other person (*i.e.*, the issuer or a person acting on behalf of the issuer) has already applied for number assignment. In connection with such application, if one is necessary, the managing underwriter is required, under the proposed rule, to provide certain information about the new issue, including a designation of the "type of issue (*e.g.*, general obligation, limited tax, or revenue)" and an indication of the "type of revenue, if the issue is a revenue issue."

In your letter you also ask for "the official definition of a 'revenue' issue." There is no "official definition" of what constitutes a revenue issue. Various publications include a definition of the term (*e.g.*, the PSA's *Fundamentals of Municipal Bonds*, the State of Florida's *Glossary of Municipal Securities Terms*, etc.) and I would urge you to consult these for further information. *MSRB interpretation of December 1, 1982.*

[1] Rule G-12(c)(v)(E) sets forth the same requirement with respect to inter-dealer confirmations.

[*][Currently codified at rules G-15(a)(i)(B) and G-15(a)(i)(C).]

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**Securities description: securities backed by letters of credit.** I am writing in connection with our previous telephone conversation of last June regarding the confirmation of a transaction in a municipal issue secured by an irrevocable letter of credit issued by a bank. In our conversation you noted that both rules G-12 and G-15 require confirmations to contain a:

> description of the securities including at a minimum..., if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service...

You inquired whether the name of the bank issuing a letter of credit securing principal and interest payments on an issue, or securing payments under the exercise of a put option or tender option feature, need be stated on the confirmation.

At that time I indicated to you that the identity of the bank issuing the letter of credit would have to be disclosed on the confirmation if the letter of credit could be drawn upon to cover scheduled interest and principal payments when due, since the bank would be "obligated ... with respect to debt service." I am writing to advise that the committee of the Board which reviewed a memorandum of our conversation has concluded that a bank issuing a letter of credit which secures a put option or tender option feature on an issue is similarly "obligated ... with respect to debt service" on such issue. The identity of the bank issuing the letter of credit securing the put option must therefore also be indicated on the confirmation. *MSRB interpretation of December 2, 1982.*

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**Securities description: prerefunded securities.** This is in response to your letter in which you ask when an issue of municipal securities may be described as prerefunded for purposes of Board rule G-12, on uniform practice, and rule G-15, on confirmation, clearance and settlement of transactions with customers. You describe a situation in which an outstanding issue of municipal securities is to be prerefunded by a new issue of municipal securities. You note that information on the issue to be prerefunded "is usually available within a few days of the new issue being priced... [but that the] new issue's settlement date is usually several weeks later,... [and] it is not until that date that funds will be available to establish the escrow to refund the bonds." You ask whether the outstanding issue of securities is considered prerefunded upon the final pricing of the refunding issue or upon settlement of that issue.

Rule G-15 governs the items of disclosure required on customer confirmations. This rule provides that, if securities are called or prerefunded, dealers must note this fact (along with

the call price and the maturity date fixed by the call notice) on the customer's confirmation.[1] In situations where an issuer has indicated its intent to prerefund an outstanding issue, it is the Board's position that the issue is not, in fact, prerefunded until the issuer has taken the necessary official actions to prerefund the issue, which would include, for example, closing of the escrow arrangement. We note further that until such official action occurs, the fact that the issuer intends to prerefund the issue may well be "material" information under rule G-17, the Board's fair dealing rule.[2] *MSRB interpretation of February 17, 1998.*

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[1] Rule G-12(c), on uniform practice, applies to confirmations of inter-dealer transactions, and requires similar disclosures. Transactions submitted to a registered clearing agency for comparison, however, are exempt from the confirmation requirements of section (c). Since almost all inter-dealer transactions are eligible for automated comparison in a system operated by a registered clearing agency, very few dealers exchange confirmations.

[2] Rule G-17 requires each dealer, in the conduct of its municipal securities business, to deal fairly with all persons and prohibits the dealer from engaging in any deceptive, dishonest or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction which could affect the customer's investment decision, including a complete description of the security, and must not omit any material facts which would render other statements misleading. Dealers also must fulfill their obligations under rule G-19, on suitability, and rule G-30, on pricing.

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**Automated clearance: "internal" transactions.** As you are aware, the Board has been considering for the past year the adoption of amendments to the Board rules to mandate the use of automated confirmation/comparison and book-entry settlement systems in connection with the clearance of certain inter-dealer and customer transactions in municipal securities. In connection with its consideration of this matter, the Board released, in July 1982, an exposure draft of a proposal to apply such requirements to customer transactions, and, in March 1983, two exposure drafts of comparable proposals with respect to customer transactions and inter-dealer transactions. The Board has recently taken action on these proposals, and adopted amendments to its rules, substantially along the lines of the March 1983 proposals, for filing with the Securities and Exchange Commission; a copy of the notice of filing of these amendments is enclosed for your information.

[The bank] commented to the Board on both the July 1982 exposure draft, by letter dated October 15, 1982 from [name omitted] of the bank's Operations Department, and on the March 1983 exposure drafts, by letter dated June 1, 1983 from yourself. In these letters, among other comments, the bank suggested that the proposed requirement for the use of automated confirmation and book-entry settlement systems on certain customer transactions should not apply in circumstances where the transaction is between the bank's dealer department and a customer who clears or safekeeps securities through the dealer department or through the bank's custodian or safekeeping department. Your June 1983 letter, for example, commented as follows:

> Internal trades [with] customers of a dealer bank are not exempt from the amendment. This seems inconsistent with operating efficiency and the objectives of the amendment. Technically, a bank dealer would have to submit to [an automated confirmation and book-entry settlement system] trades made with customers who clear or safekeep through another department in the bank. If adopted, the amendment should allow for such an exemption.

I am writing to advise you that, in reviewing the comments on the July 1982 and March 1983 proposals, the Board concurred with this suggestion. The Board is of the view that the proposed requirement for the automated confirmation and book-entry settlement of certain customer transactions does not apply to a purchase or sale of municipal securities effected by a broker, dealer, or municipal securities dealer for the account of a customer in circumstances where the securities are to be delivered to or received from a clearance or safekeeping account maintained by the customer with the broker, dealer, or municipal securities dealer itself, or with a clearance or safekeeping department of an organization of which the broker, dealer, or municipal securities dealer is a division or department. *MSRB interpretation of September 21, 1983.*

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See also:

**Rule G-12 Interpretive Letters – Confirmation disclosure: put option bonds,** *MSRB interpretation of April 24, 1981.*

**– Confirmation disclosure: put option bonds,** *MSRB interpretation of May 11, 1981.*

**– Confirmation disclosure: advance refunded securities,** *MSRB interpretation of January 4, 1984.*

**– Confirmation disclosure: tender option bonds with adjustable tender fees,** *MSRB interpretation of October 3, 1984.*

**– Confirmation disclosure: tender option bonds with adjustable tender fees,** *MSRB interpretation of March 5, 1985.*

**– Confirmation requirements for partially refunded securities,** *MSRB interpretation of August 15, 1989.*

**Rule G-17 Interpretive Letter – Put option bonds: safekeeping, pricing,** *MSRB interpretation of February 18, 1983.*

## Rule G-16: Periodic Compliance Examination

At least once each two calendar years, each broker, dealer and municipal securities dealer shall be examined in accordance with Section 15B(c)(7) of the Act to determine, at a minimum, whether such broker, dealer or municipal securities dealer and its associated persons are in compliance with all applicable rules of the Board and all applicable provisions of the Act and rules and regulations of the Commission thereunder.

### BACKGROUND

Rule G-16 relates to the scope and frequency of periodic compliance examinations of municipal securities brokers and municipal securities dealers. The rule requires that each municipal securities broker and municipal securities dealer be examined at least once each 24 months to determine, at a minimum, whether it and its associated persons are in compliance with all applicable rules of the Board, as well as the Securities Exchange Act of 1934, as amended (the "Act"), and applicable rules and regulations of the Commission.

Section 15B(c)(7)(A) of the Act provides that periodic compliance examinations of municipal securities brokers and municipal securities dealers are to be conducted by the National Association of Securities Dealers, Inc. with respect to securities firms and by the appropriate federal bank regulatory agencies with respect to bank dealers. Rule G-16 permits examinations to determine compliance with Board rules to be combined with other periodic examinations of securities firms and bank dealers, in order to avoid unnecessary regulatory duplication and undue regulatory burdens for such firms and bank dealers.

Rule G-16 was drafted in consultation with the agencies required to conduct compliance examinations. The Board has been coordinating and will continue to coordinate with each such agency to assure that the Board's rules are applied in a uniform manner to all municipal securities brokers and municipal securities dealers and in a manner consistent with the Board's intent in promulgating them.

The rule was drafted in response to Congress' direction to the Board to adopt rules to "specify the *minimum* scope and frequency of [periodic compliance] examinations" (section 15B(2(E) of the Act)) (emphasis added).

### *Interpretive Letter*

**Periodic compliance examinations.** This will acknowledge receipt of your letter dated February 2, 1978 in which you request a clarification of Board rule G-16 relating to periodic compliance examinations.

In your letter you express your understanding that rule G-16 does not apply to bank dealers. This understanding is incorrect. Rule G-16 applies to all municipal securities brokers and municipal securities dealers and requires that all such organizations be examined at least once each [two calendar years] to determine compliance with, among other things, rules of the Board. Under section 15B(c)(7) of the Securities Exchange Act of 1934, as amended (the "Act"), such examinations of bank dealers will be conducted by the appropriate federal bank regulatory agency. The Office of the Comptroller of the Currency is designated by the Act as the appropriate agency for national banks. MSRB *interpretation of February 17, 1978.*

**NOTE: Revised to reflect subsequent amendments.**

# Rule G-17: Conduct of Municipal Securities Activities

In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

## MSRB INTERPRETATIONS

### Notice of Interpretation of Rule G-17 Concerning Prompt Delivery of Securities

October 13, 1983

From time to time the Board has received inquiries from purchasers of municipal securities concerning the duty of municipal securities brokers and dealers to deliver securities to customers under the Board's rules. In particular, customers have asked what, if any, remedies are available when long delays occur between the purchase, payment and delivery of municipal securities. The Board has advised such individuals that under rule G-17, the Board's fair dealing rule, a municipal securities broker or dealer has a duty to deliver securities sold to customers in a prompt fashion.

The Board is mindful that a dealer's failure to deliver municipal securities often is caused by its failure to receive delivery of the securities from another dealer or by other circumstances beyond its control. It nevertheless believes that a dealer's duty to deliver securities promptly to customers is inherent in rule G-17.[1] A violation of that duty could occur, for example, if a dealer sells securities to a customer when it knows that it cannot effect delivery by the specified settlement date or within a reasonable length of time thereafter and does not disclose that fact to its customer.

The Board notes that customers who fail to receive securities are not entitled to take advantage of the Board's procedures to close out a failed transaction which are available only for inter-dealer transactions under rule G-12. However, if a customer sustains a loss or otherwise is damaged by his dealer's failure to deliver securities, he may seek recovery through the Board's arbitration program or through litigation. These remedies may accrue to the customer whether or not a dealer's failure to deliver violates rule G-17.

[1] The duty of a securities professional to complete promptly transactions with customers also has been found to flow from the federal securities laws by the SEC and the courts.

### Application of Board Rules to Transactions in Municipal Securities Subject to Secondary Market Insurance or Other Credit Enhancement Features

March 6, 1984

It has come to the Board's attention that insurance companies are offering to insure whole maturities of issues of municipal securities outstanding in the secondary market. The Board understands that municipal securities professionals must apply for the insurance which, once issued, will remain in effect for the life of the security. The Board further understands that other credit enhancement devices also may be developed for secondary market issues.

The Board wishes to remind the industry of the application of rule G-17, the Board's fair dealing rule, in connection with transactions with customers in securities that are subject to secondary market insurance or other credit enhancement devices or in securities for which arrangements for such insurance or device have been initiated.[1] The Board is of the view that facts, for example, that a security has been insured or arrangements for insurance have been initiated, that will affect the market price of the security are material and must be disclosed to a customer at or before execution of a transaction in the security. In addition, the Board believes that a dealer should advise a customer if evidence of insurance or other credit enhancement feature must be attached to the security for effective transference of the insurance or device.[2]

The Board also wishes to remind the industry that under rule G-13, concerning quotations, all quotations relating to municipal securities made by a dealer must be based on the dealer's best judgment of the fair market value of the securities at the time the quotation is made. Offers to buy securities that are insured or otherwise have a credit enhancement feature, or for which arrangements for insurance or other credit enhancement have been initiated, must comply with rule G-13. Similarly, the prices at which these securities are purchased or sold by a municipal securities dealer must be fair and reasonable to its customers under Board rule G-30 on prices and commissions.

[1] Rule G-17 provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

[2] The Board has adopted amendments to rule G-15 which, among other things, require that deliveries to customers of insured securities be accompanied by some evidence of the insurance.

### Notice Concerning Application of Rule G-17 to Use of Lotteries to Allocate Partial Calls to Securities Held in Safekeeping

March 6, 1984

The Board has received inquiries concerning the duty of municipal securities brokers and dealers to allocate partial calls fairly among customer securities held in safekeeping. In particular, it has come to the Board's attention that certain municipal securities dealers use lottery systems that include only customer positions and exclude the dealer's proprietary accounts when the call is exercised at a price below the current market value.

The Board recognizes that lottery systems are a proper method of allocating the results of a partial call. Principles of fair dealing require that all such lotteries treat dealer and customer account alike. The Board is of the view that a municipal securities dealer which uses a lottery that excludes the dealer's proprietary accounts when the call is exercised at a price below the current market value is acting in violation of rule G-17, the Board's fair dealing rule.[1]

[1] Rule G-17 provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

### Syndicate Manager Selling Short for Own Account to Detriment of Syndicate Account

December 21, 1984

The Board has received an inquiry concerning a situation in which a municipal securities dealer that is acting as a syndicate manager sells bonds "short" for its own account to the detriment of the syndicate account. In particular, the Board has been made aware of allegations that certain syndicate managers, with knowledge that the syndicate account on a particular new issue of securities is not successful, have sold securities of the new issue "short" for their own accounts and then required syndicate members to take their allotments of unsold bonds. The syndicate managers allegedly have subsequently covered their short positions when the syndicate members attempt to sell their allotments at the lower market price.

Rule G-17, the Board's fair dealing rule, provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

Syndicate managers act in a fiduciary capacity in relation to syndicate accounts. Therefore they may not use proprietary information about the account obtained solely as a result of acting as manager to their personal advantage over the syndicate's best interests. The Board is of the view that a syndicate manager that uses information on the status of the syndicate account which is not available to syndicate members to its own benefit and to the detriment of the syndicate account (*e.g.*, by effecting "short sale" transactions for its own account against the interests of other syndicate members) appears to be acting in violation of the fair dealing provisions of rule G-17.

## Altering the Settlement Date on Transactions in "When-Issued" Securities

February 26, 1985

The Board has received inquiries concerning situations in which a municipal securities dealer alters the settlement date on transactions in "when-issued" securities. In particular, the Board has been made aware of a situation in which a dealer sells a "when-issued" security but accepts the customer's money prior to the new issue settlement date and specifies on the confirmation for the transaction a settlement date that is weeks before the actual settlement date of the issue. The dealer apparently does this in order to put the customer's money "to work" as soon as possible. The Board is of the view that this situation is one in which a customer deposits a free credit balance with the dealer and then, using this balance, purchases securities on the actual settlement date. The dealer pays interest on the free credit balance at the same rate as the securities later purchased by the customer.

Rule G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

The Board believes that this practice would violate rule G-17 if the customer is not advised that the interest received on the free credit balance would probably be taxable. In addition, the Board notes that a dealer that specifies a fictitious settlement date on a confirmation would violate rule G-15(a) which requires that the settlement date be included on customer confirmations.

## Syndicate Managers Charging Excessive Fees for Designated Sales

July 29, 1985

The Board has received inquiries concerning situations in which syndicate managers charge fees for designated sales that do not appear to be actual expenses incurred on behalf of the syndicate or may appear to be excessive in amount. For example, one commentator has described a situation in which the syndicate managers charge $.25 to $.40 per bond as expenses on designated sales and has suggested that such a charge seems to bear no relation to the actual out-of-pocket costs of handling such transactions.

G–17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

The Board wishes to emphasize that syndicate managers should take care in determining the actual expenses involved in handling designated sales and may be acting in violation of rule G-17 if the expenses charged to syndicate members bear no relation to or otherwise overstate the actual expenses incurred on behalf of the syndicate.

## Notice Concerning the Application of Board Rules to Put Option Bonds

September 30, 1985

The Board has received a number of inquiries from municipal securities brokers and dealers regarding the application of the Board's rules to transactions in put option bonds. Put option or tender option bonds on new issue securities are obligations which grant the bondholder the right to require the issuer (or a specified third party acting as agent for the issuer), after giving required notice, to purchase the bonds, usually at par (the "strike price"), at a certain time or times prior to maturity (the "expiration date(s)") or upon the occurrence of specified events or conditions. Put options on secondary market securities also are coming into prominence. These instruments are issued by financial institutions and permit the purchaser to sell, after giving required notice, a specified amount of securities from a specified issue to the financial institution on certain expiration dates at the strike price. Put options generally are backed by letters of credit. Secondary market put options often are sold as an attachment to the security, and subsequently are transferred with that security. Frequently, however, the put option may be sold separately from that security and re-attached to other securities from the same issue.

Of course, the Board's rules apply to put option bonds just as they apply to all other municipal securities. The Board, however, has issued a number of interpretive letters on the specific application of its rules to these types of bonds. These interpretive positions are reviewed below.

### Fair Practice Rules

1. Rule G-17

Board rule G-17, regarding fair dealing, imposes an obligation on persons selling put option bonds to customers to disclose adequately all material information concerning these securities and the put features at the time of trade. In an interpretive letter on this issue,[1] the Board responded to the question whether a dealer who had previously sold put option securities to a customer would be obligated to contact that customer around the time the put option comes into effect to remind the customer that the put option is available. The Board stated that no Board rule would impose such an obligation on the dealer.

In addition, the Board was asked whether a dealer who purchased from a customer securities with a put option feature at the time of the put option exercise date at a price significantly below the put exercise price would be in violation of any Board rules. The Board responded that such dealer may well be deemed to be in violation of Board rules G-17 on fair dealing and G-30 on prices and commissions.

2. Rule G-25(b)

Board rule G-25(b) prohibits brokers, dealers, and municipal securities dealers from guaranteeing or offering to guarantee a customer against loss in municipal securities transactions. Under the rule, put options are not deemed to be guarantees against loss if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v).[2] Thus, when a municipal securities dealer is the issuer of a secondary market put option on a municipal security, the terms of the put option must be included with or on customer confirmations of transactions in the underlying security. Dealers that sell bonds subject to put options issued by an entity other than the dealer would not be subject to this disclosure requirement.

### Confirmation Disclosure Rules

1. Description of Security

Rules G-12(c)(v)(E) and G-15(a)(i)(E)[*1] require inter-dealer and customer confirmations to set forth

> a description of the securities, including... if the securities are... subject to redemption prior to maturity, an indication to such effect.

Confirmations of transactions in put option securities, therefore, would have to indicate the existence of the put option (*e.g.*, by including the designation "puttable" on the confirmation), much as confirmations concerning callable securities must indicate the existence of the call feature. The confirmation need not set forth the specific details of the put option feature.[3]

Rules G-12(c)(v)(E) and G-15(a)(i)(E)[‡] also require confirmations to contain

> a description of the securities including at a minimum... if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service...

The Board has stated that a bank issuing a letter of credit which secures a put option feature on an issue is "obligated... with respect to debt service" on such issue. Thus, the identity of the bank issuing the letter of credit securing the put option also must be indicated on the confirmation.[4]

Finally, rules G-12(c)(v)(E) and G-15(a)(i)(E)[‡] require that dealer and customer confirmations contain a description of the securities including, among other things, the interest rate on the bonds. The Board has interpreted this provision as it pertains to certain tender option bonds with adjustable tender fees to require that the net interest rate (*i.e.*, the current effective interest rate taking into account the tender fee) be disclosed in the interest rate field and that dealers include elsewhere in the description field of the confirmation the stated interest rate with the phrase "less fee for put."[5]

2. Yield Disclosure

Board rule G-12(c)(v)(I) requires that inter-dealer confirmations include the

> yield at which transaction was effected and resulting dollar price, except in the case of securities which are traded on the basis of dollar price or securities sold at par, in which event only dollar price need be shown (in cases in which securities are priced to call or to par option, this must be stated and the call or option date and price used in the calculation must be shown, and where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity);

Rule G-15(a)(i)(I)[≠] requires that customer confirmations include information on yield and dollar price as follows:

> (1) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity.
>
> (2) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown.
>
> (3) for transactions at par, the dollar price shall be shown.

In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated, and the call or option date and price used in the calculation must be shown.

Neither of these rules requires the presentation of a yield or a dollar price computed to the put option date as a part of the standard confirmation process. In many circumstances, however, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to the put option date, and that the dollar price will be computed in this fashion. If that is the case, the yield to the put date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to the put date, together with a statement that it is a "yield to the [date] put option" and an indication of the date the option first becomes available to the holder.[6] The requirement for transactions effected on a yield basis of pricing to the lowest of price to call, price to par option or price to maturity, applies only when the parties have not specified the yield on which the transaction is based.

In addition, in regard to transactions in tender option bonds with adjustable tender fees, even if the transaction is not effected on the basis of a yield to the tender date, dealers must include the yield to the tender date since an accurate yield to maturity cannot be calculated for these securities because of the yearly adjustment in tender fees.[7]

### Delivery Requirements

In a recent interpretive letter, the Board responded to an inquiry whether, in three situations, the delivery of securities subject to put options could be rejected.[8] The Board responded that, in the first situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date but delivered after the option expiration date, such delivery could be rejected since the securities delivered were no longer "puttable" securities. In the second situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date and delivered prior to that date, but too late to permit the recipient to satisfy the conditions under which it could exercise the option (*e.g.*, the trustee is located too far away for the recipient to be able to present the physical securities by the expiration date), the Board stated that there might not be a basis for rejecting delivery, since the bonds delivered were "puttable" bonds, depending on the facts and circumstances of the delivery. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

Finally, in the third situation, securities which were the subject of a put option exercisable on a stated periodic basis (*e.g.*, annually) were purchased for settlement prior to the annual exercise date so that the recipient was unable to exercise the option at the time it anticipated being able to do so. The Board stated that this delivery could not be rejected since "puttable" bonds were delivered. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

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1 See [Rule G-17 Interpretive Letter – Put option bonds: safekeeping, pricing,] MSRB interpretation of February 18, 1983, [reprinted in *MSRB Rule Book*].

2 Rule G-8(a)(v) requires dealers to record, among other things, oral or written put options with respect to municipal securities in which such municipal securities broker or dealer has any direct or indirect interest, showing the description and aggregate par value of the securities and the terms and conditions of the option.

3 See [Rule G-12 Interpretive Letter – Confirmation disclosure: put option bonds,] MSRB interpretation of April 24, 1981, [reprinted in *MSRB Rule Book*].

4 See [Rule G-15 Interpretive Letter – Securities description: securities backed by letters of credit,] MSRB interpretation of December 2, 1982, [reprinted in *MSRB Rule Book*].

5 See [Rule G-12 Interpretive Letter – Confirmation disclosure: tender option bonds with adjustable tender fees,] MSRB interpretation of March 5, 1985, [reprinted in *MSRB Rule Book*].

6 See [Rule G-12 Interpretive Letter – Confirmation disclosure: put option bonds,] MSRB interpretation of April 24, 1981, [reprinted in *MSRB Rule Book*].

7 See fn. 5.

8 See [Rule G-12 Interpretive Letter – Delivery requirements: put option bonds,] MSRB interpretation of February 27, 1985, [reprinted in *MSRB Rule Book*].

[*][Currently codified at rule G-15(a)(i)(C)(2)(a). See also current rule G-15(a)(i)(C)(2)(b).]

[†][Currently codified at rule G-15(a)(i)(C)(1)(b).]

[‡][Currently codified at rule G-15(a)(i)(B)(4). See also current rule G-15(a)(i)(B)(4)(c).]

[≠][Currently codified at rule G-15(a)(i)(A)(5). See also current rule G-15(a)(i)(A)(5)(c)(iv)(D).]

## Notice Concerning Disclosure of Call Information to Customers of Municipal Securities

March 4, 1986

The Board has been made aware of instances in which dealers are not adequately describing securities to customers at the time of trade and may not disclose that bonds are subject to redemption, in-whole or in-part, prior to maturity. In addition, the Board understands that even when this disclosure is made, and a customer asks for further information concerning the call features, in some instances a dealer may not have this information available.

Rule G-17 of the Board's rules of fair practice requires municipal securities brokers and dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and must not omit any material facts which would render other statements misleading. In addition, rule G-19, on suitability, prohibits a municipal securities professional from recommending transactions in municipal securities to a customer unless the professional has reasonable grounds for making the recommendation in light of information about the security available from the issuer or otherwise and believes that a transaction in the security is suitable for the particular customer.

The fact that a security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances, is essential to a customer's investment decision about the security and is one of the facts a dealer must disclose at the time of trade. In addition, a dealer, if asked by a customer for more specific information regarding a call feature, should obtain this information and relay it to the customer promptly. Moreover, it would be difficult for a dealer to recommend the purchase of a security to a customer without having information regarding the security's call features.

With respect to confirmations, rule G-15(a) requires dealers to note on customer confirmations if a security is subject to redemption prior to maturity (callable) and to include a legend stating that "call features may exist which could affect yield; complete information will be provided upon request." Thus, a customer, upon receipt of the confirmation, may ask for further information on call features, and dealers have a duty to obtain and disclose such information promptly. Of course, a confirmation is not received by a customer until after a transaction is effected and the Board wishes to emphasize that confirmation disclosures do not eliminate the duty of a municipal securities professional to explain the security adequately to a customer.

## Notice of Interpretation Requiring Dealers to Submit to Arbitration as a Matter of Fair Dealing

March 6, 1987

Section 2 of the Board's Arbitration Code, rule G-35, requires all dealers to submit to arbitration at the instance of a customer or another dealer. From time to time, a dealer will refuse to submit to arbitration or will delay or even refuse to make payment of an award. Such acts constitute violations of rule G-35. The Board believes that it is a violation of rule G-17, on fair dealing, for a broker, dealer or municipal securities dealer or its associated persons to fail to submit to arbitration as required by Rule G-35, or to fail to comply with the procedures therein, including the production of documents, or to fail to honor an award of arbitrators unless a timely motion to vacate the award has been made according to applicable law.[1]

[1] A party typically has 90 days to seek judicial review of an arbitration award; after that the award cannot be challenged. Challenges to arbitration awards are heard only in limited, egregious circumstances such as fraud or collusion on the part of the arbitrators.

## Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15

September 21, 1987

The Board is concerned that the market for escrowed-to-maturity securities has been disrupted by uncertainty whether these securities may be called pursuant to optional redemption provisions. Accordingly, the Board has issued the following interpretations of rule G-17, on fair dealing, and rules G-12(c) and G-15(a), on confirmation disclosure, concerning escrowed-to-maturity securities. The interpretations are effective immediately.

### Background

Traditionally, the term escrowed-to-maturity has meant that such securities are not subject to optional redemption prior to maturity. Investors and market professionals have relied on this understanding in their purchases and sales of such securities. Recently, certain issuers have attempted to call escrowed-to-maturity securities. As a result, investors and market professionals considering transactions in escrowed-to-maturity securities must review the documents for the original issue, for any refunding issue, as well as the escrow agreement and state law, to determine whether any optional redemption provisions apply. In addition, the Board understands that there is uncertainly as to the fair market price of such securities which may cause harm to investors.

On March 17, 1987, the Board sent letters to the Public Securities Association, the Government Finance Officers Association and the National Association of Bond Lawyers expressing its concern. The Board stated that it is essential that issuers, when applicable, expressly note in official statements and defeasance notices relating to escrowed-to-maturity securities whether they have reserved the right to call such securities. It stated that the absence of such express disclosure would raise concerns whether the issuer's disclosure documents adequately explain the material features of the issue and would severely damage investor confidence in the municipal securities market. Although the Board has no rulemaking authority over issuers, it advised brokers, dealers and municipal securities dealers (dealers) that assist issuers in preparing disclosure documents for escrowed-to-maturity securities to alert these issuers of the need to disclose whether they have reserved the right to call the securities since such information is material to a customer's investment decision about the securities and to the efficient trading of such securities.

### Application of Rule G-17 on Fair Dealing

In the intervening months since the Board's letter, the Board has continued to receive inquiries from market participants concerning the callability of escrowed-to-maturity securities. Apparently, some dealers now are describing all escrowed-to-maturity securities as callable and there is confusion how to price such securities. In order to avoid confusion with respect to issues that might be escrowed-to-maturity in the future, the Board is interpreting rule G-17, on fair dealing,[1] to require that municipal securities dealers that assist in the preparation of refunding documents as underwriters or financial advisors alert issuers of the materiality of information relating to the callability of escrowed-to-maturity securities. Accordingly, such dealers must recommend that issuers clearly state when the refunded securities will be redeemed and whether the issuer reserves the option to redeem the securities prior to their maturity.

### Application of Rules G-12(c) and G-15(a) on Confirmation Disclosure of Escrowed-to-Maturity Securities

Rules G-12(c)(vi)(E) and G-15(a)(iii)(E)[*] require dealers to disclose on inter-dealer and customer confirmations, respectively, whether the securities are "called" or "prerefunded," the date of maturity which has been fixed by the call notice, and the call price. The Board has stated that this paragraph would require, in the case of escrowed-to-maturity securities, a statement to that effect (which would also meet the requirement to

state "the date of maturity which has been fixed") and the amount to be paid at redemption. In addition, rules G-12(c)(v)(E) and G-15(a)(i)(E)[†] require dealers to note on confirmations if securities are subject to redemption prior to maturity (callable).

The Board understands that dealers traditionally have used the term escrowed-to-maturity only for non-callable advance refunded issues the proceeds of which are escrowed to original maturity date or for escrowed-to-maturity issues with mandatory sinking fund calls. To avoid confusion in the use of the term escrowed-to-maturity, the Board has determined that dealers should use the term escrowed-to-maturity to describe on confirmations only those issues with no optional redemption provisions expressly reserved in escrow and refunding documents. Escrowed-to-maturity issues with no optional or mandatory call features must be described as "escrowed-to-maturity." Escrowed-to-maturity issues subject to mandatory sinking fund calls must be described as "escrowed-to-maturity" and "callable." If an issue is advance refunded to the original maturity date, but the issuer expressly reserves optional redemption features, the security should be described on confirmations as "escrowed (or prerefunded) to [the actual maturity date]" and "callable."[2]

The Board believes that the use of different terminology to describe advance refunded issues expressly subject to optional calls will better alert dealers and customers to this important aspect of certain escrowed issues.[3]

[1] Rule G-17 states that "[i]n the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

[2] This terminology also would be used for any issue prerefunded to a call date, with an earlier optional call expressly reserved.

[3] The Board believes that, because of the small number of advance refunded issues that expressly reserve the right of the issuer to call the issue pursuant to an optional redemption provision, confirmation systems should be able to be programmed for use of the new terminology without delay.

[*][Currently codified at rule G-15(a)(i)(C)(3)(a). See also current rule G-15(a)(i)(C)(3)(b).]

[†][Currently codified at rule G-15(a)(i)(C)(2)(a).]

## NOTICE OF INTERPRETATION CONCERNING PRIORITY OF ORDERS FOR NEW ISSUE SECURITIES: RULE G-17

December 22, 1987

The Board is concerned about reports that senior syndicate managers may not always be mindful of principles of fair dealing in allocations of new issue securities. In particular, the Board believes that the principles of fair dealing require that customer orders should receive priority over similar dealer or certain dealer-related account[1] orders, to the extent that this is feasible and consistent with the orderly distribution of new issue securities.

Rule G-11(e) requires syndicates to establish priority provisions and, if such priority provisions may be changed, to specify the procedure for making changes. The rule also permits a syndicate to allow the senior manager, on a case-by-case basis, to allocate securities in a manner other than in accordance with the priority provisions if the senior manager determines in its discretion that it is in the best interests of the syndicate. Senior managers must furnish this information, in writing, to the syndicate members. Syndicate members must promptly furnish this information, in writing, to others upon request. This requirement was adopted to allow prospective purchasers to frame their orders to the syndicate in a manner that would enhance their ability to obtain securities since the syndicate's allocation procedures would be known.

The Board understands that senior managers must balance a number of competing interests in allocating new issue securities. In addition, a senior manager must be able quickly to determine when it is appropriate to allocate away from the priority provisions and must be prepared to justify its actions to the syndicate and perhaps to the issuer. While it does not appear necessary or appropriate at this time to restrict the ability of syndicates to permit managers to allocate securities in a manner different from the priority provisions, the Board believes senior managers should ensure that all allocations, even those away from the priority provisions, are fair and reasonable and consistent with principles of fair dealing under rule G-17.[2] Thus, in the Board's view, customer orders should have priority over similar dealer orders or certain dealer-related account orders to the extent that this is feasible and consistent with the orderly distribution of new issue securities. Moreover, the Board suggests that syndicate members alert their customers to the priority provisions adopted by the syndicate so that their customers are able to place their orders in a manner that increases the possibility of being allocated securities.

[1] A dealer-related account includes a municipal securities investment portfolio, arbitrage account or secondary trading account of a syndicate member, a municipal securities investment trust sponsored by a syndicate member, or an accumulation account established in connection with such a municipal securities investment trust.

[2] Rule G-17 provides that:

> [i]n the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice.

## NOTICE CONCERNING SECURITIES THAT PREPAY PRINCIPAL

March 19, 1991

The Board has become aware of several issues of municipal securities that prepay principal to the bondholders over the life of the issue. These securities are issued with a face value that equals the total principal amount of the securities. However, as the prepayment of principal to bondholders occurs over time, the "unpaid principal" associated with a given quantity of the securities become an increasingly lower percentage of the face amount. The Board believes that there is a possibility of confusion in transactions involving such securities, since most dealers and customers are accustomed to municipal securities in which the face amount always equals the principal amount that will be paid at maturity.

Because of the somewhat unusual nature of the securities, the Board believes that dealers should be alert to their disclosure responsibilities. For customer transactions, rule G-17 requires that the dealer disclose to its customer, at or prior to the time of trade, all material facts with respect to the proposed transaction. Because the prepayment of principal is a material feature of these securities, dealers must ensure that the customer knows that securities prepay principal. The dealer also must inform the customer of the amount of unpaid principal that will be delivered on the transaction.

For inter-dealer transactions, there is no specific requirement for a dealer to disclose all material facts to another dealer at time of trade. A selling dealer is not generally charged with the responsibility to ensure that the purchasing dealer knows all relevant features of the securities being offered for sale. The selling dealer may rely, at least to a reasonable extent, on the fact that the purchasing dealer is also a professional and will satisfy his need for information prior to entering into a contract for the securities. Nevertheless, it is possible that non-disclosure of an unusual feature such as principal prepayment might constitute an unfair practice and thus become a violation of rule G-17 even in an inter-dealer transaction. This would be especially true if the information about the prepayment feature is not accessible to the market and is intentionally withheld by the selling dealer. Whether or not non-disclosure constitutes an unfair practice in a specific case would depend upon the individual facts of the case. However, to avoid trade disputes and settlement delays in inter-dealer transactions, it generally is in dealers' interest to reach specific agreement on the existence of any prepayment feature and the amount of unpaid principal that will be delivered.

## EDUCATIONAL NOTICE ON BONDS SUBJECT TO "DETACHABLE" CALL FEATURES

May 13, 1993

New products are constantly being introduced into the municipal securities market. Dealers must ensure that, prior to effecting transactions with customers in municipal securities with new features, they obtain all necessary information regarding these features. The Board will attempt periodically through educational notices to describe new products or features of municipal securities and review the responsibilities of dealers to customers in these transactions. In this notice, the Board will review detachable call features.

Certain recent issues of municipal securities include a new feature called a detachable call right. This feature allows the issuer to sell its right to call the bond. Thus, upon the sale of this call right, the owner of the right has the ability, at certain times, to require the mandatory tender of the underlying municipal bond. The dates of mandatory tender of the underlying bonds generally correlate with the optional call dates. If the holder exercises such rights, the underlying bondholder tenders its bond to the issuer (just as if the issuer had called the bond) and the holder of the call right purchases the bond. In some instances, issuers already have issued municipal call rights and the underlying bonds in such cases are sometimes referred to as being subject to "detached" call rights.

Bonds subject to detachable call rights generally include a provision that permits an investor that owns both the detached call right and the underlying bond to link the two instruments together, subject to certain conditions. Such "linked" municipal securities would not be subject to being called at certain times by holders of call rights or the issuer. They may, however, be subject to other calls, such as sinking fund provisions. If a customer obtains a linked security, thereafter the customer has the option to de-link the security, again subject to certain conditions, into a municipal call right and an underlying bond subject to a right of mandatory tender.

### Applicability of Board Rules

Of course, the Board's rules apply to bonds subject to detachable call features and "linked" securities just as they apply to all other municipal securities. The Board, however, would like to remind dealers of certain Board rules that should be considered in transactions involving these municipal securities.

*Rule G-15(a) on Customer Confirmations*

Rule G-15(a)(i)(E)[*] requires customer confirmations to set forth "a description of the securities, including... if the securities are... subject to redemption prior to maturity..., an indication to such effect." Additionally, rule G-15(a)(iii)(F)[*] requires a legend to be placed on customer confirmations of transactions in callable securities which notes that "Call features may exist which could affect yield; complete information will be provided upon request."

Confirmations of transactions in bonds subject to detachable call rights, therefore, would have to indicate this information.[1] In addition, the details of the call provisions of such securities would have to be provided to the customer upon the customer's request.

Confirmation disclosure, however, serves merely to support—not to satisfy—a dealer's general disclosure obligations. More specifically, the disclosure items required on the confirmation do not encompass "all material facts" that must be disclosed to customers at the time of trade pursuant to rule G-17.

*Rule G-17 on Fair Dealing*

Rule G-17 of the Board's rules of fair practice requires municipal securities dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and must not omit any material facts which would render other statements misleading. Among other things, a dealer must disclose at the time of trade whether a security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances because this knowledge is essential to a customer's investment decision.

Clearly, bonds subject to detachable calls must be described as callable at the time of the trade.[2] In addition, if a dealer is asked by a customer at the time of trade for specific information regarding call features, this information must be obtained and relayed promptly.

Although the Board requires dealers to indicate to customers at the time of trade whether municipal securities are callable, the Board has not categorized which, if any, specific call features it considers to be material and therefore also must be disclosed. Instead, the Board believes that it is the responsibility of the dealer to determine whether a particular feature is material.

With regard to detachable calls, dealers must decide whether the ability of a third party to call the bond is a material fact that should be disclosed to investors. Dealers should make this determination in the same way they determine whether other facets of a municipal securities transaction are material—is it a fact that a reasonable investor would want to know when making an investment decision? For example, would a reasonable investor who knows a bond is callable base an investment decision on whether someone other than the issuer can call the bond? Does this new feature affect the pricing of the bond?

* * *

The Board is continuing its review of detachable call rights and may take additional related action at a later date. The Board welcomes the views of all persons on the application of Board rules to transactions in securities subject to detachable call rights.

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1 With regard to the confirmation requirement for linked securities, if these securities are subject to other call provisions such as sinking fund calls, the customer confirmation must indicate that these securities are callable.

2 Similarly, when considering the application of rule G-17 to transactions in "linked" securities, as with other municipal securities, dealers have the obligation to ensure that investors understand the features of the security. In particular, if a linked security to other call provisions, dealers should ensure that retail customers do not mistakenly believe the bond is "non-callable."

[*][Currently codified at rule G-15(a)(i)(C)(2)(a).]

## TRANSACTIONS IN MUNICIPAL SECURITIES WITH NON-STANDARD FEATURES AFFECTING PRICE/YIELD CALCULATIONS

June 12, 1995

Rule G-15(a) generally requires that confirmations of municipal securities transactions with customers state a dollar price and yield for the transaction. Thus, for transactions executed on a dollar price basis, a yield must be calculated; for transactions executed on a yield basis, a dollar price must be calculated. Rule G-33 provides the standard formulae for making these price/yield calculations.

It has come to the Board's attention that certain municipal securities have been issued in recent years with features that do not fall within any of the standard formulae and assumptions in rule G-33, nor within the calculation formulae available through the available settings on existing bond calculators. For example, an issue may have first and last coupon periods that are longer than the standard coupon period of six months.

With respect to some municipal securities issues with non-standard features, industry members have agreed to certain conventions regarding

price/yield calculations. For example, one of the available bond calculator setting might be used for the issue, even though the calculator setting does not provide a formula specifically designed to account for the non–standard feature. In such cases, anomalies may result in the price/yield calculations. The anomalies may appear when the calculations are compared to those using more sophisticated actuarial techniques or when the calculations are compared to those of other securities that are similar, but that do not have the non–standard feature.

The Board reminds dealers that, under rule G-17, dealers have the obligation to explain all material facts about a transaction to a customer buying or selling a municipal security. Dealers should take particular effort to ensure that customers are aware of any non-standard feature of a security. If price/yield calculations are affected by anomalies due to a non-standard feature, this may also constitute a material fact about the transaction that must be disclosed to the customer.

## NOTICE OF INTERPRETATION OF RULE G-17 CONCERNING MINIMUM DENOMINATIONS

January 30, 2002

Municipal securities issuers sometimes set a relatively high minimum denomination, typically $100,000, for certain issues. This may be done so that the issue can qualify for one of several exemptions from Securities Exchange Act Rule 15c2-12, meaning that the issue would not be subject to certain primary market or continuing disclosure requirements. In other situations, issuers may set a high minimum denomination even though the issue is subject to Securities Exchange Act Rule 15c2-12. This may be because of the issuer's (or the underwriter's) belief that the securities are not an appropriate investment for those retail investors who would be likely to purchase securities in relatively small amounts.

Several issuers have expressed concern to the MSRB upon discovering that their issues with high minimum denominations were trading in the secondary market in transaction amounts much lower than the stated minimum denomination.[1] Based on information obtained from the MSRB Transaction Reporting Program, it appears that there are significant numbers of these types of transactions. In the past, brokers, dealers and municipal securities dealers (collectively "dealers") effecting such transactions likely would have had the problem brought to their attention when attempting to make delivery of a certificate to the customer. This is because the transfer agent would not have been able to honor a request for a certificate with a par value below the minimum denomination. Today, however, increased use of book-entry deliveries and safekeeping arrangements for retail customers largely preclude the need for individual certificates for customers and there is no other systemic screening to identify transactions that are in below-minimum denomination amounts.

Rule G-17 states: "In the conduct of its municipal securities activities, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice." The MSRB has interpreted this rule to mean, among other things, that dealers are required to disclose, at or before a transaction in municipal securities with a customer, all material facts concerning the transaction, including a complete description of the security. The MSRB has proposed an amendment to rule G-15 that would prohibit transactions in below-minimum denomination amounts for municipal securities issued after June 1, 2002, with certain limited exceptions.[2] The MSRB anticipates that some transactions in below-minimum denomination amounts may continue to occur for issues issued prior to June 1, 2002, as well as under the limited exceptions to the proposed amendment to rule G-15.[3] In either case, the MSRB believes that any time a dealer is selling to a customer a quantity of municipal securities below the minimum denomination for the issue, the dealer should consider this to be a material fact about the transaction. The MSRB believes that a dealer's failure to disclose such a material fact to the customer, and to explain how this could affect the liquidity of the customer's position, generally would constitute a violation of the dealer's duty under rule G-17 to disclose all material facts about the transaction to the customer.

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[1] Occasionally, bond documents may state a minimum transaction amount that applies only to primary market transactions, but with a clear indication by the issuer that transactions may occur at lower amounts in the secondary market. The MSRB is not aware of non-authorized transaction amounts occurring for issues of these types. In general, however, bond documents describing a minimum "denomination" would appear to be intended to apply to both primary and secondary market transactions.

[2] Proposed rule change SR-MSRB-2001-07, filed with the Securities and Exchange Commission on October 16, 2001.

[3] Even for municipal securities issued after June 1, 2002, below-minimum denomination transactions may need to be effected in compliance with proposed MSRB rule G-15(f) to liquidate below-minimum denomination positions created through the exercise of a will, division of a marital estate, as a result of an investor giving a portion of a position as a gift, etc. In addition, the exercise of a sinking fund or other partial redemption by an issuer can sometimes result in customers holding below-minimum denomination amounts.

## INTERPRETIVE NOTICE REGARDING RULE G-17, ON DISCLOSURE OF MATERIAL FACTS

March 20, 2002

Rule G-17, the MSRB's fair dealing rule, encompasses two general principles. First, the rule imposes a duty on dealers[1] not to engage in deceptive, dishonest, or unfair practices. This first prong of rule G-17 is essentially an antifraud prohibition.

Second, the rule imposes a duty to deal fairly. Statements in the MSRB's filing for approval of rule G-17 and the SEC's order approving the rule note that rule G-17 was implemented to establish a minimum standard of fair conduct by dealers in municipal securities. In addition to the basic antifraud prohibitions in the rule, the duty to "deal fairly" is intended to "refer to the customs and practices of the municipal securities markets, which may, in many instances differ from the corporate securities markets."[2] As part of a dealer's obligation to deal fairly, the MSRB has interpreted the rule to create affirmative disclosure obligations for dealers. The MSRB has stated that dealer's affirmative disclosure obligations require that a dealer disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security. [3] These obligations apply even when a dealer is acting as an order taker and effecting non-recommended secondary market transactions.

Rule G-17 was adopted many years prior to the adoption of SEC Rule 15c2-12. The development of the NRMSIR system,[4] the MSRB's Municipal Securities Information Library® (MSIL®) system[5] and Transaction Reporting System ("TRS"),[6] rating agencies and indicative data sources in the post-Rule 15c2-12 era have created much more readily available information sources. Recently, the market has made progress and market professionals (including institutional investors) can, and do, go to these industry sources to find securities descriptive information, official statements, rating agency ratings and reports, and ongoing disclosure information. These developments suggest a need for further explanation of what "disclosure of all material facts" means in today's market.

Rule G-17 requires that dealers disclose to a customer at the time of trade all material facts about a transaction known by the dealer. In addition, a dealer is required to disclose material facts about a security when such facts are reasonably accessible to the market. Thus, a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction made publicly available through sources such as the NRMSIR system, the MSIL® system, TRS, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in the

type of municipal securities at issue (collectively, "established industry sources"). [7]

The customs and practices of the industry suggest that the sources of information generally used by a dealer that effects transactions in municipal securities may vary with the type of municipal security. For example, a dealer might have to draw on fewer industry sources to disclose all material facts about an insured "triple-A" rated general obligation bond than for a non-rated conduit issue. In addition, to the extent that a security is more complex, for example because of complex structure or where credit quality is changing rapidly, a dealer might need to take into account a broader range of information sources prior to executing a transaction.

With respect to primary offerings of municipal securities, the SEC has noted, "By participating in an offering, an underwriter makes an implied recommendation about the securities." The SEC stated, "This recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings."[8] Similarly, if a dealer recommends a secondary market municipal security transaction, rule G-19 requires a dealer to "have reasonable grounds for the recommendation in light of information available from the issuer or otherwise."[9] If this "reasonable basis" suitability cannot be obtained from the established industry sources, then further review may be necessary before making a recommendation. To the extent that such review elicits material information that would not have become known through a review of established industry sources, dealers recommending transactions would be obligated to disclose such information in addition to information available from established industry sources.

[1] The term "dealer" is used in this interpretive notice as shorthand for "broker," "dealer" or "municipal securities dealer," as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this interpretive notice does not imply that the entity is necessarily taking a principal position in a municipal security.

[2] *See* Exchange Act Release No. 13987 (Sept. 22, 1977).

[3] *See e.g.*, Rule G-17 Interpretation—Educational Notice on Bonds Subject to "Detachable" Call Features, May 13, 1993, MSRB *Rule Book* (July 2001) at 129-130. The SEC described material facts as those "facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision." *Municipal Securities Disclosure*, Securities Exchange Act Release No. 26100 (September 22, 1988) (the "1988 SEC Release") at note 76, quoting *In re Walston & Co. Inc., and Harrington*, Securities Exchange Act Release No. 8165 (September 22, 1967). Furthermore, the United States Supreme Court has stated that a fact is material if there is a substantial likelihood that its disclosure would have been considered significant by a reasonable investor. *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

[4] For purposes of this notice, the "NRMSIR system" refers to the disclosure dissemination system adopted by the SEC in SEC Rule 15c2-12. Under Rule 15c2-12, as adopted in 1989, participating underwriters provide a copy of the final official statement to Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") to reduce their obligation to provide a final official statement to customers. In the 1994 amendments to Rule 15c2-12 the SEC determined to require that annual financial information and audited financial statements submitted in accordance with issuer undertakings must be delivered to each NRMSIR and to the State Information Depository ("SID") in the issuer's state, if such depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID was included in Rule 15c2-12 to ensure that all NRMSIRs receive disclosure information directly. Under the 1994 amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information, must be delivered to each NRMSIR or the MSRB, and the appropriate SID.

[5] The MSIL® system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB rule G-36, as well as certain secondary market material event disclosures provided by issuers under SEC Rule 15c2-12. Municipal Securities Information Library® and MSIL® are registered trademarks of the MSRB.

[6] The MSRB's TRS collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

[7] Dealers operating electronic trading platforms have inquired whether providing electronic access to material information is consistent with the obligation to disclose information under rule G-17. The MSRB believes that the provision of electronic access to material information to customers who elect to transact in municipal securities on an electronic platform is generally consistent with a dealer's obligation to disclose such information, but that whether such access is effective disclosure ultimately depends upon the particular facts and circumstances present.

[8] 1988 SEC Release at text following note 70. The SEC also stated that an underwriter must review the issuer's disclosure documents for possible inaccuracies and omissions. In the case of a negotiated offering, the SEC expects the underwriter to make an inquiry into the key representations included in the disclosure materials. In the case of a competitive offering, the SEC acknowledges that the underwriter may have more limited opportunities to undertake such a review and investigation but nonetheless is obligated to take appropriate actions under the particular facts and circumstances of such offering.

[9] *See e.g.*, Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985 MSRB *Rule Book* (July 2001) at 134; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989) (discussing "reasonable basis" suitability).

## INTERPRETIVE NOTICE REGARDING THE APPLICATION OF MSRB RULES TO TRANSACTIONS WITH SOPHISTICATED MUNICIPAL MARKET PROFESSIONALS

April 30, 2002

### Introduction

Industry participants have suggested that the MSRB's fair practice rules should allow dealers[1] to recognize the different capabilities of certain institutional customers as well as the varied types of dealer-customer relationships. Prior MSRB interpretations reflect that the nature of the dealer's counter-party should be considered when determining the specific actions a dealer must undertake to meet its duty to deal fairly. The MSRB believes that dealers may consider the nature of the institutional customer in determining what specific actions are necessary to meet the fair practice standards for a particular transaction. This interpretive notice concerns only the manner in which a dealer determines that it has met certain of its fair practice obligations to certain institutional customers; it does not alter the basic duty to deal fairly, which applies to all transactions and all customers. For purposes of this interpretive notice, an institutional customer shall be an entity, other than a natural person (corporation, partnership, trust, or otherwise), with total assets of at least $100 million invested in municipal securities in the aggregate in its portfolio and/or under management.

### Sophisticated Municipal Market Professionals

Not all institutional customers are sophisticated regarding investments in municipal securities. There are three important considerations with respect to the nature of an institutional customer in determining the scope of a dealer's fair practice obligations. They are:

- Whether the institutional customer has timely access to all publicly available material facts concerning a municipal securities transaction;
- Whether the institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and
- Whether the institutional customer is making independent investment decisions about its investments in municipal securities.

When a dealer has reasonable grounds for concluding that an institutional customer (i) has timely access to the publicly available material facts concerning a municipal securities transaction; (ii) is capable of independently evaluating the investment risk and market value of the municipal securities at issue; and (iii) is making independent decisions about its investments in municipal securities, and other known facts do not contradict such a conclusion, the institutional customer can be considered a sophisticated municipal market professional ("SMMP"). While it is difficult to define in advance the scope of a dealer's fair practice obligations with respect to a particular transaction, as will be discussed later, by making a reasonable determination that an institutional customer is an SMMP,

then certain of the dealer's fair practice obligations remain applicable but are deemed fulfilled. In addition, as discussed below, the fact that a quotation is made by an SMMP would have an impact on how such quotation is treated under rule G-13.

**Considerations Regarding The Identification of Sophisticated Municipal Market Professionals**

The MSRB has identified certain factors for evaluating an institutional investor's sophistication concerning a municipal securities transaction and these factors are discussed in detail below. Moreover, dealers are advised that they have the option of having investors attest to SMMP status as a means of streamlining the dealers' process for determining that the customer is an SMMP. However, a dealer would not be able to rely upon a customer's SMMP attestation if the dealer knows or has reason to know that an investor lacks sophistication concerning a municipal securities transaction, as discussed in detail below.

Access to Material Facts

A determination that an institutional customer has timely access to the publicly available material facts concerning the municipal securities transaction will depend on the customer's resources and the customer's ready access to established industry sources (as defined below) for disseminating material information concerning the transaction. Although the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer has timely access to publicly available information could include:

- the resources available to the institutional customer to investigate the transaction (*e.g.*, research analysts);
- the institutional customer's independent access to the NRMSIR system,[2] and information generated by the MSRB's Municipal Securities Information Library® (MSIL®) system[3] and Transaction Reporting System ("TRS"),[4] either directly or through services that subscribe to such systems; and
- the institutional customer's access to other sources of information concerning material financial developments affecting an issuer's securities (e.g., rating agency data and indicative data sources).

Independent Evaluation of Investment Risks and Market Value

Second, a determination that an institutional customer is capable of independently evaluating the investment risk and market value of the municipal securities that are the subject of the transaction will depend on an examination of the institutional customer's ability to make its own investment decisions, including the municipal securities resources available to the institutional customer to make informed decisions. In some cases, the dealer may conclude that the institutional customer is not capable of independently making the requisite risk and valuation assessments with respect to municipal securities in general. In other cases, the institutional customer may have general capability, but may not be able to independently exercise these functions with respect to a municipal market sector or type of municipal security. This is more likely to arise with relatively new types of municipal securities and those with significantly different risk or volatility characteristics than other municipal securities investments generally made by the institution. If an institution is either generally not capable of evaluating investment risk or lacks sufficient capability to evaluate the particular municipal security, the scope of a dealer's fair practice obligations would not be diminished by the fact that the dealer was dealing with an institutional customer. On the other hand, the fact that a customer initially needed help understanding a potential investment need not necessarily imply that the customer did not ultimately develop an understanding and make an independent investment decision.

While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is capable of independently evaluating investment risk and market value considerations could include:

- the use of one or more consultants, investment advisers, research analysts or bank trust departments;
- the general level of experience of the institutional customer in municipal securities markets and specific experience with the type of municipal securities under consideration;
- the institutional customer's ability to understand the economic features of the municipal security;
- the institutional customer's ability to independently evaluate how market developments would affect the municipal security that is under consideration; and
- the complexity of the municipal security or securities involved.

Independent Investment Decisions

Finally, a determination that an institutional customer is making independent investment decisions will depend on whether the institutional customer is making a decision based on its own thorough independent assessment of the opportunities and risks presented by the potential investment, market forces and other investment considerations. This determination will depend on the nature of the relationship that exists between the dealer and the institutional customer. While the following list is not exhaustive, the MSRB notes that relevant considerations in determining that an institutional customer is making independent investment decisions could include:

- any written or oral understanding that exists between the dealer and the institutional customer regarding the nature of the relationship between the dealer and the institutional customer and the services to be rendered by the dealer;
- the presence or absence of a pattern of acceptance of the dealer's recommendations;
- the use by the institutional customer of ideas, suggestions, market views and information relating to municipal securities obtained from sources other than the dealer; and
- the extent to which the dealer has received from the institutional customer current comprehensive portfolio information in connection with discussing potential municipal securities transactions or has not been provided important information regarding the institutional customer's portfolio or investment objectives.

Dealers are reminded that these factors are merely guidelines which will be utilized to determine whether a dealer has fulfilled its fair practice obligations with respect to a specific institutional customer transaction and that the inclusion or absence of any of these factors is not dispositive of the determination. Such a determination can only be made on a case-by-case basis taking into consideration all the facts and circumstances of a particular dealer/customer relationship, assessed in the context of a particular transaction. As a means of ensuring that customers continue to meet the defined SMMP criteria, dealers are required to put into place a process for periodic review of a customer's SMMP status.

**Application of SMMP Concept to Rule G-17's Affirmative Disclosure Obligations**

The SMMP concept as it applies to rule G-17 recognizes that the actions of a dealer in complying with its affirmative disclosure obligations under rule G-17 when effecting non-recommended secondary market transactions may depend on the nature of the customer. While it is difficult to define in advance the scope of a dealer's affirmative disclosure obligations to a particular institutional customer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with the affirmative disclosure aspects of rule G-17.

When the dealer has reasonable grounds for concluding that the institutional customer is an SMMP, the institutional customer, by definition, is already aware, or capable of making itself aware of, material facts and is able to independently understand the significance of the material facts available from established industry sources.[5] When the dealer has reasonable grounds for concluding that the customer is an SMMP then the dealer's obligation when effecting non-recommended secondary market transactions to ensure disclosure of material information available from established industry sources is fulfilled. There may be times when an SMMP is not satisfied that the information available from established industry sources is sufficient to allow it to make an informed investment decision. In those circumstances, the MSRB believes that an SMMP can recognize that risk and take appropriate action, be it declining to transact, undertaking additional investigation or asking the dealer to undertake additional investigation.

This interpretation does nothing to alter a dealer's duty not to engage in deceptive, dishonest, or unfair practices under rule G-17 or under the federal securities laws. In essence, a dealer's disclosure obligations to SMMPs when effecting non-recommended secondary market transactions would be on par with inter-dealer disclosure obligations. This interpretation will be particularly relevant to dealers operating electronic trading platforms, although it will also apply to dealers who act as order takers over the phone or in-person.[6] This interpretation recognizes that there is no need for a dealer in a non-recommended secondary market transaction to disclose material facts available from established industry sources to an SMMP customer that already has access to the established industry sources.[7]

As in the case of an inter-dealer transaction, in a transaction with an SMMP, a dealer's intentional withholding of a material fact about a security, where the information is not accessible through established industry sources, may constitute an unfair practice violative of rule G-17. In addition, a dealer may not knowingly misdescribe securities to the customer. A dealer's duty not to mislead its customers is absolute and is not dependent upon the nature of the customer.

**Application of SMMP Concept to Rule G-18 Interpretation—Duty to Ensure That Agency Transactions Are Effected at Fair and Reasonable Prices**

Rule G-18 requires that each dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.[8] The actions that must be taken by a dealer to make reasonable efforts to ensure that its non-recommended secondary market agency transactions with customers are effected at fair and reasonable prices may be influenced by the nature of the customer as well as by the services explicitly offered by the dealer.

If a dealer effects non-recommended secondary market agency transactions for SMMPs and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the dealer is not required to take further actions on individual transactions to ensure that its agency transactions are effected at fair and reasonable prices.[9] By making the determination that the customer is an SMMP, the dealer necessarily concludes that the customer has met the requisite high thresholds regarding timely access to information, capability of evaluating risks and market values, and undertaking of independent investment decisions that would help ensure the institutional customer's ability to evaluate whether a transaction's price is fair and reasonable.

This interpretation will be particularly relevant to dealers operating alternative trading systems in which participation is limited to dealers and SMMPs. It clarifies that in such systems rule G-18 does not impose an obligation upon the dealer operating such a system to investigate each individual transaction price to determine its relationship to the market. The MSRB recognizes that dealers operating such systems may be merely aggregating the buy and sell interest of other dealers or SMMPs. This function may provide efficiencies to the market. Requiring the system operator to evaluate each transaction effected on its system may reduce or eliminate the desired efficiencies. Even though this interpretation eliminates a duty to evaluate each transaction, a dealer operating such system, under the general duty set forth in rule G-18, must act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer may be subject to rule G-18 violations if it fails to take actions to address system or participant pricing abuses.

If a dealer effects agency transactions for customers who are not SMMPs, or has held itself out to do more than provide anonymity, communication, matching and/or clearance services, or performs such services with discretion as to how and when the transaction is executed, it will be required to establish that it exercised reasonable efforts to ensure that its agency transactions with customers are effected at fair and reasonable prices.

**Application of SMMP Concept to Rule G-19 Interpretation—Suitability of Recommendations and Transactions**

The MSRB's suitability rule is fundamental to fair dealing and is intended to promote ethical sales practices and high standards of professional conduct. Dealers' responsibilities include having a reasonable basis for recommending a particular security or strategy, as well as having reasonable grounds for believing the recommendation is suitable for the customer to whom it is made. Dealers are expected to meet the same high standards of competence, professionalism, and good faith regardless of the financial circumstances of the customer. Rule G-19, on suitability of recommendations and transactions, requires that, in recommending to a customer any municipal security transaction, a dealer shall have reasonable grounds for believing that the recommendation is suitable for the customer based upon information available from the issuer of the security or otherwise and based upon the facts disclosed by the customer or otherwise known about the customer.

This guidance concerns only the manner in which a dealer determines that a recommendation is suitable for a particular institutional customer. The manner in which a dealer fulfills this suitability obligation will vary depending on the nature of the customer and the specific transaction. Accordingly, this interpretation deals only with guidance regarding how a dealer will fulfill such "customer-specific suitability obligations" under rule G-19. This interpretation does not address the obligation related to suitability that requires that a dealer have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers. In the case of a recommended transaction, a dealer may, depending upon the facts and circumstances, be obligated to undertake a more comprehensive review or investigation in order to meet its obligation under rule G-19 to have a "reasonable basis" to believe that the recommendation could be suitable for at least some customers.[10]

The manner in which a dealer fulfills its "customer-specific suitability obligations" will vary depending on the nature of the customer and the specific transaction. While it is difficult to define in advance the scope of a dealer's suitability obligation with respect to a specific institutional customer transaction recommended by a dealer, the MSRB has identified the factors that define an SMMP as factors that may be relevant when considering compliance with rule G-19. Where the dealer has reasonable grounds for concluding that an institutional customer is an SMMP, then a dealer's obligation to determine that a recommendation is suitable for that particular customer is fulfilled.

This interpretation does not address the facts and circumstances that go into determining whether an electronic communication does or does not constitute a "recommendation."

### Application of SMMP Concept to Rule G-13, on Quotations

New electronic trading systems provide a variety of avenues for disseminating quotations among both dealers and customers. In general, except as described below, any quotation disseminated by a dealer is presumed to be a quotation made by such dealer. In addition, any "quotation" of a non-dealer (e.g., an investor) relating to municipal securities that is disseminated by a dealer is presumed, except as described below, to be a quotation made by such dealer.[11] The dealer is affirmatively responsible in either case for ensuring compliance with the bona fide and fair market value requirements with respect to such quotation.

However, if a dealer disseminates a quotation that is actually made by another dealer and the quotation is labeled as such, then the quotation is presumed to be a quotation made by such other dealer and not by the disseminating dealer. Furthermore, if an SMMP makes a "quotation" and it is labeled as such, then it is presumed not to be a quotation made by the disseminating dealer; rather, the dealer is held to the same standard as if it were disseminating a quotation made by another dealer.[12] In either case, the disseminating dealer's responsibility with respect to such quotation is reduced. Under these circumstances, the disseminating dealer must have no reason to believe that either: (i) the quotation does not represent a bona fide bid for, or offer of, municipal securities by the maker of the quotation or (ii) the price stated in the quotation is not based on the best judgment of the maker of the quotation of the fair market value of the securities.

While rule G-13 does not impose an affirmative duty on the dealer disseminating quotations made by other dealers or SMMPs to investigate or determine the market value or bona fide nature of each such quotation, it does require that the disseminating dealer take into account any information it receives regarding the nature of the quotations it disseminates. Based on this information, such a dealer must have no reason to believe that these quotations fail to meet either the bona fide or the fair market value requirement and it must take action to address such problems brought to its attention. Reasons for believing there are problems could include, among other things, (i) complaints received from dealers and investors seeking to execute against such quotations, (ii) a pattern of a dealer or SMMP failing to update, confirm or withdraw its outstanding quotations so as to raise an inference that such quotations may be stale or invalid, or (iii) a pattern of a dealer or SMMP effecting transactions at prices that depart materially from the price listed in the quotations in a manner that consistently is favorable to the party making the quotation.[13]

In a prior MSRB interpretation stating that stale or invalid quotations published in a daily or other listing must be withdrawn or updated in the next publication, the MSRB did not consider the situation where quotations are disseminated electronically on a continuous basis.[14] In such case, the MSRB believes that the bona fide requirement obligates a dealer to withdraw or update a stale or invalid quotation promptly enough to prevent a quotation from becoming misleading as to the dealer's willingness to buy or sell at the stated price. In addition, although not required under the rule, the MSRB believes that posting the time and date of the most recent update of a quotation can be a positive factor in determining whether the dealer has taken steps to ensure that a quotation it disseminates is not stale or misleading.

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[1] The term "dealer" is used in this notice as shorthand for "broker," "dealer" or "municipal securities dealer," as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

[2] For purposes of this notice, the "NRMSIR system" refers to the disclosure dissemination system adopted by the SEC in Rule 15c2-12. Under Rule 15c2-12, as adopted in 1989, participating underwriters provide a copy of the final official statement to a Nationally Recognized Municipal Securities Information Repository ("NRMSIR") to reduce their obligation to provide a final official statement to potential customers upon request. In the 1994 amendments to Rule 15c2-12 the Commission determined to require that annual financial information and audited financial statements submitted in accordance with issuer undertakings must be delivered to each NRMSIR and to the State Information Depository ("SID") in the issuer's state, if such depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID was included in Rule 15c2-12 to ensure that all NRMSIRs receive disclosure information directly. Under the 1994 amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information, must be delivered to each NRMSIR or the MSRB, and the appropriate SID.

[3] The MSIL® system collects and makes available to the marketplace official statements and advance refunding documents submitted under MSRB rule G-36, as well as certain secondary market material event disclosures provided by issuers under SEC Rule 15c2-12. Municipal Securities Information Library® and MSIL® are registered trademarks of the MSRB.

[4] The MSRB's TRS collects and makes available to the marketplace information regarding inter-dealer and dealer-customer transactions in municipal securities.

[5] The MSRB has filed a related notice regarding the disclosure of material facts under rule G-17 concurrently with this filing. *See* SEC File No. SR-MSRB-2002-01. The MSRB's rule G-17 notice provides that a dealer would be responsible for disclosing to a customer any material fact concerning a municipal security transaction (regardless of whether such transaction had been recommended by the dealer) made publicly available through sources such as the NRMSIR system, the MSIL® system, TRS, rating agency reports and other sources of information relating to the municipal securities transaction generally used by dealers that effect transactions in municipal securities (collectively, "established industry sources").

[6] For example, if an SMMP reviewed an offering of municipal securities on an electronic platform that limited transaction capabilities to broker-dealers and then called up a dealer and asked the dealer to place a bid on such offering at a particular price, the interpretation would apply because the dealer would be acting merely as an order taker effecting a non-recommended secondary market transaction for the SMMP.

[7] In order to meet the definition of an SMMP an institutional customer must, at least, have access to established industry sources.

[8] This guidance only applies to the actions necessary for a dealer to ensure that its agency transactions are effected at fair and reasonable prices. If a dealer engages in principal transactions with an SMMP, rule G-30(a) applies and the dealer is responsible for a transaction-by-transaction review to ensure that it is charging a fair and reasonable price. In addition, rule G-30(b) applies to the commission or service charges that a dealer operating an electronic trading system may charge to effect the agency transactions that take place on its system.

[9] Similarly, the MSRB believes the same limited agency functions can be undertaken by a broker's broker toward other dealers. For example, if a broker's broker effects agency transactions for other dealers and its services have been explicitly limited to providing anonymity, communication, order matching and/or clearance functions and the dealer does not exercise discretion as to how or when a transaction is executed, then the MSRB believes the broker's broker is not required to take further actions on individual transactions to ensure that its agency transactions with other dealers are effected at fair and reasonable prices.

[10] *See e.g.*, Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985, *MSRB Rule Book* (July1, 2001) at 135; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989). The SEC, in its discussion of municipal underwriters' responsibilities in a 1988 Release, noted that "a broker-dealer recommending securities to investors implies by its recommendation that it has an adequate basis for the recommendation." *Municipal Securities Disclosure*, Securities Exchange Act Release No. 26100 (September 22, 1988) (the "1988 SEC Release") at text accompanying note 72.

[11] A customer's bid for, offer of, or request for bid or offer is included within the meaning of a "quotation" if it is disseminated by a dealer.

[12] The disseminating dealer need not identify by name the maker of the quotation, but only that such quotation was made by another dealer or an SMMP, as appropriate.

[13] The MSRB believes that, consistent with its view previously expressed with respect to "bait-and-switch" advertisements, a dealer that includes a price in its quotation that is designed as a mechanism to attract potential customers interested in the quoted security for the primary purpose of drawing such potential customers into a negotiation on that or another security, where the quoting dealer has no intention at the time it makes the quotation of executing a transaction in such security at that price, could be a violation of rule G-17. *See* Rule G-21 Interpretive Letter – Disclosure obligations, MSRB interpretation of May 21, 1998, *MSRB Rule Book* (July 1, 2001) at p. 139.

[14] *See* Rule G-13 Interpretation, Notice of Interpretation of Rule G-13 on Published Quotations, April 21, 1988, *MSRB Rule Book* (July 1, 2001) at 91.

See also:

Rule G-11 Interpretations – Notice Concerning Syndicate Expenses, November 14, 1991.

– Syndicate Expenses: Per Bond Fee for Bookrunning Expenses, June 14, 1995.

Rule G-15 Interpretations – Notice Concerning Confirmation, Delivery and Reclamation of Interchangeable Securities, August 10, 1988.

– Notice Concerning Stripped Coupon Municipal Securities, March 13, 1989.

Rule G-21 Interpretation – Application of Fair Practice and Advertising Rules to Municipal Fund Securities, May 14, 2002.

Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001.

Rule G-32 Interpretation – Notice Regarding the Disclosure Obligations of Brokers, Dealers and Municipal Securities Dealers in Connection with New Issue Municipal Securities Under Rule G-32, November 19, 1998.

## *Interpretive Letters*

**"Wooden tickets."** This is in response to your letter of February 4, 1981 asking whether the practice of a broker-dealer using "wooden tickets" is prohibited by Board rule G-17. According to your letter, this practice refers to the mailing of confirmations of sales to customers who, in fact, have not placed orders to purchase securities. Thereafter, if any customer objects, stating that it never authorized the transaction, the sale is canceled. You state that, in some cases, customers accept the transaction and make payment.

The Board has determined that the practice by a municipal securities dealer of knowingly issuing confirmations of sales to customers who have not placed orders to purchase the bonds is a deceptive, dishonest, and unfair practice under rule G-17. *MSRB interpretation of March 3, 1981.*

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**Put option bonds: safekeeping, pricing.** I am writing in response to your recent letter regarding issues of municipal securities with put option or tender option features, under which a holder of the securities may put the securities back to the issuer or an agent of the issuer at par on certain stated dates. In your letter you inquire generally as to the confirmation disclosure requirements applicable to such securities. You also raise several questions regarding a dealer's obligation to advise customers of the existence of the put option provision at times other than the time of sale of the securities to the customer.

Your letter was referred to a committee of the Board which has responsibility for interpreting the Board's confirmation rules, among other matters. That committee has authorized my sending you the following response.

Both rules G-12(c) and G-15, applicable to inter-dealer and customer confirmations respectively, require that confirmations of transactions in securities which are subject to put option or tender option features must indicate that fact (e.g., through inclusion of the designation "puttable" on the confirmation). The date on which the put option feature first comes into effect need be stated on the confirmation only if the transaction is effected on a yield basis and the parties to the transaction specifically agree that the transaction dollar price should be computed to that date. In the absence of such an agreement, the put date need not be stated on the confirmation, and any yield disclosed should be a yield to maturity.

Of course, municipal securities brokers and dealers selling to customers securities with put option or tender option features are obligated to disclose adequately the special characteristics of these securities at the time of trade. The customer therefore should be advised of information about the put option or tender option feature at this time.

In your letter you inquire whether a dealer who had previously sold securities with a put option or tender option feature to a customer would be obliged to contact that customer around the time the put option comes into effect to remind the customer that the put option is available. You also ask whether such an obligation would exist if the dealer held the securities in safekeeping for the customer. The committee can respond, of course, only in terms of the requirements of Board rules; the committee noted that no Board rule would impose such an obligation on the dealer.

In your letter you also ask whether a dealer who purchased from a customer securities with a put option or tender option feature at the time of the put option exercise date at a price significantly below the put exercise price would be in violation of any Board rules. The committee believes that such a dealer might well be deemed to be in violation of Board rules G-17 on fair dealer and G-30 on prices and commissions. *MSRB interpretation of February 18, 1983.*

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**Description provided at or prior to the time of trade.** This is in response to your February 27, 1986 letter and our prior telephone conversation concerning the application of Board rules to the description of municipal securities exchanged at or prior to the time of trade. You note that it is becoming more and more common in the municipal securities secondary market for sellers, both dealers and customers, to provide only a "limited description" and CUSIP number for bonds being sold. Recently you were asked by a customer to bid on $4 million of bonds and were given the coupon, maturity date, and issuer. When you asked for more information, you were given the CUSIP number. You then bid on and purchased the bonds. After the bonds were confirmed, you discovered that the bonds were callable and that, when these bonds first came to market, they were priced to the call. You state that the seller was aware that the bonds were callable.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Board rule G-17 provides that

> In the conduct of its municipal securities business, *each broker, dealer, and municipal securities dealer* shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. (emphasis added)

The Board has interpreted this rule to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision and not omit any material facts which would render other statements misleading. The fact that a municipal security may be redeemed in-whole, in-part, or in extraordinary circumstances prior to maturity is essential to a customer's investment decision and is one of the facts a dealer must disclose.

I note from our telephone conversation that you ask whether Board rules specify what infor-

mation a customer must disclose to a dealer at the time it solicits bids to buy municipal securities. Customers are not subject to the Board's rules, and no specific disclosure rules would apply to customers beyond the application of the anti-fraud provisions of the federal securities laws. I note, however, that a municipal securities professional buying securities from a customer should obtain sufficient information about the securities so that it can accurately describe these securities when the dealer reintroduces them into the market.

In regard to inter-dealer transactions, the items of information that professionals must exchange at or prior to the time of trade are governed by principles of contract law and essentially are those items necessary adequately to describe the security that is the subject of the contract. As a general matter, these items of information may not encompass all material facts, but must be sufficient to distinguish the security from other similar issues. The Board has interpreted rule G-17 to require dealers to treat other dealers fairly and to hold them to the prevailing ethical standards of the industry. Also, dealers may not knowingly misdescribe securities to another dealer. MSRB *interpretation of April 30, 1986.*

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**Purchase of new issue from issuer.** This is in response to your letter in which you ask whether Board rule G-17, on fair dealing, or any other rule, regulation or federal law, requires an underwriter to purchase a bond issue from a municipal securities issuer at a "fair price."

Rule G-17 states that, in the conduct of its municipal securities business, each broker, dealer and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. Thus, the rule requires dealers to deal fairly with issuers in connection with the underwriting of their municipal securities. Whether or not an underwriter has dealt fairly with an issuer is dependent upon the facts and circumstances of an underwriting and cannot be addressed simply by virtue of the price of the issue. For example, in a competitive underwriting where an issuer reserves the right to reject all bids, a dealer submits a bid at a net interest cost it believes will enable it to successfully market the issue to investors. One could not view a dealer as having violated rule G-17 just because it did not submit a bid that the issuer considers fair. On the other hand, when a dealer is negotiating the underwriting of municipal securities, a dealer has an obligation to negotiate in good faith with the issuer. If the dealer represents to the issuer that it is providing the best market price available on this issue, and this is not the case, the dealer may violate rule G-17. Also, if the dealer knows the issuer is unsophisticated or otherwise depending on the dealer as its sole source of market information, the dealer's duty under rule G-17 is to ensure that the issuer is treated fairly, specifically in light of the relationship of reliance that exists between the issuer and the underwriter. MSRB *interpretation of December 1, 1997.*

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See also:

**Rule G-15 Interpretive Letters – Callable securities: pricing to call and extraordinary mandatory redemption features,** MSRB *interpretation of February 10, 1984.*

**– Callable securities: pricing to mandatory sinking fund calls,** MSRB *interpretation of April 30, 1986.*

**– Disclosure of pricing: calculating the dollar price of partially prerefunded bonds,** MSRB *interpretation of May 15, 1986.*

**– Disclosure of the investment of bond proceeds,** MSRB *interpretation of August 16, 1991.*

**– Securities description: prerefunded securities, MSRB interpretation of** *February 17, 1998.*

**Rule G-21 Interpretive Letter – Disclosure obligations,** MSRB *interpretation of May 21, 1998.*

## Rule G-18: Execution of Transactions

Each broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. A broker, dealer or municipal securities dealer acting as a "broker's broker" shall be under the same obligation with respect to the execution of a transaction in municipal securities for or on behalf of a broker, dealer, or municipal securities dealer.

### *MSRB INTERPRETATIONS*

See also:

Rule G-17 Interpretation – Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Principals, April 30, 2002.

#### *Interpretive Letters*

See also:

Rule G-8 Interpretive Letter – Time of receipt and execution of orders, MSRB *interpretation of April 20, 1987.*

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

(a) *Account Information.* Each broker, dealer and municipal securities dealer shall obtain at or before the completion of a transaction in municipal securities with or for the account of a customer a record of the information required by rule G-8(a)(xi).

(b) *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).

(c) *Suitability of Recommendations.* 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) *Discretionary Accounts.* No broker, dealer or municipal securities dealer shall effect a transaction in municipal securities with or for a discretionary account

(i) except to the extent clearly permitted by the prior written authorization of the customer and accepted in writing by a municipal securities principal or municipal securities sales principal on behalf of the broker, dealer or municipal securities dealer; and

(ii) unless the broker, dealer or municipal securities dealer first determines that the transaction is suitable for the customer as set forth in section (c) of this rule or unless the transaction is specifically directed by the customer and has not been recommended by the dealer to the customer.

(e) *Churning.* No broker, dealer or municipal securities dealer shall recommend transactions in municipal securities to a customer, or effect such transactions or cause such transactions to be effected for a discretionary account, that are excessive in size or frequency in view of information known to such broker, dealer or municipal securities dealer concerning the customer's financial background, tax status, and investment objectives.

### MSRB INTERPRETATIONS

#### NOTICE CONCERNING THE APPLICATION OF SUITABILITY REQUIREMENTS TO INVESTMENT SEMINARS AND CUSTOMER INQUIRIES MADE IN RESPONSE TO A DEALER'S ADVERTISEMENTS

May 7, 1985

Rule G-19 prohibits a municipal securities professional from recommending transactions in municipal securities to a customer unless the professional makes certain determinations with respect to the suitability of the transactions. The Board believes that rule G-19 applies to recommendations made by a professional at an investment seminar as follows: A dealer recommending a transaction in a particular security during the course of an investment seminar must have reasonable grounds for the recommendation in light of information about the security available from the issuer or otherwise. This duty applies to recommendations made generally to all participants in the seminar as well as to recommendations made to individual customers. In addition, a professional who makes a recommendation to a particular customer—whether during the course of the seminar or in response to an inquiry from the customer resulting from the customer's attendance at the seminar—must have reasonable grounds for believing that the recommendation is suitable based upon information available from the issuer of the security or otherwise and the facts disclosed by such customer or otherwise known about such customer.

The Board also wishes to advise the industry that the requirements of rule G-19 apply to recommendations made to customers who contact a dealer in response to an advertisement for municipal securities in the same way as they apply to all other recommendations made to customers.[1]

***This notice has been revised to reflect amendments that became effective on April 7, 1994.***

[1] Rule G-21, on advertising, defines an advertisement as—

> ...any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by municipal securities brokers or municipal securities dealers.

#### NOTICE REGARDING APPLICATION OF RULE G-19, ON SUITABILITY OF RECOMMENDATIONS AND TRANSACTIONS, TO ONLINE COMMUNICATIONS

September 25, 2002

**Background**

In the municipal securities markets, dealers[1] typically communicate with investors one-on-one, in person, or by telephone. These dealer/customer communications are made to provide the investor with information concerning the municipal securities the

dealer wants to sell and to allow the dealer to find out about the customer's investment objectives. Over the last few years there has been a dramatic increase in the use of the Internet for communication between dealers and their customers. Dealers are looking to the Internet as a mechanism for offering customers new and improved services and for enhancing the efficiency of delivering traditional services to customers. For example, dealers have developed online search tools that computerize the process by which customers can obtain and compare information on the availability of municipal securities of a specific type that are offered for sale by a particular dealer.[2] Technological advancements have provided many benefits to investors and the brokerage industry. These technological innovations, however, also have presented new regulatory challenges, including those arising from the application of the suitability rule to online activities. In consideration of this, the Municipal Securities Rulemaking Board ("MSRB") is issuing this notice to provide dealers with guidance concerning their obligations under MSRB Rule G-19, relating to suitability of recommendations,[3] in the electronic environment.[4]

Rule G-19 prohibits a dealer from recommending transactions in municipal securities to a customer unless the dealer makes certain determinations with respect to the suitability of the transactions.[5] Specifically, the dealer must have reasonable grounds for believing that the recommendation is suitable based upon information available from the issuer of the security or otherwise and the facts disclosed by the customer or otherwise known about such customer.

As the rule states, a dealer's suitability obligation only applies to securities that the dealer recommends to a customer.[6] A dealer or associated person who simply effects a trade initiated by a customer without a related recommendation from the dealer or associated person is not required to perform a suitability analysis. However, under MSRB Rules, even when a dealer does not recommend a municipal security transaction to a customer but simply effects or executes the transaction, the dealer is obligated to fulfill certain other important fair practice obligations. For example, under Rule G-17, when effecting a municipal security transaction for a customer, a dealer is required to disclose all material facts about a municipal security that are known by the dealer and those that are reasonably accessible.[7] In addition, Rule G-18 requires that each dealer, when executing a municipal securities transaction for or on behalf of a customer as agent, make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. Similarly, under Rule G-30, if a dealer engages in principal transactions with a customer, the dealer is responsible for ensuring that it is charging a fair and reasonable price. The MSRB wishes to emphasize the importance of these fair practice obligations even when a dealer effects a non-recommended transaction online.[8]

### Applicability of the Suitability Rule to Electronic Communications—General Principles

There has been much debate about the application of the suitability rule to online activities.[9] Industry commentators and regulators have debated two questions: first, whether the current suitability rule should even apply to online activities, and second, if so, what types of online communications constitute recommendations for purposes of the rule. The NASD published NASD Notice to Members 01-23, Online Suitability-Suitability Rule and Online Communication (the "NASD Online Suitability Notice") (April 2001) to provide guidance to its members in April 2001.[10] In answer to the first question, the MSRB, like the NASD, believes that the suitability rule applies to all recommendations made by dealers to customers—including those made via electronic means—to purchase, sell, or exchange a security. Electronic communications from dealers to their customers clearly can constitute recommendations. The suitability rule, therefore, remains fully applicable to online activities in those cases where the dealer recommends securities to its customers.

With regard to the second question, the MSRB does not seek to identify in this notice all of the types of electronic communications that may constitute recommendations. As the MSRB has often emphasized, "[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances."[11] That is, the test for determining whether any communication (electronic or traditional) constitutes a recommendation remains a "facts and circumstances" inquiry to be conducted on a case-by-case basis.

The MSRB also recognizes that many forms of electronic communications defy easy characterization. The MSRB believes this is especially true in the online municipal securities market, which is in a relatively early stage of development. Nevertheless, the MSRB offers as guidance the following general principles for dealers to use in determining whether a particular communication could be deemed a recommendation.[12] The "facts and circumstances" determination of whether a communication is a recommendation requires an analysis of the content, context, and presentation of the particular communication or set of communications. The determination of whether a recommendation has been made, moreover, is an objective rather than a subjective inquiry. An important factor in this regard is whether—given its content, context, and manner of presentation—a particular communication from a dealer to a customer reasonably would be viewed as a "call to action," or suggestion that the customer engage in a securities transaction. Dealers should bear in mind that an analysis of the content, context, and manner of presentation of a communication requires examination of the underlying substantive information transmitted to the customer and consideration of any other facts and circumstances, such as any accompanying explanatory message from the dealer.[13] Another principle that dealers should keep in mind is that, in general, the more individually tailored the communication is to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood is that the communication may be viewed as a recommendation.

### Scope of the Term Recommendation

As noted earlier, the MSRB agrees with and has in this guidance adopted the general principles enunciated in the NASD Online Suitability Notice as well as the NASD guidelines for evaluating suitability obligations discussed below. While the MSRB believes that the additional examples of communications that do not constitute recommendations provided by the NASD in its Online Suitability Notice are useful instruction for dealers who develop equity trading web sites, as the examples are based upon communications that exist with great regularity in the Nasdaq market, the MSRB believes that the examples have limited application to the types of information and electronic trading systems that are present in the municipal securities market.

For example, the NASD's third example of a communication that is not a recommendation describes a system that permits customer-directed searches of a "wide-universe" of securities and references all exchange-listed or Nasdaq securities, or externally recognized indexes.[14] The NASD example therefore applies to

dealer web sites that effectively allow customers to request lists of securities that meet broad objective criteria from a list of all the securities available on an exchange or Nasdaq. These are examples of groups of securities in which the dealer does not exercise any discretion as to which securities are contained within the group of securities shown to customers. This example makes sense in the equity market where there are centralized exchanges and where electronic trading platforms routinely utilize databases that provide customer access to all of the approximately 7,300 listed securities on Nasdaq, the NYSE and Amex. However, no dealer in the municipal securities market has the ability to offer all of the approximately 1.3 million outstanding municipal securities for sale or purchase. The municipal securities market is a fragmented dealer market. Municipal securities do not trade through a centralized exchange and only a small number of securities (approximately 10,000) trade at all on any given day. Therefore, there is no comparable central exchange that could serve as a reference point for a database that is used in connection with municipal securities research engines. The databases used by dealer systems typically are limited to the municipal securities that a dealer, or a consortium of dealers, holds in inventory. In these types of systems the customer's ability to search for desirable securities that meet the broad, objective criteria chosen by the customer (*e.g.*, all insured investment grade general obligation bonds offered by a particular state) is limited. The concept of a wide universe of securities, which is central to all of the NASD's examples, is thus difficult to define and has extremely limited, or no, application in the municipal securities market.

Given the distinct features of the municipal securities market and the existing online trading systems, the MSRB believes it would be impractical to attempt to define the features of an electronic trading system that would have to be present for the system transactions to not be considered the result of a dealer recommendation. The online trading systems for municipal securities that are in place today limit customer choices to the inventory that the dealer or dealer consortium hold, and therefore, the dealer will always have a significant degree of discretion over the securities offered to the customer. A system that allows this degree of dealer discretion is a dramatic departure from the types of no recommendation examples provided by the NASD guidance, and thus, these communications must be carefully analyzed to determine whether or not a recommendation has been made.

The MSRB, however, does believe that the examples of communications that are recommendations provided in the NASD Online Suitability Notice are communications that take place in the municipal securities market. Therefore, the MSRB has adopted these examples and generally would view the following communications as falling within the definition of recommendation:

- A dealer sends a customer-specific electronic communication (*e.g.*, an e-mail or pop-up screen) to a targeted customer or targeted group of customers encouraging the particular customer(s) to purchase a municipal security.[15]
- A dealer sends its customers an e-mail stating that customers should be invested in municipal securities from a particular state or municipal securities backed by a particular sector (such as higher education) and urges customers to purchase one or more stocks from a list with "buy" recommendations.
- A dealer provides a portfolio analysis tool that allows a customer to indicate an investment goal and input personalized information such as age, financial condition, and risk tolerance. The dealer in this instance then sends (or displays to) the customer a list of specific municipal securities the customer could buy or sell to meet the investment goal the customer has indicated.[16]
- A dealer uses data-mining technology (the electronic collection of information on Web Site users) to analyze a customer's financial or online activity—whether or not known by the customer—and then, based on those observations, sends (or "pushes") specific investment suggestions that the customer purchase or sell a municipal security.

Dealers should keep in mind that these examples are meant only to provide guidance and are not an exhaustive list of communications that the MSRB does consider to be recommendations. As stated earlier, many other types of electronic communications are not easily characterized. In addition, changes to the factual predicates upon which these examples are based (or the existence of additional factors) could alter the determination of whether similar communications may or may not be viewed as recommendations. Dealers, therefore, should analyze all relevant facts and circumstances, bearing in mind the general principles noted earlier and discussed below, to determine whether a communication is a recommendation, and they should take the necessary steps to fulfill their suitability obligations. Furthermore, these examples are based on technological services that are currently used in the marketplace. They are not intended to direct or limit the future development of delivery methods or products and services provided online.

**Guidelines for Evaluating Suitability Obligations**

- Dealers should consider, at a minimum, the following guidelines when evaluating their suitability obligations with respect to municipal securities transactions.[17] None of these guidelines is determinative of whether a recommendation exists. However, each should be considered in evaluating all of the facts and circumstances surrounding the communication and transaction.
- A dealer cannot avoid or discharge its suitability obligation through a disclaimer where the particular communication reasonably would be viewed as a recommendation given its content, context, and presentation.[18] The MSRB, however, encourages dealers to include on their web sites (and in other means of communication with their customers) clear explanations of the use and limitations of tools offered on those sites.[19]
- Dealers should analyze any communication about a security that reasonably could be viewed as a "call to action" and that they direct, or appear to direct, to a particular individual or targeted group of individuals—as opposed to statements that are generally made available to all customers or the public at large—to determine whether a recommendation is being made.[20]
- Dealers should scrutinize any communication to a customer that suggests the purchase, sale, or exchange of a municipal security—as opposed to simply providing objective data about a security—to determine whether a recommendation is being made.[21]
- A dealer's transmission of unrequested information will not necessarily constitute a recommendation. However, when a dealer decides to send a particular customer unrequested information about a security that is not of a generalized or administrative nature (e.g., notification of an official communication), the dealer should carefully review the cir-

cumstances under which the information is being provided, the manner in which the information is delivered to the customer, the content of the communication, and the original source of the information. The dealer should perform this review regardless of whether the decision to send the information is made by a representative employed by the dealer or by a computer software program used by the dealer.

- Dealers should be aware that the degree to which the communication reasonably would influence an investor to trade a particular municipal security or group of municipal securities—either through the context or manner of presentation or the language used in the communication—may be considered in determining whether a recommendation is being made to the customer.

The MSRB emphasizes that the factors listed above are guidelines that may assist dealers in complying with the suitability rule. Again, the presence or absence of any of these factors does not by itself control whether a recommendation has been made or whether the dealer has complied with the suitability rule. Such determinations can be made only on a case-by-case basis taking into account all of the relevant facts and circumstances.

**Conclusion**

The foregoing discussion highlights some suggested principles and guidelines to assist in determining when electronic communications constitute recommendations, thereby triggering application of the MSRB's suitability rule. The MSRB acknowledges the numerous benefits that may be realized by dealers and their customers as a result of the Internet and online brokerage services. The MSRB emphasizes that it neither takes a position on, nor seeks to influence, any dealer's or customer's choice of a particular business model in this electronic environment. At the same time, however, the MSRB urges dealers both to consider carefully whether suitability requirements are adequately being addressed when implementing new services and to remember that customers' best interests must continue to be of paramount importance in any setting, traditional or online.

As new technologies and/or services evolve, the MSRB will continue to work with regulators, members of the industry and the public on these and other important issues that arise in the online trading environment.

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[1] The term "dealer" is used in this notice as shorthand for "broker," "dealer" or "municipal securities dealer," as those terms are defined in the Securities Exchange Act of 1934. The use of the term in this notice does not imply that the entity is necessarily taking a principal position in a municipal security.

[2] The Bond Market Association's ("TBMA") 2001 Review of Electronic Transaction Systems found that at the end of 2001, there were at least 23 systems based in the United States that allow dealers or institutional investors to buy or sell municipal securities electronically compared to just 3 such systems in 1997. While dealers are also developing electronic trading platforms that allow retail customers to buy or sell municipal securities online, the development of online retail trading systems for municipal securities lags far behind that for equities.

[3] Rule G-19 provides in pertinent part:

> (c) *Suitability of Recommendations*. In recommending to a customer any municipal security transaction, a [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.

[4] Although the focus of this notice is on the application of the suitability rule to electronic communications, much of the discussion is also relevant to more traditional communications, such as discussions made in person, over the telephone, or through postal mail.

[5] This notice focuses on customer-specific suitability under Rule G-19. Under Rule G-19, a dealer must also have a reasonable basis to believe that the recommendation could be suitable for at least some customers. *See e.g.*, Rule G-19 Interpretation—Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement, May 7, 1985, *MSRB Rule Book* (July 1, 2002) at 143; *In re F.J. Kaufman and Company of Virginia*, 50 S.E.C. 164, 168, 1989 SEC LEXIS 2376, *10 (1989) (the "reasonable basis" obligation relates only to the particular recommendation, rather than to any particular customer). The SEC, in its discussion of municipal underwriters' responsibilities in a 1988 Release, noted that "a broker-dealer recommending securities to investors implies by its recommendation that it has an adequate basis for the recommendation." *Municipal Securities Disclosure*, Securities Exchange Act Release No. 26100 (September 22, 1988) (the "1988 SEC Release") at text accompanying note 72.

[6] Similarly, the suitability rule does not apply where a dealer merely gathers information on a particular customer, but does not make any recommendations. This is true even if the information is the type of information generally gathered to satisfy a suitability obligation. Dealers should nonetheless remember that regardless of any determination of whether the dealer is making a recommendation and subject to the suitability requirement, the dealer is required to make reasonable efforts to obtain certain customer specific information pursuant to rule G-8 (a)(xi) so that dealers can protect themselves and the integrity of the securities markets from customers who do not have the financial means to pay for transactions.

[7] *See* Rule G-17 Interpretation—Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, MSRB Rule Book (July 1, 2002) at 135.

[8] On April 30, 2002, the Securities and Exchange Commission ("SEC") approved a proposed rule change relating to the manner in which dealers fulfill their fair practice obligations to certain institutional customers. Release No. 34-45849 (April 30, 2002), 67 FR 30743. *See* Rule G-17 Interpretation—Notice Regarding the Application of MSRB Rules to Transactions With Sophisticated Municipal Market Professionals ("SMMPs") (the "SMMP Notice"), *MSRB Rule Book* (July 1, 2002) at 136. The SMMP Notice recognizes the different capabilities of SMMPs and retail or non-sophisticated institutional customers and provides that dealers may consider the nature of the institutional customer when determining what specific actions are necessary to meet the dealer's fair practice obligations to such customers. The SMMP Notice provides that, while it is difficult to define in advance the scope of a dealer's fair practice obligations with respect to a particular transaction, by making a reasonable determination that an institutional customer is an SMMP, then certain of the dealer's fair practice obligations remain applicable but are deemed fulfilled.

[9] *See generally* Report of Commissioner Laura S. Unger to the SEC, *On-Line Brokerage: Keeping Apace of Cyberspace*, at n. 64 (Nov. 1999) ("Unger Report") (discussing various views espoused by online brokerage firms, regulators and academics on the topic of online suitability); *Developments in the Law—The Law of Cyberspace*, 112 Harv. L. Rev. 1574, 1582-83 (1999) (The article highlights the broader debate by academics and judges over whether "to apply conventional models of regulation to the Internet.")

[10] The guidance contained in this notice is intended to be consistent with the general statements and guidelines contained in the NASD Online Suitability Notice.

[11] *See e.g.*, Rule G-19 Interpretive Letter dated February 17, 1998, *MSRB Rule Book* (July 1, 2002) at 144.

[12] These general principles were first enunciated in the NASD Online Suitability Notice.

[13] For example, if a dealer transmitted a rating agency research report to a customer at the customer's request, that communication may not be subject to the suitability rule; whereas, if the same dealer transmitted the very same research report with an accompanying message, either oral or written, that the customer should act on the report, the suitability analysis would be different.

[14] NASD Online Suitability Notice at 3.

[15] Note that there are instances where sending a customer an electronic communication that highlights a particular municipal security (or securities) will not be viewed as a recommendation. For instance, while each case requires an analysis of the particular facts and circumstances, a dealer generally would not be viewed as making a recommendation when, pursuant to a customer's request, it sends the customer (1) electronic "alerts" (such as account activity alerts, market alerts, or rating agency changes) or (2) research announcements (e.g., sector reports) that are not tailored to the individual customer, as long as neither—given their content, context, and manner of presentation—would lead a customer reasonably to believe that the dealer is suggesting that the customer take action in response to the communication.

[16] Note, however, that a portfolio analysis tool that merely generates a suggested mix of general classes of financial assets (e.g., 60 percent equities, 20 percent bonds, and 20 percent cash equivalents), without an accompanying list of securities that the customer could purchase to achieve that allocation, would not trigger a suitability obligation. On the other hand, a series of actions which may not constitute recommendations when considered individually, may amount to a recommendation when considered in the aggregate. For example, a portfolio allocator's suggestion that a customer could alter his or her current mix of investments followed by provision of a list of municipal securities that could be purchased or sold to accomplish the alteration could be a recommendation. Again, however, the determination of whether a portfolio analysis tool's communication constitutes a recommendation will depend on the content, context, and presentation of the communication or series of communications.

[17] These guidelines were originally set forth in the NASD Online Suitability Notice.

[18] Although a dealer cannot disclaim away its suitability obligation, informing customers that generalized information provided is not based on the customer's particular financial situation or needs may help clarify that the information provided is not meant to be a recommendation to the customer. Whether the communication is in fact a recommendation would still depend on the content, context, and presentation of the communication. Accordingly, a dealer that sends a customer or group of customers information about a security might include a statement that the dealer is not providing the information based on the customers' particular financial situation or needs. Dealers may properly disclose to customers that the opinions or recommendations expressed in research do not take into account individual investors' circumstances and are not intended to represent recommendations by the dealer of particular municipal securities to particular customers.

Dealers, however, should refer to previous guidelines issued by the SEC that may be relevant to these and/or related topics. For instance, the SEC has issued guidelines regarding whether and under what circumstances third-party information is attributable to an issuer, and the SEC noted that the guidance also may be relevant regarding the responsibilities of dealers. *See* SEC Guidance on the Use of Electronic Media, Release Nos. 34-7856, 34-42728, IC-24426, 65 Fed. Reg. 25843 at 25848-25849 (April 28, 2000).

[19] The MSRB believes that a dealer should, at a minimum, clearly explain the limitations of its search engine and the decentralized nature of the municipal securities market. The dealer should also clearly explain that securities that meet the customer's search criteria might be available from other sources.

[20] The MSRB notes that there are circumstances where the act of sending a communication to a specific group of customers will not necessarily implicate the suitability rule. For instance, a dealer's business decision to provide only certain types of investment information (*e.g.*, research reports) to a category of "premium" customers would not, without more, trigger application of the suitability rule. Conversely, dealers may incur suitability obligations when they send a communication to a large group of customers urging those customers to invest in a municipal security.

[21] As with the other general guidelines discussed in this notice, the presence of this factor alone does not automatically mean that a recommendation has been made.

See also:

**Rule G-17 Interpretations – Notice Concerning Disclosure of Call Information to Customers of Municipal Securities,** March 4, 1986.

**– Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts,** March 20, 2002.

**– Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals,** April 30, 2002.

**Rule G-21 Interpretation – Application of Fair Practice Rules to Municipal Fund Securities,** May 14, 2002.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## *Interpretive Letters*

**Recommendations.** This is in response to your letter in which you ask whether certain activities of [name deleted] (the "dealer") described in your letter constitute recommendations of municipal securities transactions to its customers within the meaning of Board rule G-19, on suitability of recommendations and transactions. In preparing this response, we have limited the scope of our review to the rules adopted by the Board, including rule G-19. You should consult with the Securities and Exchange Commission (the "SEC") for any interpretations of its Rule 15c2-12.[1]

We agree with the SEC's statement that "most situations in which a broker, dealer or municipal securities dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer."[2] We also agree with the position taken by NASDR that "[w]hether a particular transaction is in fact recommended depends on an analysis of all the relevant facts and circumstances."[3] Thus, the Board believes that, for purposes of rule G-19, a determination of whether a recommendation has been made under any particular set of facts and circumstances is dependent upon a close examination of such specific facts and circumstances. Such an inquiry is properly undertaken by the agencies charged with enforcing the Board's rules. *MSRB interpretation of February 17, 1998.*

[1] You have stated that staff of NASD Regulation, Inc. ("NASDR") found during an examination of the dealer "a failure to comply with MSRB Rule G-27(c), in that a review of written supervisory procedures indicated that the firm's procedures manual does not establish written procedures with respect to SEC Rule 15c2-12." To the extent that the dealer argues that its written supervisory procedures are not deficient under Board rule G-27 because it believes that it does not recommend any municipal securities to customers within the meaning of section (c) of SEC Rule 15c2-12, the dealer should, as noted above, consult with the SEC for an interpretation of the term "recommend" as used in its rule.

[2] Exchange Act Rel. No. 33742 (Mar. 9, 1994).

[3] Letter dated January 23, 1997 from John M. Ramsey, Deputy General Counsel, NASDR, to Stuart J. Kaswell, Senior Vice President and General Counsel, Securities Industry Association.

**Recommendations: advertisements.** This is in response to your letter in which you state that your firm is counsel to [name deleted] with regard to a certain issue of municipal securities. You note that, while the issue was in its planning stages, a solicitation for purchase of securities from the issue was distributed by a certain dealer without the knowledge or approval of the issuer. In addition, you state that the solicitation incorrectly indicated a date the issue was scheduled to be issued and incorrectly stated the term of the issue.

Rule G-21, on advertising, provides that no dealer shall publish or cause to be published any advertisement concerning municipal securities which such dealer knows or has reason to know is materially false or misleading. The rule defines advertisement as any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing.

On May 7, 1985, the Board released an interpretive notice concerning the application of suitability requirements to investment seminars and customer inquires made in response to a dealer's advertisements.[1] In that notice the Board stated that the requirements of rule G-19, on suitability of recommendations and transactions, apply to recommendations made to customers who contact a dealer in response to an advertisement for municipal securities in the same way as they apply to all other recommendations made to customers. Under rule G-19, a dealer may make a recommendation only if the dealer has reasonable grounds, based upon information available from the issuer of the securities or otherwise, for recommending the security and, in addition, the dealer believes that the recommendation is suitable for the particular customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by the dealer.[2]

If an individual contacts a dealer for additional information concerning municipal securities that were the subject of any advertisement, a professional is permitted to recommend a particular transaction to the individual only if he has reasonable grounds for recommending the security in light of information about the security available from the issuer or otherwise. Moreover, the professional may make the recommendation to the customer only if, after making a reasonable inquiry, he has reasonable grounds to believe and does believe that the recommendation is suitable for the customer on the basis of the financial and other information provided by the customer or obtained from other reliable sources.

With respect to the advertisement in question, the fact that it includes an application form to be submitted by customers along with a check in purchasing securities from the issue would

seem to indicate that the dealer was intending to effect transactions in the issue without undertaking a review of appropriate suitability determinations. A transaction effected in such a manner would be a violation of rule G-19. *MSRB interpretation of February 24, 1994.*

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[1] [See Rule G-19 Interpretation – Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisements, May 7, 1985, reprinted in MSRB Rule Book.]

[2] Rule G-8, on books and records, requires the information obtained about the customer to be recorded in the customer account record to assist in monitoring compliance with rule G-19. Dealers must ensure that these records are kept current if subsequent changes in the customer's position affect the suitability of recommendations made to the customer.

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See also:

**Rule G-21 Intepretive Letter – Disclosure obligations,** *MSRB interpretation of May 21, 1998.*

## Rule G-20: Gifts and Gratuities

(a) *Limitation on Value*. No broker, dealer or municipal securities dealer shall, directly or indirectly, give or permit to be given any thing or service of value, including gratuities, in excess of $100 per year to a person other than an employee or partner of such broker, dealer or municipal securities dealer, if such payments or services are in relation to the municipal securities activities of the employer of the recipient of the payment or service. For purposes of this rule the term "employer" shall include a principal for whom the recipient of a payment or service is acting as agent or representative.

(b) *Normal Business Dealings*. Notwithstanding the foregoing, the provisions of section (a) of this rule shall not be deemed to prohibit occasional gifts of meals or tickets to theatrical, sporting, and other entertainments; the sponsoring of legitimate business functions that are recognized by the Internal Revenue Service as deductible business expenses; or gifts of reminder advertising; provided, that such gifts shall not be so frequent or so expensive as to raise a suggestion of conduct inconsistent with high standards of professional ethics in the municipal securities industry.

(c) *Compensation for Services*. Notwithstanding the foregoing, the provisions of section (a) of this rule shall not apply to contracts of employment with or to compensation for services rendered by another person; provided, that there is in existence prior to the time of employment or before the services are rendered a written agreement between the broker, dealer or municipal securities dealer subject to this rule and the person who is to perform such services; and provided, further, that such agreement shall include the nature of the proposed services, the amount of the proposed compensation, and the written consent of such person's employer.

### *Interpretive Letters*

**"Person."** Your letter regarding rule G-20 has been referred to me. Rule G-20 prohibits a municipal securities professional from giving gifts or providing services to a person in relation to the municipal securities activities of such person's employer, in excess of a specified amount.

In your letter, you inquire whether the term "person" in rule G-20 is intended to include "a 'corporate' person as well as a 'real' person."As used in the rule, the term "person" refers only to a natural person. The rule is intended to discourage municipal securities professionals from attempting to induce individual employees from acting in a manner inconsistent with their obligations to, or contrary to the interests of, their employers. *MSRB interpretation of March 19, 1980.*

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**Authorization of sales contests.** Your letter of May 27, 1982 has been referred to me for response. In your letter you request an interpretation regarding the applicability of Board rule G-20 concerning gifts and gratuities to sales contests offered by an underwriter to participating members of a syndicate. Your letter asks specifically whether such sales contests are considered compensation for services as described in paragraph (c) of rule G-20, and, if they are, whether the requirements of rule G-20 imposed on agreements for the compensation of services must be met by the underwriter sponsoring the sales contest.

The Board believes that sales contests which provide gifts or payments to employees of municipal securities brokers and municipal securities dealers other than the broker or dealer sponsoring the contest constitute compensation for services as described in rule G-20(c). Consequently, the requirements of that rule must be met: that is, the sponsoring dealer must obtain

> prior to the time of employment or before the services are rendered a written agreement between the municipal securities broker or municipal securities dealer subject to this rule and the person who is to perform such services; ... such agreement [to] include the nature of the proposed services, the amount of the proposed compensation, and the written consent of such person's employer.

In the context of sales contests, agreements of the kind referred to in the rule are required between the municipal securities broker or municipal securities dealer sponsoring the contest and all contestants employed by other municipal securities brokers and municipal securities dealers. *MSRB interpretation of June 25, 1982.*

## Rule G-21: Advertising

(a) *Definition of "Advertisement."* For purposes of this rule, the term "advertisement" means any material (other than listings of offerings) published or designed for use in the public, including electronic, media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter, telemarketing script or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by brokers, dealers or municipal securities dealers.

(b) *Professional Advertisements.* No broker, dealer or municipal securities dealer shall publish or cause to be published any advertisement concerning the facilities, services or skills with respect to municipal securities of such broker, dealer, or municipal securities dealer or of another broker, dealer, or municipal securities dealer, that is materially false or misleading.

(c) *Product Advertisements.* No broker, dealer or municipal securities dealer shall publish or cause to be published any advertisement concerning municipal securities which such broker, dealer, or municipal securities dealer knows or has reason to know is materially false or misleading.

(d) *New Issue Advertisements.* In addition to the requirements of section (c), all advertisements for new issue municipal securities shall also be subject to the following requirements:

(i) *Accuracy at Time of Sale.* A syndicate or syndicate member which publishes or causes to be published any advertisement regarding the offering by the syndicate of a new issue of municipal securities, or any part thereof, may show the initial reoffering prices or yields for the securities, even if the price or yield for a maturity or maturities may have changed, provided that the advertisement contains the date of sale of the securities by the issuer to the syndicate. In the event that the prices or yields shown in a new issue advertisement are other than the initial reoffering prices or yields, such an advertisement must show the prices or yields of the securities as of the time the advertisement is submitted for publication. For purposes of this rule, the date of sale shall be deemed to be, in the case of competitive sales, the date on which bids are required to be submitted to an issuer and, in the case of negotiated sales, the date on which a contract to purchase securities from an issuer is executed.

(ii) *Accuracy at Time of Publication.* Each advertisement relating to a new issue of municipal securities shall also indicate, if applicable, that the securities shown as available from the syndicate may no longer be available from the syndicate at the time of publication or may be available from the syndicate at a price or yield different from that shown in the advertisement.

(e) *Approval by Principal.* Each advertisement subject to the requirements of this rule must be approved in writing by a municipal securities principal or general securities principal prior to first use. Each broker, dealer and municipal securities dealer shall make and keep current in a separate file records of all such advertisements.

### MSRB INTERPRETATIONS

#### APPLICATION OF FAIR PRACTICE AND ADVERTISING RULES TO MUNICIPAL FUND SECURITIES

May 14, 2002

The Municipal Securities Rulemaking Board ("MSRB") is aware that the market for municipal fund securities continues to evolve rapidly, particularly with respect to the so-called Section 529 college savings plan market.[1] Many brokers, dealers and municipal securities dealers ("dealers") active in the market for municipal fund securities have no other experience effecting municipal securities transactions and therefore may not be familiar with the rules of the MSRB. Further, even where a dealer has a sound understanding of MSRB rules derived from its other municipal securities activities relating to traditional debt securities, the unique nature of municipal fund securities may result in these otherwise familiar rules being applied in unfamiliar ways. As a result, the MSRB has been committed to providing interpretive guidance regarding the application of its rules to dealers effecting transactions in municipal fund securities as the MSRB becomes aware of issues where such guidance would be beneficial.[2]

This notice seeks to provide guidance on the basic customer protection obligations that dealers have when effecting transactions in municipal fund securities. At the core of the MSRB's customer protection rules is Rule G-17, which provides that, in the conduct of its municipal securities activities, each dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice. As the MSRB has recently noted, the rule encompasses two basic principles: an anti-fraud prohibition similar to the standard set forth in Rule 10b-5 adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act"), and a general duty to deal fairly even in the absence of fraud.[3] All activities of dealers must be viewed in light of these basic principles, regardless of whether other MSRB rules establish specific requirements applicable to such activities.

**Sales Practice Issues**

Dealers must keep in mind the requirements under Rule G-17 – that they deal fairly with all persons and that they not engage in any deceptive, dishonest or unfair practice – when considering the appropriateness of day-to-day sales practices with respect to municipal fund securities. In some cases, certain sales-related activities are governed in part by specific MSRB rules, such as Rule G-19, relating to suitability of recommendations and transactions, Rule G-21, on advertising, and Rule G-30, on prices and commissions.[4] Other activities may not be explicitly addressed by a specific MSRB rule. In either case, the general principles of Rule G-17 always apply.

The MSRB has previously described its approach to dealer regulation in the context of a market in which issuer activities are largely unregulated. In establishing the MSRB, Congress determined that dealer regulation was the appropriate manner of providing investor protection in the munic-

ipal securities market while maintaining the existing exemption for issuers. Consistent with this Congressional purpose, the MSRB's rules are designed to recognize that issuers, as largely unregulated entities, may act in their best judgment in widely divergent manners. The MSRB observes that municipal fund securities are, in many respects, similar but not identical to registered investment company securities. Thus, the MSRB has crafted its rules so that the obligations placed on dealers are sufficiently flexible to permit dealers to act in a lawful manner in view of this wide divergence of circumstances and structures while maintaining an appropriate level of customer protection. In many cases, the MSRB has determined that its existing rules, with some minor modifications, operate effectively in the context of municipal fund securities. In other cases, the MSRB has modified its existing rules to operate consistently with rules applicable to registered investment company securities, where this was found to be appropriate. The MSRB notes, however, that certain rules of the SEC and the National Association of Securities Dealers, Inc. ("NASD") applicable to registered investment companies and their securities are specifically authorized by the Investment Company Act, which does not apply to municipal fund securities. In these cases, the MSRB may have more circumscribed authority to emulate such SEC and NASD rules, even if the MSRB were to determine that such emulation would be appropriate.

The MSRB remains committed to this rulemaking approach.[5]

Suitability of Recommended Transactions. Under Rule G-19, a dealer that recommends to a customer a transaction in a municipal fund security must have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer of the security or otherwise and the facts disclosed by or otherwise known about the customer. To assure that a dealer effecting a recommended transaction with a non-institutional customer has the information needed about the customer to make its suitability determination, the rule requires the dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, as well as any other information reasonable and necessary in making the recommendation.

In the context of a recommended transaction relating to a Section 529 college savings plan, the MSRB believes that it is crucial for dealers to remain cognizant of the fact that these securities are designed for a particular purpose and that this purpose generally should match the customer's investment objective. For example, dealers should bear in mind the potential tax consequences of a customer making an investment in a Section 529 college savings plan where the dealer understands that the customer's investment objective may not involve use of such funds for qualified higher education expenses.[6] Furthermore, investors generally are required to designate a specific beneficiary under a Section 529 college savings plan. The MSRB believes that information known about the designated beneficiary generally would be relevant in weighing the investment objectives of the customer, including (among other things) information regarding the age of the beneficiary and the number of years until funds will be needed to pay qualified higher education expenses of the beneficiary. The MSRB notes that, since the person making the investment in a Section 529 college savings plan retains significant control over the investment (*e.g.*, may withdraw funds, change plans, or change beneficiary, etc.), this person is appropriately considered the customer for purposes of Rule G-19 and other MSRB rules. As noted above, information regarding the designated beneficiary should be treated as information relating to the customer's investment objective for purposes of Rule G-19.

In many cases, dealers may offer the same municipal fund security of an issuer sold with different commission structures. For example, an A share may have a front-end load, a B share may have a contingent deferred sales charge or back-end load that reduces in amount depending upon the number of years that the investment is held, and a C share may have an annual asset-based charge. A customer's investment objective – particularly, the number of years until withdrawals are expected to be made – can be a significant factor in determining which share class would be suitable for the particular customer.

Rule G-19(e), on churning, prohibits a dealer from recommending transactions to a customer that are excessive in size or frequency, in view of information known to such dealer concerning the customer's financial background, tax status and investment objectives. Thus, for example, where the dealer knows that a customer is investing in a Section 529 college savings plan with the intention of receiving the available federal tax benefit, such dealer could, depending upon the facts and circumstances, violate rule G-19(e) if it were to recommend roll-overs from one Section 529 college savings plan to another with such frequency as to lose the federal tax benefit. Even where the frequency does not imperil the federal tax benefit, roll-overs recommended year after year by a dealer could, depending upon the facts and circumstances (including consideration of legitimate investment and other purposes), be viewed as churning. Similarly, depending upon the facts and circumstances, where a dealer recommends investments in one or more plans for a single beneficiary in amounts that far exceed the amount that could reasonably be used by such beneficiary to pay for qualified higher education expenses, a violation of rule G-19(e) could result.[7]

Marketing Activities. No MSRB rule explicitly governs the manner in which marketing activities are structured. However, dealers must remain aware of the applicability of the general principles of Rule G-17 to their marketing activities. In particular, dealers must ensure that they do not engage in transactions primarily designed to increase commission revenues in a manner that is unfair to customers under Rule G-17. Thus, in addition to being a potential violation of Rule G-19 as discussed above, recommending a particular share class to a customer that is not suitable for that customer, or engaging in churning, may also constitute a violation of Rule G-17 if the recommendation was made for the purpose of generating higher commission revenues. Further, recommending transactions to customers in amounts designed to avoid commission discounts (*i.e.*, sales below breakpoints where the customer would be entitled to lower commission charges) may also violate Rule G-17, depending upon the facts and circumstances. For example, a recommendation that a customer invest in two separate but nearly identical municipal fund securities for the purposes of avoiding a reduced commission rate that would be available upon purchasing a larger quantity of a single such security, or that a customer time his or her multiple investments in a municipal fund security so as to avoid being able to take advantage of a lower commission rate, in either case without a legitimate investment-based purpose, could violate Rule G-17.

With respect to sales contests, the MSRB has previously interpreted Rule G-20, relating to gifts and gratuities, to require a dealer that sponsors a sales contest involving representatives who are not employed by the sponsoring dealer to have in place written agreements with these representatives.[8] The MSRB otherwise does not mandate specific requirements with respect to sales contests, but the general principles of Rule G-17 are applicable. Thus, if a dealer or any of its associated persons engages in any marketing activities that result in a customer being treated unfairly, or if the dealer or any of its associated persons engages in any deceptive, dishonest or unfair practice in connection with such marketing activities, Rule G-17 could be violated. The MSRB believes that, depending upon the specific facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer or such other dealer's associated persons to violate the principles of Rule G-17 or other MSRB customer protection rules, such as Rule G-19 or Rule G-30.

Advertising. Dealer advertisements of municipal fund securities are

not subject to the requirements of NASD Rule 2210. Rather, as is the case with any other dealer advertisement of a municipal security, advertisements of municipal fund securities are governed by MSRB Rule G-21.[9] Rule G-21 establishes a general ethical standard for dealer advertisements[10] rather than a detailed code of required elements and specific prohibitions. Under the rule, a dealer is prohibited from publishing any advertisement concerning its facilities, services or skills with respect to municipal securities that is materially false or misleading. In addition, a dealer is prohibited from publishing any advertisement concerning municipal securities that it knows or has reason to know is materially false or misleading.[11] Rule G-21 generally does not require that any specific statements or information be included in an advertisement but does require that any statement or information that is included not be materially false or misleading.[12]

The MSRB previously has stated that, although dealers are not required to comply with NASD Rule 2210 in connection with their advertisements of municipal fund securities, an advertisement that would be compliant with the NASD rule (if the securities were registered investment company securities) also would be in compliance with Rule G-21. Similarly, a dealer advertisement of municipal fund securities that would be compliant with the SEC's Rules 156 and 482 under the Securities Act of 1933 also would be in compliance with Rule G-21.[13] Of course, a dealer advertisement of a municipal fund security that does not comply with every element of these NASD or SEC rules may still, depending upon the facts and circumstances, comply with Rule G-21 so long as the dealer does not know or has no reason to know that the advertisement is materially false or misleading and has otherwise complied with the MSRB's interpretive guidance on advertising, including the guidance set forth below.

The MSRB also has stated that any use of historical yields in a municipal fund security advertisement typically would require a description of the nature and significance of the yield shown in the advertisement in order to assure that such advertisement is not false or misleading. Further, depending upon the facts and circumstances, a dealer may be required to disclose information regarding a fee or other charge relating to municipal fund securities that may have a material effect on such advertised yield, to the extent that such disclosure is necessary to ensure that the advertisement is not materially false or misleading with respect to such yield.[14]

Rule G-21 does not provide for the filing of advertisements with the MSRB or any other regulatory agency.[15] The MSRB observes that filing of registered investment company advertisements is mandated under Section 24(b) of the Investment Company Act, and the SEC has by rule authorized dealers to file advertisements with the NASD in order to meet this statutory requirement. Of course, the Investment Company Act does not apply to municipal fund securities. The MSRB believes that, given the nature of the issuers and the securities and the overall structure of the federal securities laws, it would not be appropriate at this time to require filing of municipal fund securities advertisements with the MSRB or any other regulatory agency. However, all advertisements of municipal securities must be approved in writing by a municipal securities principal (which may include a municipal fund securities limited principal in the case of an advertisement relating to municipal fund securities) or a general securities principal prior to first use. Dealers are required to maintain in a separate file records of all advertisements. A copy of each advertisement is required to be preserved for a period of at least three years pursuant to Rule G-9(b)(xiii).

The MSRB provides below additional guidance to dealers on compliance with Rule G-21. Since the MSRB understands that production and publication schedules and other technical issues may in some cases make immediate compliance with this additional guidance problematic, the MSRB has determined to delay the effectiveness of such guidance on advertising until July 15, 2002. Nonetheless, the MSRB urges dealers to comply with this guidance as soon as practicable.

Historical data. As previously noted, the use of historical yields in an advertisement requires a description of their nature and significance so as to assure that such advertisement is not false or misleading. The MSRB believes that an advertisement that includes historical yield or other historical data must make clear that such information relates to past performance, which may not be indicative of future investment performance.

Nature of issuer and security. An advertisement for a specific municipal fund security must provide sufficient information to identify such specific security in a manner that is not false or misleading. For example, the MSRB believes that an advertisement of a particular municipal fund security that does not clearly disclose the identity of the issuer may, depending upon the facts and circumstances, be misleading, particularly since the identity of the issuer may be a relevant factor in determining the nature of certain tax and other features of the security. Thus, an advertisement that identifies a municipal fund security but omits the name of the issuer generally would be misleading, as would an advertisement that implies that a different entity is the issuer of the municipal fund security (*e.g.*, the dealer or the investment manager retained by the issuer to manage the underlying portfolio). At the same time, a dealer must take care not to raise an inference that, because the securities are issued under a government-sponsored plan, an investor might expect that the governmental issuer would guarantee the investor against investment losses if no such guarantee in fact exists. If the advertisement concerns a specific class of that issuer's securities (*e.g.*, A shares vs. B shares; direct sale shares vs. advisor shares; in-state shares vs. national shares; etc.), this also must clearly be disclosed.

Capacity of dealer and other parties. The MSRB understands that in many cases a dealer serving as primary distributor for a municipal fund security program acts in such capacity in conjunction with certain of its affiliates or other unrelated entities that may provide investment management, transfer agent or other services to the issuer. The MSRB believes that a dealer advertisement that relates to or describes services provided with respect to municipal fund securities must clearly indicate the entity providing those services. Similarly, a dealer advertisement soliciting purchases of municipal fund securities that would in fact be effected by another dealer must clearly state which dealer would effect the sales.

Tax consequences. Any discussion of tax implications of investments in municipal fund securities (*e.g.*, exemption of earnings from federal income tax, deductibility of investments from state income tax, etc.) included in an advertisement must not be false or misleading. In the case of an advertisement that includes statements regarding state tax exemption, the MSRB believes that the advertisement must make clear that the availability of such exemption may be limited based upon residency or other applicable factors. Similarly, if an advertisement refers to exemption from federal income tax, it must make clear that such exemption is only available under certain defined circumstances.[16]

Underlying registered securities. The MSRB recognizes that many municipal fund securities represent investments in pools of registered securities that are themselves subject to the various requirements of the SEC and NASD (*e.g.*, registered investment company securities). In some cases, an advertisement of a municipal fund security may provide specific details regarding underlying assets that are themselves subject to SEC and NASD advertising rules. Under these circumstances, the MSRB believes that any details of a registered security that are included in the municipal fund security advertisement must be presented in a manner that would be in compliance with the SEC and NASD advertising rules applicable where the same registered security is sold directly to an investor.[17] The MSRB takes this position because it believes that it would be unfair and possibly misleading to investors, in violation of Rules G-17 and G-21, for a dealer to advertise an underlying registered security in a manner that would make comparison with the features of the same registered security sold directly to investors difficult.

Disclosure Issues

Tax Treatment. The treatment of interest on municipal debt securities for federal income tax purposes traditionally has been an important feature for investors in such securities. MSRB rules, however, only specifically provide for certain limited disclosures of tax treatment. For example, MSRB Rule G-15(a)(i)(C)(4), relating to confirmation of customer transactions, requires confirmation disclosures relating to municipal debt securities that are taxable, subject to the federal alternative minimum tax or subject to special tax treatment as a result of original issue discount. These limited disclosures are based in large measure on the generally well understood nature of the tax-exempt municipal bond market, where specific disclosures are needed only when the tax treatment diverges from the norms of the market.

On the other hand, the tax treatment of the emerging Section 529 college savings plan market has been in considerable flux. In particular, various states have recently enacted or amended their own state tax provisions that may provide advantageous tax treatment for their residents if they invest in the Section 529 college savings plan sponsored by their home state.[18] The Investment Company Institute ("ICI") has requested that the MSRB adopt a requirement that would provide for written disclosure by dealers selling Section 529 college savings plan securities that an "investor's home state may only offer favorable tax treatment for investing in a plan offered by such state."[19]

The MSRB believes that Rule G-17 prohibits a dealer from misleading a customer regarding the availability of state tax benefits in connection with an investment in municipal fund securities. For example, a dealer would violate Rule G-17 if it were to inform a customer that investment in the Section 529 college savings plan of the customer's own state did not provide the customer with any state tax benefit when the dealer knows or has reason to know that such a state tax benefit likely would be available. Furthermore, a dealer would violate Rule G-17 if it were to inform a customer that investment in the Section 529 college savings plan of another state would provide the customer with the same tax benefits as would be available if the customer were to invest in his or her own state's plan, if the dealer knows or has reason to know that this is not the case. Typically, however, the affirmative obligation arising under Rule G-17 to disclose material information regarding a particular transaction to a customer relates to material information about the securities that are the subject of the transaction rather than alternatives available in the market to such investment.

The MSRB believes that, in the case of sales to a customer of out-of-state Section 529 college savings plan interests, Rule G-17 requires a dealer to disclose that, depending upon the laws of the customer's home state, favorable state tax treatment for investing in a Section 529 college savings plan may be limited to investments made in a Section 529 college savings plan offered by the customer's home state. Since dealers cannot reasonably be expected to become expert in state tax laws throughout the country, the MSRB believes that such disclosure, coupled with a suggestion that the customer consult a tax adviser about any state tax consequences of the investment, should adequately address the concerns expressed by the ICI.[20]

As the ICI noted, the MSRB has interpreted Rule G-32 to permit that certain required disclosures to new issue customers be made in the official statement, should the issuer choose to include such information.[21] The MSRB believes that the disclosure obligation regarding the availability of favorable state tax treatment for sales of Section 529 college savings plan interests under Rule G-17 would be deemed to be met if such information is included in the official statement delivered to the customer, appearing in a manner reasonably likely to be noted by an investor.[22] However, the MSRB has no authority to mandate inclusion of any particular items in the official statement. Thus, if the issuer has not included this information regarding the availability of favorable state tax treatment in the official statement, the dealer would remain obligated to provide such information to the customer under Rule G-17.

As with its guidance on advertising set forth above, the MSRB has determined to delay the effectiveness of the disclosure obligation with respect to state tax consequences of investments in out-of-state Section 529 college savings plans until July 15, 2002. Nonetheless, the MSRB urges dealers to comply with this guidance as soon as practicable.

Non-Material Amendments to Official Statement. The MSRB understands that an issuer may make minor modifications to the official statement in order to correct typographical or grammatical errors, or to make such other modifications that the issuer may deem to be immaterial. If the issuer has acknowledged in writing to the primary distributor that it does not consider such modification to be material to investors and does not believe that such modification is required to make the statements in the official statement not misleading, then the modification need not be sent by a dealer to a customer that has previously received the official statement, notwithstanding the provisions of Rule G-32(a)(i).[23] The primary distributor must maintain the issuer's written acknowledgement under Rule G-8(a)(xiii), relating to records concerning deliveries of official statements. The primary distributor must send all amendments, regardless of materiality, to the MSRB under Rule G-36.

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[1] Section 529 college savings plans are established by states under section 529(b)(A)(ii) of the Internal Revenue Code as "qualified tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries. A security may still constitute a municipal fund security subject to MSRB rules even if the issuer has not complied with Section 529 of the Internal Revenue Code in connection with an educational savings program or if it is issued for any other purpose (*e.g.*, a local government investment pool), so long as it meets the definition set forth in Rule D-12. Rule D-12 defines municipal fund security as a municipal security issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940 (the "Investment Company Act"), would constitute an investment company within the meaning of Section 3 of the Investment Company Act.

[2] Further interpretive guidance relating to municipal fund securities is provided in the following MSRB notices: Rule G-37 Interpretation – Interpretation on the Effect of a Ban on Municipal Securities Business Under Rule G-37 Arising During a Pre-Existing Engagement Relating to Municipal Fund Securities, April 2, 2002, *published at* http://ww1.msrb.org/msrb1/rules/notg37.htm; Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001 (the "December 2001 Interpretation"), *reprinted in MSRB Rule Book*; Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001, *reprinted in MSRB Rule Book*.

[3] *See* Rule G-17 Interpretation – Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *published at* http://ww1.msrb.org/msrb1/rules/notg17.htm. The MSRB interprets Rule G-17 to require a dealer to disclose to its customer, at or before the time of trade, all material facts concerning the transaction known by the dealer, as well as material facts about the security when such facts are reasonably accessible to the market.

[4] The MSRB has previously provided guidance on advertisements and commissions in the December 2001 Interpretation.

[5] For detailed discussions of the MSRB's approach to rulemaking with respect to municipal fund securities, *see* "Municipal Fund Securities – Rule Changes Approved by the Securities and Exchange Commission," *MSRB Reports*, Vol. 21, No. 1 (May 2001) at 21; "Municipal Fund Securities – Revised Draft Rule Changes," *MSRB Reports*, Vol. 19, No. 3 (Sept. 1999) at 3; "Municipal Fund Securities," *MSRB Reports*, Vol. 19, No. 2 (April 1999) at 9.

[6] *See* Section 529(c)(3) of the Internal Revenue Code. State tax laws also may result in certain adverse consequences for use of funds other than for educational costs.

[7] The MSRB understands that investors may change designated beneficiaries and therefore amounts in excess of what a single beneficiary could use ultimately might be fully expended by additional beneficiaries. The MSRB expresses no view as to the applicability of federal tax law to any particular plan of investment and does not interpret its rules to prohibit transactions in furtherance of legitimate tax planning objectives, so long as any recommended transaction is suitable.

[8] *See* Rule G-20 Interpretive Letter – Authorization of sales contests, June 25, 1982, *reprinted in MSRB Rule Book*.

[9] The rule defines advertisements broadly to consist of any material (other than listings of offerings) published or designed for use in the public, including electronic, media or any

promotional literature designed for dissemination to the public, such as notices, circulars, reports, market letters, form letters, telemarketing scripts or reprints or excerpts of the foregoing. The term does not apply to preliminary or final official statements but does apply to abstracts or summaries of official statements, offering circulars or other similar documents prepared by dealers. This definition generally would include Internet web-sites and form or broadcast e-mail messages relating to municipal securities, including municipal fund securities.

[10] MSRB rules apply solely to dealers. Although Rule G-21 does not govern advertisements published by issuers or other parties, the MSRB previously has stated that an advertisement produced by a dealer as agent for an issuer must comply with Rule G-21. *See* Rule G-21 Interpretive Letter – Advertisements on behalf of issuer, February 24, 1994, *reprinted in MSRB Rule Book*.

[11] The rule also establishes standards for advertisement of initial reoffering prices or yields of new issue municipal securities.

[12] For example, if a dealer makes a statement in an advertisement that explicitly or implicitly refers to a particular feature of a security (*e.g.*, the soundness or safety of an investment in such security), such dealer must include any information necessary to ensure that the advertisement is not materially false or misleading with respect to such feature. *See* Rule G-21 Interpretive Letter – Disclosure obligations, May 21, 1998, *reprinted in MSRB Rule Book*.

[13] *See* December 2001 Interpretation. The MSRB notes that these NASD and SEC advertising rules include essentially the same general "false or misleading" standard as does Rule G-21, in addition to itemized standards for specific elements of advertisements.

[14] *See* December 2001 Interpretation.

[15] The MSRB understands that NASD staff is willing to undertake an informal review of any municipal fund securities advertisements that a dealer may elect to voluntarily file with the NASD and to provide comment on any compliance concerns that may be raised by the advertisements under Rule G-21 and the relevant MSRB interpretations. A dealer that voluntarily files its municipal fund securities advertisements with the NASD should consult with NASD staff regarding the legal effect of such filing as it relates to potential enforcement actions for violations of Rule G-21.

[16] For example, in the case of municipal bonds that are subject to the federal alternative minimum tax, the MSRB has stated that any statement in an advertisement that the bonds are tax-exempt must also disclose that they are subject to the alternative minimum tax. *See* Rule G-21 Interpretive Letter – Advertising of securities subject to alternative minimum tax, February 23, 1988, *reprinted in MSRB Rule Book*.

[17] Merely identifying an underlying registered security would not trigger a requirement that additional details of the security be included. Instead, information relating to the registered security that is specifically included in the advertisement must meet the appropriate standards in SEC and NASD rules with respect to such information. Further, the MSRB does not require that such advertisement be filed with the NASD or SEC, although a dealer may voluntary do so.

[18] State legislation on the subject of taxation varies greatly, with some states providing broader tax benefits and others providing no favorable tax treatment.

[19] Letter dated April 1, 2002 from Craig S. Tyle, General Counsel, ICI, to Diane G. Klinke, General Counsel, MSRB (the "ICI Letter"). In support of its request for such disclosure, the ICI states that it "believes it is appropriate for the MSRB to impose this additional disclosure requirement in connection with the delivery of Section 529 plan official statements even in the absence of a similar requirement in the case of traditional municipal securities. First, the targeted market for Section 529 plan securities is generally middle-income investors saving for their children's college education, as opposed to the market for traditional municipal securities, which is more likely to be made up of wealthier, more sophisticated investors. Second, unlike traditional municipal securities, 529 plans are a relatively new product and there may be less knowledge among investors about the tax consequences of investing in them."

[20] Of course, should the dealer proceed to provide information about such state tax consequences, it must ensure that the information meets the standards of Rule G-17 enunciated above.

[21] The rule requires that information regarding underwriting spread and fees paid in connection with the underwriting, as well as the initial offering price for securities other than municipal fund securities, be disclosed to customers.

[22] Inclusion in a manner no less prominent than information regarding other tax-related consequences of investing in the Section 529 college savings plan would be deemed to satisfy this requirement.

[23] Rule G-32(a)(i) requires delivery of an official statement to a customer purchasing municipal fund securities by settlement of the transaction. In the case of a repeat purchaser who has already received the official statement, dealers generally are required to deliver any amendments or supplements to the official statement in connection with subsequent purchases of the securities.

See also:

**Rule G-19 Interpretation – Notice Concerning the Application of Suitability Requirements to Investment Seminars and Customer Inquiries Made in Response to a Dealer's Advertisement,** May 7, 1985.

**Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Changes, Advertisements and Official Statements Relating to Municipal Fund Securities,** December 19, 2001.

## *Interpretive Letters*

**Legend satisfying requirement.** I refer to your letter of June 29, 1979 in which you request advice regarding rule G-21(c) on product advertisements. As you noted in your letter, the notice of approval of rule G-34 [prior rule on advertising] stated that the Board believes that the advertisements may be misleading if they show

> only a percentage rate without specifying whether it is the coupon rate or yield and, if yield, the basis on which calculated (for example, discount, par or premium securities and if discount securities, whether before-tax or after-tax yield).

You have requested advice as whether the following legend, to be used in connection with the sale of discount bonds, would be satisfactory for purposes of the rule:

> "Discount bonds may be subject to capital gains tax. Rates of such tax vary for individual taxpayers. Discount yields shown herein are gross yields to maturity."

As I previously indicated to you in our telephone conversation, the proposed legend would satisfy the requirements of rule G-21(c). *MSRB interpretation of August 28, 1979.*

**Advertisements of securities not owned.** This is in response to your letter of May 5, 1982 concerning a dealer bank's advertising practices. Your letter states that the dealer bank has recently published newspaper advertisements which list specific municipal securities as "Current Offerings," and that your review of the dealer's inventory positions has disclosed that "on the date the advertisement was published the dealer held no position in four of the issues advertised and a nominal position in the fifth advertised issue." Your letter reports that the dealer stated that it was his intention to obtain the advertised issues from other dealers when customer orders were received. Your first question is whether "it is misleading and thus in violation of rule G-21, to advertise securities which the dealer does not own..."

The Board has recently considered this advertising practice and concluded that it would not violate Board rules provided that: (1) the advertisement indicates that the securities are advertised "subject to availability;" (2) the dealer placing the advertisement is not aware that the bonds are no longer available in the market; and (3) the dealer would attempt to acquire the bonds advertised if contacted by a potential customer.

Your letter also expresses concern that this type of advertising might be seriously misleading to customers since the advertisement must be prepared and the printer's proof copy approved five days in advance of the date of publication. You note that "significant changes in the market can occur over a five, or even three-day period" and that, if such market changes had occurred between submission and publication of the advertisement, the customer could be seriously misled. The Board is aware that delays occur between the time an advertisement is composed and approved for publication by a municipal securities dealer and the time it is actually published. The Board believes that inclusion in the advertisement of a statement indicating that the securities are advertised subject to change in price provides adequate notice to a potential customer that the prices and yields quoted in the advertisement may not represent market yields and prices at the time the customer contacts the dealer. *MSRB interpretation of July 1, 1982.*

**Contents of advertisement: put options.** Your letter dated June 15, 1981, has been referred to me for response. In your letter you mention our previous conversation regarding the appropriate definition of "put bonds", which definition your firm would like to use in advertisements offering such securities for sale. You request confirmation of the Board's views concerning the aspects of the "put option" feature on these securities that would be appropriate to cover in such a definition.

The type of "put option" issue with which the Board is familiar, and which we discussed, has a provision in the indenture which permits the holder of the securities to tender or "put" the securities back to the issuer on specified dates at par. This feature typically commences six (or more) years after the date of issuance, is exercisable only once annually (on an interest payment date), and is exercisable only upon the provision of irrevocable prior notice to the issuer (typically three or more months before the exercise date).

If I remember our conversation correctly, you indicated that the firm wished to describe a security of this type in an advertisement as having a "put option" feature, available once annually, permitting redemption of the securities at par. I suggested that, while the items of information you detailed were appropriate, it might also be advisable to mention in the advertisement the "prior notice" requirement under the option exercise procedure. It would also be helpful to make clear the irrevocable nature of such notice.

If the content of your definition of the "put option" feature goes beyond the items we discussed (for example, by indicating that the "put option" is secured by a bank letter of credit, additional disclosures might also be appropriate. *MSRB interpretation of July 13, 1981.*

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**Advertising of securities subject to alternative minimum tax.** This is in response to your letter concerning the application of rule G-21, on advertising, to advertisements for municipal securities subject to the alternative minimum tax (AMT). You state that advertisements for municipal securities usually note that the securities are "free from federal and state taxes." You ask whether an advertisement for municipal securities subject to AMT should note the applicability of AMT if such advertisements describe the securities as "tax exempt." The Board has considered the issue and authorized this reply.

Rule G-21(c) prohibits a broker, dealer or municipal securities dealer from publishing any advertisement concerning municipal securities which the broker, dealer or municipal securities dealer knows or has reason to know is materially false or misleading. The Board has stated that the use of the term "tax exempt" in advertisements for municipal securities connotes that the securities are exempt from all federal, state and local income taxes. If this is not true of the security being advertised, the Board has required that the use of the term "tax exempt" in an advertisement must be explained, *e.g.*, by footnote.[1] In regard to municipal securities subject to AMT, the Board has determined that advertisements for such securities that describe the securities as being exempt from federal income tax also must describe the securities as subject to AMT. *MSRB Interpretation of February 23, 1988.*

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[1] Frequently asked questions concerning advertising, *MSRB Reports*, Vol. 3, No. 2 (April 1983), at 22.

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**Advertisements showing current yield.** This is in response to your letter concerning the application of rule G-21, on advertising, to advertisements that include information on current yield of municipal securities.[1] You have asked for the Board's views whether including current yield information in advertisements for municipal securities, alone or with other yield information, would be materially misleading. You also ask if a dealer may advertise current yield if other yield information is included but is in smaller print. The Board has considered this issue and authorized this reply.

Rule G-21 prohibits a dealer from publishing an advertisement concerning a municipal security that the dealer knows or has reason to know is materially false or misleading. The Board has stated that an advertisement showing a percentage rate of return must specify whether it is the coupon rate or the yield. The Board noted that, if a yield is presented, the advertisement must indicate the basis on which the yield is calculated.[2]

The Board frequently has stated that the yield to call or yield to maturity is the most important factor in determining the fairness and reasonableness of the price of any given transaction in municipal securities. Such yields typically are used as a basis for dealers and customers to evaluate an investment in municipal securities. The disclosure of yield to call or yield to maturity is the longstanding practice of the municipal securities industry and this practice is reflected in rule G-15(a) which requires dealers to disclose yield to call or yield to maturity on customer confirmations.[3] A customer who purchases a municipal security relying only on the current yield information disclosed in an advertisement would be confused upon receipt of the confirmation when the yield to call or yield to maturity of the security is different. Moreover, a customer would not be able to compare municipal securities advertised at a current yield with those advertised at a yield to call or yield to maturity.[4] The Board has determined that the use of current yield information in municipal securities advertisements without other yield information would be materially misleading under rule G-21. Thus, dealers may not show only current yield in municipal securities advertisements.

The Board also has determined that, while showing only current yield information in advertisements is materially misleading, if advertisements also include, at a minimum, the lowest of yield to call or yield to maturity, current yield may be used if all the information is clearly presented as discussed below. The Board notes that including yield to call or yield to maturity in municipal securities advertisements would give customers a more realistic view of the yield they can expect to receive on the investment and would enable them to compare the security advertised with other municipal securities. In addition, the yield to call or yield to maturity information would be consistent with the yield information disclosed on customer confirmations. If the yield to call is used, the call date and price also should be noted.

The Board is concerned that, even if dealers comply with this interpretation of rule G-21 and include current yield and other yield information in municipal securities advertisements, such advertisements still could be misleading due to the size of type used and the placement of the information. For example, it would not be appropriate for the type size of the current yield to be larger than other yield information. Thus, whether a particular advertisement is materially misleading requires the appropriate regulatory body, for example, an NASD District Business Conduct Committee, to consider a number of objective and subjective factors. The Board urges the regulatory authorities to continue to review advertisements on a case-by-case basis to make a determination whether any such advertisements, in fact, are misleading. *MSRB interpretation of April 22, 1988.*

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[1] Current yield is a calculation of current income on a bond. It is the ratio of the annual dollar amount of interest paid on a security to the purchase price of the security, stated as a percentage. If the securities are sold at par, the current yield equals the coupon rate on the securities. Current yield, however, does not take into account the time value of money. Thus, generally, if a bond is selling at a discount, the current yield would be less than the yield to maturity and, if the bond is selling at a premium, the current yield would be greater than the yield to maturity

[2] Frequently Asked Questions Concerning Advertising, *MSRB Reports*, Vol. 3, No. 2 (Apr. 1983), at 21-23.

[3] Rule G-15(a)(i)(1) [currently codified at rule G-15(a)(i)(A)(5)] requires that the yield or dollar price at which the transaction was effected be disclosed on customer confirmations, with the resulting dollar price (if the transaction is done on a yield basis) or yield (if the transaction is done on a dollar basis) calculated to the lowest of dollar price or yield to call, to par option or to

maturity. In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated and the call or option date and price used in the calculation must be shown.

4 The Board also notes that some dealers have used current yield in municipal securities advertisements in an attempt to compete with municipal securities mutual funds, which often use a "current yield" in their advertisements. However, a mutual fund "yield" is not directly comparable to a municipal securities yield because a mutual fund "yield" represents historical information, while the yield on a municipal security represents a future rate of return.

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**Disclosure obligations.** This is in response to your letters dated March 18, 1998 and March 31, 1998 in which you present an example where a dealer advertises a specific municipal security which it knows, or has reason to know, is subject to a material adverse circumstance such as a technical default. You ask whether a dealer is obligated to include disclosure information indicating that a bond is subject to additional risk in order to avoid publishing a false or misleading advertisement as prohibited by rule G-21(c). The Board reviewed your letters and has authorized this response.

Section (c) of rule G-21 provides, among other things, that no dealer shall publish any advertisement[1] concerning municipal securities which such dealer knows or has reason to know is materially false or misleading. The Board has previously interpreted the rule as not requiring that any specific statements or information be included in an advertisement but that any statement or information that is included must not be materially false or misleading. Thus, if a dealer makes a statement in an advertisement that explicitly or implicitly refers to the soundness or safety of an investment in the municipal securities described in the advertisement, such dealer must include any information necessary to ensure that the advertisement is not materially false or misleading with respect to the soundness or safety of such investment. The rule establishes a general ethical standard that provides the enforcement agencies with the flexibility that is needed to evaluate advertisements in light of what information is printed and how the information physically is presented. Thus, the enforcement agencies should continue to evaluate advertisements on a case-by-case basis to make a determination whether any such advertisements, in fact, are misleading.

You also ask whether the relative specificity of any such disclosure obligation that may exist depends on the level of detail provided about the municipal security. As stated above, rule G-21 does not require that any specific statements or information be included in an advertisement but that any statement or information that is included must not be materially false or misleading. Thus, the nature and extent of any disclosures or other explanatory statements that must be included in an advertisement is dependent upon the substance and form of the information presented in the advertisement.

The Board wishes to emphasize that the enforcement agencies should remain cognizant of certain other rules of the Board that may be relevant in evaluating whether a dealer's advertisement and such dealer's interactions with customers or potential customers that arise as a result of such advertisement are in conformity with Board rules. Thus, depending upon the facts and circumstances, an advertisement for a particular municipal security that on its face conforms with the requirements of rule G-21 may nonetheless be violative of rule G-17, the Board's fair dealing rule,[2] if, for example, the advertisement is designed as a "bait-and-switch" mechanism that attracts potential customers interested in an advertised security that the dealer is not in a legitimate position to sell (because of its unavailability, unsuitability or otherwise) for the primary purpose of creating a captive audience for the offering of other securities. In addition, a dealer that in fact sells the municipal securities that are described in its advertisement must fulfill its obligations under rule G-19, on suitability, and rule G-30, on pricing. *MSRB Interpretation of May 21, 1998*

1 "Advertisement" is defined in rule G-21 as any material (other than listings of offerings) published or designed for use in the public, including electronic, media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter, telemarketing script or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by dealers.

2 Rule G-17 requires each dealer, in the conduct of its municipal securities business, to deal fairly with all persons and prohibits the dealer from engaging in any deceptive, dishonest or unfair practice.

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**Advertisements on behalf of issuer.** You ask whether a certain advertisement is subject to approval by a principal pursuant to rule G-21, on advertising. You state that an issuer asked the bank to act as its agent in producing the advertisement. Rule G-21 defines an advertisement as any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by dealers. Each advertisement subject to the requirements of rule G-21 must be approved in writing by a municipal securities principal or general securities principal prior to first use. The fact that a bank dealer is acting as an agent of an issuer in the production of an advertisement meeting the definition contained in rule G-21 does not relieve a bank from complying with the requirements of the rule. *MSRB interpretation of June 20, 1994.*

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See also:

**Rule G-19 Interpretive Letter – Recommendations: advertisements,** *MSRB interpretation of February 24, 1994.*

**Rule G-30 Interpretive Letter – Differential re-offering prices,** *MSRB interpretation of December 11, 2001.*

## Rule G-22: Control Relationships

(a) *Control Relationship.* For purposes of this rule, a control relationship with respect to a municipal security shall be deemed to exist if a broker, dealer, or municipal securities dealer (or a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) controls, is controlled by, or is under common control with the issuer of the security or a person other than the issuer who is obligated, directly or indirectly, with respect to debt service on the security.

(b) *Discretionary Accounts.* No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for the discretionary account of a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to such security unless such transaction has been specifically authorized by such customer.

(c) *Disclosure.* No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to the security unless, before entering into a contract with or for the customer for the purchase, sale, or exchange of such security, the broker, dealer, or municipal securities dealer discloses to the customer the nature of the control relationship, and if such disclosure is not made in writing, such disclosure must be supplemented by the sending of written disclosure concerning the control relationship at or before the completion of the transaction.

### *MSRB INTERPRETATION*

See:

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

### *Interpretive Letters*

**Letters of credit.** This is in response to your April 9, 1981, letter asking whether Board rule G-22, regarding control relationships, and G-23, regarding financial advisory agreements, would apply if a bank's issuance of a letter of credit were contingent upon its being named underwriter or manager for the issue, or if a bank issuing a letter of credit retained authority to require an issuer, in effect, to call the securities.

Rule G-22 provides that

> a control relationship with respect to a municipal security shall be deemed to exist if a broker, dealer, or municipal securities dealer (or a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) controls, is controlled by, or is under common control with the issuer of the security or a person other than the issuer who is obligated, directly or indirectly, with respect to debt service on the security.

The existence of a control relationship is a question of fact to be determined from the entire situation. Most recently, the Securities and Exchange Commission suggested that, for purposes of the Regulatory Flexibility Act, a registered broker-dealer would be deemed to be controlled by a person or entity who, among other things, has the ability to direct or cause the direction of management or the policies of the broker-dealer. Based upon the above, it is questionable whether a bank that conditions the issuance of a letter of credit upon being named an underwriter or upon a tie-in deposit arrangement should be deemed to control the issuer. Similarly, it does not appear that a bank that retains discretion under a letter of credit to cause the trustee to call the whole issue has a control relationship with the issuer.

You also ask whether under Board rule G-23 a financial advisory relationship is created if a bank conditions the issuance of a letter of credit upon being named an underwriter or upon obtaining a tie-in deposit arrangement. Under rule G-23, a financial advisory relationship is deemed to exist when a municipal securities professional provides, or enters into an agreement to provide, financial advisory services to, or on behalf of, an issuer with respect to a new issue of securities regarding such matters as the structure, timing or terms of the issue, in return for compensation or for the expectation of compensation. It does not appear that rule G-23 would apply in your example since the bank is not providing financial advisory or consulting services with respect to the structure, timing or other substantive terms of the issue. *MSRB interpretation of July 27, 1981.*

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**Associated person on issuer governing body.** This will respond to your letter to the Municipal Securities Rulemaking Board concerning rule G-22 on disclosure of control relationships. You ask whether the rule requires a dealer to disclose to customers that an associated person of the dealer is a member of a five-person town council that issued the securities.

Rule G-22(c) states that a dealer may not effect a customer transaction in a municipal security with respect to which the dealer has a control relationship, unless the dealer discloses to the customer the nature of the control relationship prior to executing the transaction. Section (a) of rule G-22 defines a control relationship to exist with respect to a security if the dealer controls, is controlled by, or is under common control with the issuer of the security. This includes any control relationship with an associated person of the dealer.[1] Whether a control relationship exists in a particular case is a factual question. The Board, however, previously has stated that:

> A control relationship with respect to a municipal security does not necessarily exist if an associated person of a securities professional is a member of the governing body or acts as an officer of the issuer of the security. However, if the associated person in fact controls the issuer, rule G-22 does apply. For example, rule G-22 applies if the associated person is the chairman of an issuing authority and, in that capacity, actually makes the decision on behalf of the issuing authority to issue securities. The rule does not apply if the associated person as chairman does not make that decision and does not have the authority alone to make the decision, or if the decision is made by a governing body of which he is only one of several members.[2]

*MSRB interpretation of June 25, 1987.*

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1 Rule D-11 states that references to "brokers," "dealers," "municipal securities dealers," and "municipal securities brokers" also mean associated persons, unless the context indicates otherwise.

2 Notice of Approval of Fair Practice Rules, October 24, 1978, at 6.

## Rule G-23: Activities of Financial Advisors

(a) *Purpose.* The purpose and intent of this rule is to establish ethical standards and disclosure requirements for brokers, dealers, and municipal securities dealers who act as financial advisors to issuers of municipal securities.

(b) *Financial Advisory Relationship.* For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services. Notwithstanding the foregoing, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a broker, dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.

(c) *Basis of Compensation.* Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences). Such writing shall set forth the basis of compensation for the financial advisory services to be rendered, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such broker, dealer, or municipal securities dealer or by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer in connection with the rendering of such financial advisory services.

(d) *Underwriting Activities.* No broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or act as agent for the issuer in arranging the placement of such issue, unless

(i) if such issue is to be sold by the issuer on a negotiated basis,

(A) the financial advisory relationship with respect to such issue has been terminated in writing and at or after such termination the issuer has expressly consented in writing to such acquisition or participation, as principal or agent, in the purchase of the securities on a negotiated basis;

(B) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination that there may be a conflict of interest in changing from the capacity of financial advisor to purchaser of or placement agent for the securities with respect to which the financial advisory relationship exists and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; and

(C) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the broker, dealer, or municipal securities dealer with respect to such issue in addition to the compensation referred to in section (c) of this rule, and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; or

(ii) if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

The limitations and requirements set forth in this section (d) shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a financial advisory relationship. The use of the term "indirectly" in this section (d) shall not preclude a broker, dealer, or municipal securities dealer who has a financial advisory relationship with respect to a new issue of municipal securities from purchasing such securities from an underwriter, either for its own trading account or for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule.

(e) *Remarketing Activities.* No broker, dealer, or municipal securities dealer that has a financial advisory relationship with an issuer with respect to a new issue of municipal securities shall act as agent for the issuer in remarketing such issue, unless the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer:

(i) that there may be a conflict of interest in acting as both financial advisor and remarketing agent for the securities with respect to which the financial advisory relationship exists; and

(ii) the source and basis of the remuneration the broker, dealer or municipal securities dealer could earn as remarketing agent on such issue.

This written disclosure to the issuer may be included either in a separate writing provided to the issuer prior to the execution of the remarketing agreement or in the remarketing agreement. The issuer must expressly acknowledge in writing to the

broker, dealer, or municipal securities dealer receipt of such disclosure and consent to the financial advisor acting in both capacities and to the source and basis of the remuneration.

(f) *Disclosure to Issuer of Corporate Affiliation.* If the financial advisor for the issue is not a broker, dealer or municipal securities dealer, and the broker, dealer or municipal securities dealer that acquires the issue or arranges for such acquisition pursuant to section (d) of this rule is controlling, controlled by, or under common control with such financial advisor, the broker, dealer or municipal securities dealer must disclose this affiliation in writing to the issuer prior to the acquisition and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipts of such disclosure.

(g) Each broker, dealer, and municipal securities dealer subject to the provisions of sections (d), (e) or (f) of this rule shall maintain a copy of the written disclosures, acknowledgments and consents required by these sections in a separate file and in accordance with the provisions of rule G-9.

(h) *Disclosure to Customers.* If a broker, dealer, or municipal securities dealer acquires new issue municipal securities or participates in a syndicate or other account that acquires new issue municipal securities in accordance with section (d) of this rule, such broker, dealer, or municipal securities dealer shall disclose the existence of the financial advisory relationship in writing to each customer who purchases such securities from such broker, dealer, or municipal securities dealer, at or before the completion of the transaction with the customer.

(i) *Applicability of State or Local Law.* Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or local law applicable to the activities of financial advisors.

## MSRB INTERPRETATIONS

### NOTICE ON APPLICATION OF BOARD RULES TO FINANCIAL ADVISORY SERVICES RENDERED TO CORPORATE OBLIGORS ON INDUSTRIAL DEVELOPMENT BONDS

May 23, 1983

In a recent letter to the Office of the Comptroller of the Currency, the staff of the Securities and Exchange Commission has taken the position that private placements of industrial development bonds ("IDBs") constitute transactions in municipal securities as defined in the Securities Exchange Act of 1934, as amended. The Municipal Securities Rulemaking Board has received a number of inquiries concerning this letter. The Board is publishing this notice for the purposes of: (1) reviewing the application of its rules to private placements of municipal securities and (2) expressing its views concerning whether certain Board rules apply to financial advisory services rendered by municipal securities dealers and brokers to corporate obligors on IDBs.

**A. Private Placements of IDBs**

The Board's rules apply, of course, to all transactions in municipal securities, including securities which are IDBs. The SEC letter dealt in particular with the activities of commercial banks. That letter pointed out that if a commercial bank has a registered municipal securities dealer department, under Board rule G-1, which defines the term "separately identifiable department or division of a bank," any private placement activities of the bank in securities which are IDBs must be conducted as a part of the registered dealer department. The Board urges all bank dealers which have registered as a separately identifiable department or division to review their organizations and assure that all departments or units which engage in the private placement of IDBs are designated on the bank's Form MSD registration and other applicable bank records as part of its separately identifiable department or division. The Board also notes that such activities must be under the supervision of a person designated by the bank's board of directors as responsible for these activities. In addition, under Board rule G-3, concerning professional qualifications, persons who are engaged in privately placing municipal securities must be qualified as municipal securities representatives and be supervised with respect to that activity by a qualified municipal securities principal.

**B. Financial Advisory Services Rendered to Corporate Obligors on IDBs**

Board rules G-1 and G-3 provide that rendering "financial advisory or consultant services for issuers" is an activity to which those rules are applicable (emphasis added). Similarly, Board rule G-23, on the activities of financial advisors, applies to brokers, dealers, and municipal securities dealers who agree to render "financial advisory or consultant services to or on behalf of an issuer" (emphasis added). Clearly these rules are applicable to financial advisory services rendered to state or local governments and their agencies, as well as to municipal corporations. In the Board's view, however, rules G-1, G-3, and G-23 do not apply to financial advisory services which are provided to corporate obligors in connection with proposed IDB financings.

The Board wishes to emphasize that the scope of its definition of financial advisory services is limited to "advice with respect to the structure, timing, terms, and other similar matters" concerning a proposed issue.[1] If persons providing such advice to the corporate obligor on an IDB issue also participate in negotiations with prospective purchasers or are otherwise engaged in effecting placement of the issue, then, as indicated above, rules G-1 and G-3 would apply to their activities.

[Excerpts of the Commission letter follow:]

This is in response to your letter of December 1, 1981, requesting our views concerning certain activities by commercial banks in connection with industrial development bonds ("IDBs")[2] Specifically, you asked (1) whether the private placement activities of banks in IDBs involve transactions in municipal securities, (2) whether involvement in such activities alone would require such banks to register with the Commission under Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act") as municipal securities dealers, (3) whether a bank that had registered a separately identifiable department or division with the Commission as a municipal securities dealer would be required to conduct such activities through such separately identifiable department or division, and (4) if such bank activities are required to be conducted in the separately identifiable department or division, whether the advisory services provided by those banks to the corporate obligor on an IDB should be regarded as advisory services provided to an issuer of municipal securities in connection with the issuance of municipal securities. Pursuant to your letter and subsequent telephone conversations, we understand the following facts to be typical of the activities in question.

A commercial bank offers private placement and financial advisory services to corporate entities on a regular and continuous basis. From time to time the bank recommends to the corporate entity that IDBs be used to

raise capital. The bank advises the corporate entity regarding the terms and timing of the proposed IDB issuance, prepares the Direct Placement Memorandum describing the terms of the IDB, and contacts potential purchasers of the IDB. Such purchasers then make independent reviews of the corporate entity's financial status. The bank then obtains comments from the potential buyers and relays such comments to the corporate entity. The bank might also assist the corporate entity in subsequent negotiations with the purchasers. An industrial development authority nominally issues the IDB on behalf of the corporate entity which becomes the economic obligor on the issue.

The bank engages in these activities in order to assist the corporate obligor in the sale of the IDBs. In return for its services, the bank receives from the corporate entity either a fixed fee or a percentage of the proceeds of the sale. The bank does not purchase any of the IDBs. The bank could, however, supply "bridge loans" to the corporate entity pending receipt of the proceeds of the IDB sale. In addition, the bank might provide investors with a letter of credit committing the bank to pay any interest or principal not paid by the corporate issuer. The bank might also act as trustee or paying agent for the nominal issuer of the IDB, for which the bank would receive a set fee.

*IDBs as Municipal Securities*

Section 3(a)(10) of the Exchange Act defines a "security" as, among other things, "any note... bond, debenture... investment contract, ...or in general, any instrument commonly known as a 'security'... " Section 3(a)(29) of the Exchange Act defines "municipal securities" to include any security which is an industrial development bond as defined in Section 103(b)(2) of the Code the interest on which is tax-exempt under Sections 103(b)(4) or 103(b)(6) of the Code. In our opinion, the private placement activities you have described involve transactions in municipal securities as defined in the Exchange Act.[3]

*Registration as Municipal Securities Dealer*

Section 15B(a) of the Exchange Act makes it unlawful for any municipal securities dealer to use the mails or any instrumentality of interstate commerce to "effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security unless such municipal securities dealer is registered" with the Commission. Section 3(a)(30) of the Exchange Act defines "municipal securities dealer" to include a bank or a separately identifiable department or division of a bank if that bank is engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity, through a broker or otherwise. Banks that engage solely in private placement activities in IDBs as described by you would not be required to register as municipal securities dealers since they do not appear to be engaged in the business of buying and selling municipal securities for their own accounts, but rather appear to be acting as brokers. Section 3(a)(4) of the Exchange Act defines the term broker as "any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank." Since they are excluded from the definition of broker, banks that act solely as brokers need not register under the Exchange Act.[4]

*Inclusion in Separately Identifiable Department or Division*

Section 15B(b)(2)(H) of the Exchange Act authorizes the Municipal Securities Rulemaking Board (the "MSRB") to make rules defining the term "separately identifiable department or division" ("SID") of a bank as used in Section 3(a)(30) of the Exchange Act. MSRB rule G-1 defines the SID as "that unit of the bank which conducts all the activities of the bank relating to the conduct of business as a municipal securities dealer..." The rule defines municipal securities dealer activities to include "sales of municipal securities" and "financial advisory and consultant services for issuers in connection with the issuance of municipal securities." Therefore, those banks that have registered an SID with the Commission also must conduct the private placement activities within the SID in accordance with MSRB rules...

Based upon the facts and representations set forth in your letter, it would appear that the private placement activities of banks involving IDBs, as described in your example, constitute transactions in municipal securities that, if done alone, would not require a bank to register with the Commission as a municipal securities dealer. However, such activities, when conducted by a bank municipal securities dealer that had registered a separately identifiable department or division, would be treated as municipal securities dealer activities and, therefore, would be required to be conducted in the bank's dealer department...

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[1] Rule G-23(b).

[2] You have represented that the IDBs involved would be primarily those defined in Section 103(b)(2) of the Internal Revenue Code of 1954 (the "Code"), the interest on which is tax-exempt under Sections 103(b)(4) and 103(b)(6) of the Code.

[3] This determination is based on an analysis of the specific facts as described by you. Different facts and circumstances could result in a transaction involving municipal debt instruments being treated as loan participations not subject to the federal securities laws. Such determinations can only be made on a case by case basis after a thorough examination of the context of the transaction.

[4] See letter dated February 17, 1977, from Anne E. Chafer, Attorney, Securities and Exchange Commission, to Bruce F. Golden and letter dated January 11, 1982, from Thomas G. Lovett, Attorney, Securities and Exchange Commission, to Harriet E. Munrett regarding Citytrust of Bridgeport, Connecticut.

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See also:

**Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market,** January 18, 2001.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## *Interpretive Letters*

**Financial advisory relationship: blanket agreement.** I refer to your letter of December 4, 1980 and a subsequent conversation regarding the application of rule G-23(d) to the participation by your client, a municipal securities dealer, in the underwriting of securities to be issued by the County referred to in your letter (the "County").

Rule G-23(d) provides in pertinent part that no municipal securities dealer "that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal ... from the issuer all or any portion of such issue ..." unless the dealer complies with certain specified provisions of the rule. You indicate that your client has a financial advisory agreement with the County which provides that your client will furnish financial advisory services from time to time at the County's request.

You state, however, that your client was not requested to furnish financial advisory services with respect to the particular issue of securities which the County now proposes to sell and was selected by the County after responding to an advertisement for underwriters. You request our concurrence in your opinion that a financial advisory relationship with respect to the proposed new issue does not exist.

For purposes of the rule, a financial advisory relationship is deemed to exist when a "municipal securities dealer renders or *enters into an agreement to render* financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities ..." (emphasis added). Therefore, where a dealer has entered into a blanket agreement to render financial advisory services, a financial advisory relationship with respect to a

particular issue of securities may be presumed to exist despite the fact that the municipal securities dealer does not furnish any financial advice concerning such issue. Whether or not your client has a financial advisory relationship with respect to the proposed new issue referred to in your letter is a factual question which we are not in a position to resolve. Therefore, we are unable to concur in your opinion. *MSRB interpretation of January 5, 1981.*

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**Financial advisory relationship: identity of issuer.** This is in response to your letter of February 27, 1981, asking whether a dealer bank which is retained by the Board of Water Governors of a water utility owned by City X to provide advice regarding the structure, timing, and terms of a new issue of mortgage revenue bonds to be issued by City X has entered into a financial advisory agreement for purposes of rule G-23. You note that the bonds would be sold at a competitive underwriting and payable from the revenues of the water utility.

Under rule G-23, a financial advisory relationship is deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory services to or on behalf of an issuer with respect to a new issue or issues of municipal securities. Based solely upon the facts contained in your letter, it appears that the Board of Water Commissioners is a political subdivision of City X. It further appears that the Board of Water Governors entered into the financial advisory agreement for the specific purpose of obtaining advice regarding the new issue of bonds on behalf of the City. Thus, the fact that City X, rather than the Board of Water Governors, actually will issue the bonds would not itself support a conclusion that the financial advisory agreement is not subject to the provisions of rule G-23. *MSRB interpretation of March 13, 1981.*

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**Financial advisory relationship: mortgage-related services.** This is in response to your letter of March 26, 1982 requesting an opinion regarding whether Board rule G-23 concerning the activities of financial advisors applies to certain activities of [name deleted] (the "Company").

Your letter states that the Company, a mortgage banker and wholly-owned subsidiary of [name deleted] (the "Bank"), identifies "proposed real estate development projects which it believes are economically feasible" and attempts to "arrange for the financing of such projects ..." You note that a common means of financing such projects involves the issuance and sale of tax-exempt obligations, with the proceeds of the sale being made available by the issuing entity to a mortgage approved by the Federal Housing Administration ("FHA"), which in turn provides financing secured by the FHA mortgage. You indicate that the services the Company performs in such instances include "... making the initial determination as to whether the contemplated project meets FHA criteria, negotiating with the developer regarding financing terms and conditions relating to the mortgage, contacting the issuer regarding its interest in issuing the bonds for the project, and, in certain cases where the issuer is not familiar or experienced in the area, assisting the issuer in understanding the rules and regulations of the FHA or the Department of Housing and Urban Development ..." You add that "the Company may also act as servicer of the construction loans which entails processing FHA insurance request forms, disbursing funds for completed work, etc." You state that "the Company does not provide financial advice to issuers regarding the structuring of the bond issues, or receive any fees, directly or indirectly, from issuers." You emphasize that any advice regarding the structuring of the actual bond issues is provided by the issuers' "staffs, financial advisors, bond counsel, or the underwriters of the issues." Your specific question concerns whether rule G-23 applies where the Company acts as mortgage banker and the Bank underwrites the bonds.

As you know, rule G-23(b) states that "... a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues for a fee or other compensation ..." Based upon the representations contained in your letter, it would appear that the Company does not render financial advisory services to issuers with respect to new issues of municipal securities. Since the activities which you state the Company performs in the ordinary course of its mortgage banking business do not constitute financial advisory activities for the purposes of rule G-23, the rule would not apply to those financings where the Bank serves as underwriter and the Company performs its mortgage banking functions, as described. *MSRB interpretation of April 12, 1982.*

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**Financial advisory relationship: potential underwriter.** This responds to your letter of July 20, 1983, requesting our view on the applicability of Board rule G-23 to the following situation:

Your firm, a registered municipal securities dealer, along with an architectural firm and a construction firm, plans to present to a municipality a proposal to design, build and finance a criminal justice facility. If the municipality shows interest, the team members will suggest that the municipality engage them to put together a specific, customized proposal for review. If the municipality accepts this proposal, the team will ask the municipality to execute a contract covering the additional services. This contract will provide for compensation to be paid to the firm in connection with the creation of a financing proposal. This proposal could encompass such issues as those set forth in Rule G-23(b). Further, it is the intent of the team members that a project may ultimately be brought to fruition by all or any one of the team members. Therefore, the firm may make the final financing proposal but fail to be retained by the municipality to actually finance the construction. In this event, the other two team members will proceed and the municipality will obtain another underwriter. However, it will be the firm's intent throughout the negotiation phase to ultimately be retained as the municipality's underwriter.

You express concern whether the above facts create a financial advisory relationship under rule G-23(b). Board rule G-23(b), concerning activities of financial advisors, provides that a financial advisory relationship shall be deemed to exist:

> "when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, ..."

The rule provides, however, that a financial advisory relationship shall not be deemed to exist

> "when, *in the course of acting as an underwriter*, a municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities." [Underlining added]

It does not appear that your firm would be rendering advice to the municipality "in the course of acting as an underwriting." In the beginning of the firm's relationship with the municipality, it is acting as a financial advisor, and being compensated as such. No underwriting agreement has been executed with the municipality. Therefore, based upon the representations in your letter, it appears that the firm's activities would be subject to the requirements of rule G-23. *MSRB interpretation of September 7, 1983.*

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**Financial advisory relationship: private placements.** This is in response to your letter in which you seek clarification on certain matters related to rules G-23, on activities of financial advisors, and G-37, on political contributions and prohibitions on municipal securities business.

You ask when it is "necessary in the process of commencing preliminary work with a potential financial advisory client to enter into a formal written financial advisory contract." Rule G-23(c) states that "[e]ach financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences)." Rule G-23(b) states that "...a financial advisory relationship shall be deemed to exist when a broker, dealer or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services."

You ask whether you are to advise the Board by means of reporting on Form G-37/G-38 or by any other means when you commence work on subsequent financing transactions with an issuer with which your firm has an ongoing financial advisory contract. The Instructions for Completing and Filing Form G-37/G-38 provide a guideline to use in determining when to report financial advisory services on Form G-37/G-38.[1] Pursuant to these Instructions, dealers should indicate financial advisory services when an agreement is reached to provide the services. In addition, the Instructions note that dealers also should indicate financial advisory services during a reporting period when the settlement date for a new issue on which the dealer acted as financial advisor occurred during such period. There are no other requirements for reporting financial advisory services to the Board.

Finally, you ask whether rules G-23 or G-37 contain requirements concerning private placement activities. The term "municipal securities business" is defined in rule G-37 to include "the offer or sale of a primary offering of municipal securities on behalf of any issuer (*e.g.*, private placement)..." The Instructions for Completing and Filing Form G-37/G-38 provide that private placements should be indicated at least by the settlement date if within the reporting period.

With respect to rule G-23, section (d) of the rule states that no dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or act as agent for the issuer in arranging the placement of such issue, unless various actions are taken.[2] In addition, rule G-23(g) states that each dealer subject to the provisions of sections (d), (e) or (f) of rule G-23 shall maintain a copy of the written disclosures, acknowledgments and consents required by these sections in a separate file and in accordance with the provisions of rule G-9, on preservation of records. Finally, rule G-23(h) states that, if a dealer acquires new issue municipal securities or participates in a syndicate or other account that acquires new issue municipal securities in accordance with section (d) of rule G-23, such dealer shall disclose the existence of the financial advisory relationship in writing to each customer who purchases such securities from such dealer, at or before the completion of the transaction with the customer. *MSRB interpretation of October 5, 1999.*

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[1] I have enclosed a copy of the Instructions for Completing and Filing Form G-37/G-38 as contained in the *MSRB Rule Book*. The Instructions are also contained on the Board's web site (www.msrb.org) under the link for rule G-37.

[2] These actions are: (i) if such issue is to be sold by the issuer on a negotiated basis, (A) the financial advisory relationship with respect to such issue has been terminated in writing and at or after such termination the issuer has expressly consented in writing to such acquisition or participation, as principal or agent, in the purchase of the securities on a negotiated basis; (B) the dealer has expressly disclosed in writing to the issuer at or before such termination that there may be a conflict of interest in changing from the capacity of financial advisor to purchaser of or placement agent for the securities with respect to which the financial advisory relationship exists and the issuer has expressly acknowledged in writing to the dealer receipt of such disclosure; and (C) the dealer has expressly disclosed in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the dealer with respect to such issue in addition to the compensation referred to in section (c) of rule G-23, and the issuer has expressly acknowledged in writing to the dealer receipt of such disclosure; or (ii) if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

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**Blanket consent.** This is in response to your April 7, 1981, letter asking whether, consistent with rule G-23(d)(ii), a municipal securities dealer acting as a financial advisor to an issuer may obtain from the issuer prospective approval to participate in any and all new issues the issuer may sell on a competitive basis at some future date.

Rule G-23(d)(ii) provides that a municipal securities dealer which is acting as a financial advisor may not acquire or participate in the distribution of a new issue unless

> if such issue is to be sold by the issuer at competitive bid the issuer has consented in writing to such acquisition or participation.

The rule is designed to minimize the "prima facie" conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue. Rule G-23(d) speaks in terms of "a new issue" and the implication is that consent should be obtained on an issue-by-issue basis.

The Board believes that such a reading of the rule is consistent with the rule's rationale—that an issuer should have an opportunity to consider whether, under the particular circumstances of an offering, the financial advisor's potential conflict of interest is sufficient to warrant not consenting to its participation in the sale. The Board has concluded that an unrestricted consent would not afford an issuer such an opportunity and, accordingly, has determined that such a consent would not satisfy the requirements of rule G-23(d)(ii). *MSRB interpretation of July 30, 1981.*

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**Issuer consent: financial advisor participation in underwriting.** This responds to your letter of March 6, 1984, regarding the application of rule G-23, concerning the activities of financial advisors to the following activities of [name deleted] (the "Company").

Your letter states that the Company serves as a financial advisor to a number of municipal entities with respect to the issuance and delivery of bonds. In the majority of circumstances in which bonds are to be marketed through a competitive bidding process, the Company is requested by the issuer either to bid for the bonds independently for its own account or as a participant with others in a syndicate organized to submit a bid. You state that the Company's customary financial advisory contract, in almost all instances, specifically reserves to the Company the right to bid independently or in a syndicate with others for any bonds marketed through a competitive bid.

However, to further accommodate these circumstances, you state that it is the Company's practice to include in the official statement on any bond issue subject to competitive bids specific language, such as:

> The Company is employed as Financial Advisor to the City in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bond is contingent upon the issuance and delivery of the Bonds. The Company may submit a bid for the Bonds, either independently or as a member of a syndicate organized to submit a bid for the Bonds.

In the notice of sale, the following language is included:

> The Company, the City's Financial Advisor, reserves the right to bid on the Bonds.

You add that these two documents, the official statement and the notice of sale, must be

approved by formal resolution of the governing authority of the issuer, such as a city council or a board of directors, before bids are requested or on the date of sale. You ask whether the above language printed in the official statement and the notice of sale, which is approved by formal resolution of the governing authority of the issuer, constitutes compliance with rule G-23(d)(ii).

Rule G-23, concerning the activities of financial advisors, is designed to minimize the *prima facie* conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue. Specifically, rule G-23(d)(ii) provides that a municipal securities dealer which is acting as a financial advisor may not acquire or participate in the distribution of a new issue unless,

> if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

Compliance with the rule's requirement that an issuer expressly consent in writing to the financial advisor's participation in the underwriting cannot be inferred from its approval of the official statement and notice of sale. These documents are designed primarily to describe the new issue and a passing reference to the advisor's possible participation in the underwriting of the bond issue cannot be construed as express approval of such activity since it is not clear that the issuer is provided with a sufficient opportunity to determine whether it is in its best interests to allow its financial advisor to participate in the competitive bidding.

While the Board does not mandate the form of the issuer's consent, it understands that financial advisory contracts often may include consent language applicable to a specific new issue. Alternatively, financial advisors may obtain the consent of an issuer by means of a separate document. However, a financial advisory contract that reserves to the financial advisor the right to bid for any of the issuer's bonds marketed through a competitive bid does not satisfy the requirements of rule G-23(d)(ii). The Board has stated that such "blanket consents" do not afford an issuer a sufficient opportunity to consider whether, under the particular circumstances of an offering, the financial advisor's potential conflict of interest is sufficient to warrant not consenting to the financial advisor's participation in the sale. *MSRB interpretation of April 10, 1984.*

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**Fairness opinions.** This is in response to your letter concerning the retention of your firm by issuers to render a fairness opinion on the pricing associated with certain negotiated issues of general obligation municipal securities issued by [state deleted] governmental units. You ask whether the rendering of these fairness opinions on the pricing of municipal securities issues is a financial advisory activity which must be disclosed on Form G-37/G-38 as municipal securities business.

Rule G-23, on activities of financial advisors, states in paragraph (b) that a financial advisory relationship shall be deemed to exist when

> a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, **including advice with respect to the** structure, timing, **terms** and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services. [Emphasis added]

Thus, the activity your firm performs on behalf of issuers of municipal securities pursuant to an agreement (*i.e.*, rendering advice with respect to the terms of a new issue) establishes that a financial advisory relationship exists between your firm and these issuers.

Rule G-37, on political contributions and prohibitions on municipal securities business, requires dealers to report municipal securities business to the Board on Form G-37/G-38. The definition of "municipal securities business" contained in rule G-37(g)(viii) includes

> the provision of financial advisory or consultant services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis.

Pursuant to the information contained in your letter, your firm should submit a Form G-37/G-38 during each quarter in which the firm reaches an agreement to provide the financial advisory services you described. If your firm has an on-going financial advisory arrangement with an issuer, your firm would need to list each new issue in which your firm acted as financial advisor during the quarter in which the new issue settled. I have enclosed for your information a copy of the Rule G-37 and Rule G-38 Handbook which includes instructions for completing and filing Form G-37/G-38. *MSRB interpretation of January 10, 1997.*

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See also:

**Rule G-22 Interpretive Letter – Letters of credit,** *MSRB interpretation of July 27, 1981.*

## Rule G-24: Use of Ownership Information Obtained in Fiduciary or Agency Capacity

No broker, dealer, or municipal securities dealer having access to confidential, non-public information concerning the ownership of municipal securities that was obtained by such broker, dealer, or municipal securities dealer (or by a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) in the course of acting in a fiduciary or agency capacity for an issuer of municipal securities or for another broker, dealer, or municipal securities dealer, including but not limited to acting as a paying agent, transfer agent, registrar, or indenture trustee for an issuer or as clearing agent, safekeeping agent, or correspondent of another broker, dealer, or municipal securities dealer, shall use such information for the purpose of soliciting purchases, sales, or exchanges of municipal securities or otherwise make use of such information for financial gain except with the consent of such issuer or such broker, dealer, or municipal securities dealer or the person on whose behalf the information was given.

### *MSRB INTERPRETATION*

See:

Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

## Rule G-25: Improper Use of Assets

(a) *Improper Use*. No broker, dealer, or municipal securities dealer shall make improper use of municipal securities or funds held on behalf of another person.

(b) *Guaranties*. No broker, dealer, or municipal securities dealer shall guarantee or offer to guarantee a customer against loss in

(i) an account carried or introduced by such broker, dealer, or municipal securities dealer in which municipal securities are held or for which municipal securities are purchased, sold or exchanged or

(ii) a transaction in municipal securities with or for a customer.

Put options and repurchase agreements shall not be deemed to be guaranties against loss if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v).

(c) *Sharing Account*. No broker, dealer, or municipal securities dealer shall share, directly or indirectly, in the profits or losses of

(i) an account of a customer carried or introduced by such broker, dealer, or municipal securities dealer in which municipal securities are held or for which municipal securities are purchased or sold or

(ii) a transaction in municipal securities with or for a customer.

Nothing herein contained shall be construed to prohibit an associated person of a broker, dealer, or municipal securities dealer from participating in his or her private capacity in an investment partnership or joint account, provided that such participation is solely in direct proportion to the financial contribution made by such person to the partnership or account.

### *MSRB INTERPRETATIONS*

See:

**Rule G-17 Interpretation – Notice Concerning the Application of Board Rules to Put Option Bonds,** September 30, 1985.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

### *Interpretive Letters*

**Letters of credit.** This is in response to your letter dated August 1, 1980, requesting the Board's views on the application of rule G-25 to bank standby letters of credit issued in connection with new issues of securities which the dealer department of the bank intends to underwrite. Specifically, you have asked our views on whether such transactions would violate rule G-25(b), which generally prohibits a municipal securities dealer from guaranteeing a customer against loss in municipal securities transactions.

For the reasons discussed below, rule G-25(b) would not prohibit a municipal securities bank dealer from issuing a letter of credit which is publicly disclosed and for the benefit of all holders of the security.

Rule G-25(b) is an antimanipulation rule which is primarily designed to prevent a municipal securities dealer from artificially stimulating the market in a security, for example, by "parking" it with a customer who has assumed no market risk. It does not appear that the issuance of a fully disclosed letter of credit provided by a bank dealer for the benefit of all bondholders could be used to serve a market manipulative purpose, even though the letter would also serve to protect the bank's own customers. Generally, such letters of credit protect bondholders from particular risks of loss, such as the inability of the issuer to make payments of principal or interest. Bondholders are not protected from general market risks, however, and, like all bona fide purchasers of securities, they incur gains or losses as the market price of the bonds fluctuates. Moreover, unlike the situation contemplated by rule G-25 which addresses guarantees made by dealers to their customers, the bondholders for whose benefit a letter of credit is issued would not necessarily have a customer relationship with the bank dealer issuing the letter. *MSRB interpretation of March 6, 1981.*

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**Indemnity agreement.** This is in response to your letter dated March 18, 1981, regarding your client's (the "Bank") proposal to sell participations in industrial development bonds to one or more unit investment trusts or closed-end investment company (the "trust"), which bonds would be insured against default by the American Municipal Bond Assurance Corporation (AMBAC). Specifically you ask whether an agreement by the Bank to indemnify AMBAC to the extent of 25 percent of any losses suffered in the event of default would violate Board rule G-25(b) which generally prohibits a municipal securities dealer from guaranteeing a customer against loss in municipal securities transactions.

As you note in your letter, the Board has taken the position that a municipal securities bank dealer issuing a letter of credit which is publicly disclosed and for the benefit of all holders of the security would not violate the provisions of rule G-25(b). You state that the Bank's agreement to indemnify AMBAC would be disclosed to and, at least indirectly would be for the benefit, of all investors.

Based upon the facts contained in your letter, it appears that the proposed agreement would not be prohibited by rule G-25(b). *MSRB interpretation of March 26, 1981.*

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**Retroactive price adjustment for early redemption.** This is in response to your letter dated January 15, 1986, regarding the application of Board rules to a plan to guarantee a minimum return to customers who purchase certain municipal securities. You note that many [state deleted] municipalities issue General Obligation Temporary Notes with maturities of approximately one year. The municipalities also reserve the right to redeem at par any or all of the notes at any time prior to maturity. Historically, few notes are actually redeemed prior to their stated maturity.

You state that, acting as a municipal securities dealer, you desire to bid on these notes with the intent of selling them to your customers. The notes would be sold at a premium to generate trading profits. Because the notes can be redeemed by the issuer at any time at par, it is conceivable that someone who pays a premium

for the notes could incur an actual return on their investment that is extremely small – even negative.

You ask whether, under Board rules, a municipal securities dealer may sell notes as described above, with the provision that if the notes are redeemed by the issuer prior to maturity, the dealer will adjust the original purchase price retroactively to provide a minimum return to the purchaser for the time held. The minimum return would be negotiated with the purchaser and confirmed in writing at the time of purchase from the dealer. You cite the following example:

> The XYZ Bank, a municipal securities dealer, purchases from the City of Anywhere, $100,000 par value of its 6% General Obligation Temporary Notes, dated 1-1-86, maturing 1-1-87 at par, redeemable at anytime at the option of the issuer.
>
> The XYZ Bank sells the notes to its customer, the ABC Bank, for settlement 1-1-86 to yield 5.75%. Can the XYZ bank agree that if the notes are redeemed prior to maturity by the issuer, it will adjust the original price at which the ABC Bank purchased the notes to provide a minimum return of at least 5% for the time held?

Board rule G-25(b) generally prohibits a municipal securities dealer from guaranteeing a customer against loss. Under the rule, put options and repurchase agreements are not deemed to be guarantees against loss if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v). The rule is anti-manipulative in purpose and was designed, in part, to prevent a dealer from artificially stimulating the market in a security by selling securities to customers who assume no market risk. In addition, rule G-25(c) prohibits a municipal securities dealer from sharing, directly or indirectly, in the profits or losses of a transaction in municipal securities with or for a customer. Finally, rule G-30 requires municipal securities dealers to effect transactions with customers at fair and reasonable prices, taking into consideration, among other matters, the price of securities of comparable quality.

The arrangement you pose may be viewed as a guarantee against loss because the dealer would guarantee the customer a minimum return on his investment. In addition, the arrangement may be viewed as a sharing of loss arising from the customer's transaction because the dealer would participate in any loss sustained by the customer when it retroactively readjusts the price of the securities downward to grant the customer the promised return. Finally, rule G-30, on prices and commissions, requires that the price charged the customer for the securities at the time of sale, without taking into account any readjustment to the price at some future date, must be fair. *MSRB interpretation of January 31, 1986.*

## Rule G-26: Customer Account Transfers

(a) *Definitions*. For purposes of this rule, the following terms have the following meanings:

(i) The term "delayed delivery asset" means an asset subject to a delayed delivery and includes when-issued securities.

(ii) The term "in-transfer asset" means an asset which has been submitted to the registrar or transfer agent for transfer and shipment to the customer at the time the transfer instruction is received by the carrying party.

(iii) The term "nontransferable asset" means an asset that is incapable of being transferred from the carrying party to the receiving party because (A) it is an issue in default for which the carrying party does not possess the proper denominations to effect delivery and no transfer agent is available to re-register the securities, or (B) it is a municipal fund security which the issuer requires to be held in an account carried by one or more specified brokers, dealers or municipal securities dealers that does not include the receiving party.

(b) *Responsibility to Expedite Customer's Request*. When a customer whose municipal securities account is carried by a broker, dealer or municipal securities dealer (the "carrying party") wishes to transfer its entire account to another broker, dealer or municipal securities dealer (the "receiving party") and gives written notice of that fact to the receiving party, the receiving party and the carrying party must expedite and coordinate activities with respect to the transfer as follows.

(c) *Transfer Instructions*.

(i) Parties may use Form G-26, the transfer instruction prescribed by the Board, or the transfer instructions required by a clearing agency registered with the Securities and Exchange Commission in connection with its automated customer account transfer system, or transfer instructions that are substantially similar to those required by such clearing agency, when accomplishing account transfers pursuant to this rule.

(ii) If an account includes any nontransferable assets, the carrying party must request, in writing and prior to or at the time of validation of the transfer instruction, further instructions from the customer with respect to the disposition of such assets. Such request shall provide the customer with the following alternative methods of disposition of nontransferable assets, if applicable:

(A) liquidation, with a specific indication of any redemption or other liquidation-related fees that may result from such liquidation and that those fees may be deducted from the money balance due the customer;

(B) retention by the carrying party for the customer's benefit; or

(C) in the case of a nontransferable asset described in section (a)(iii)(B), transfer to another broker, dealer or municipal securities dealer, if any, which the issuer has specified as being permitted to carry such asset.

(d) *Transfer Procedures*.

(i) Upon receipt from the customer of a signed transfer instruction to receive such customer's securities account from the carrying party, the receiving party must immediately submit such instruction to the carrying party. The carrying party must, within three business days following receipt of such instruction, validate and return the transfer instruction to the receiving party (with an attachment reflecting all positions and money balances as shown on its books) or take exception to the transfer instruction for reasons other than securities positions or money balance differences and advise the receiving party of the exception taken.

(ii) A carrying party may take exception to a transfer instruction only if:

(A) it has no record of the account on its books;

(B) the transfer instruction is incomplete; or

(C) the transfer instruction contains an improper signature.

(iii) The carrying party and the receiving party must promptly resolve any exceptions taken to the transfer instruction.

(iv) Upon validation of a transfer instruction, the carrying party must:

(A) "freeze" the account to be transferred, *i.e.*, all open orders must be cancelled and no new orders may be taken; and

(B) return the transfer instruction to the receiving party with an attachment indicating all securities positions and any money balance in the account as shown on the books of the carrying party. Except as hereinafter provided, the attachment must include a then-current market value for all assets in the account. However, delayed delivery assets, nontransferable assets, and assets in-transfer to the customer, need not be valued, although the "delayed delivery," "nontransferable," or "in-transfer" status of such assets, respectively, must be indicated on the attachment. A carrying party must provide the description set forth in rule G-12(c)(v)(E) with respect to any municipal security that has not been assigned a CUSIP number in an account it is to transfer.

(v) Within four business days following the validation of a transfer instruction, the carrying party must complete the transfer of the account to the receiving party. The receiving party and the carrying party must immediately establish fail-to-receive and fail-to-deliver contracts at the then-current market value as of the date of validation upon their respective books of account against the long/short positions in the customer's accounts that have not been physically delivered/received and the receiving party/carrying party must debit/credit the related money amount. Nontransferable assets and assets in-transfer to the customer are exempt from the requirement that fail-to-receive and fail-to-deliver contracts must be established for positions in a customer's securities account that have not been physically delivered. Zero value fail-to-receive and fail-to-deliver instructions shall be established for delayed delivery assets. The customer's account(s) shall thereupon be deemed transferred.

(vi) To the extent any assets in the account are not readily transferable, with or without penalties, such assets are not subject to the time frames required by the rule; and if the customer has authorized liquidation of any nontransferable assets, the carrying member must distribute the resulting money balance to the customer within five business days following receipt of the customer's disposition instructions.

(e) *Fail Contracts Established.*

Any fail contracts resulting from this account transfer procedure must be closed out in accordance with rule G-12(h).

(f) *Prompt Resolution of Discrepancies.* Any discrepancies relating to positions or money balances that exist or occur after transfer of a customer's securities account must be resolved promptly.

(g) *Exemptions.*

The Board may exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any dealer or any type of account, security or municipal security.

(h) *Participant in a Registered Clearing Agency.* When both the carrying party and the receiving party are direct participants in a clearing agency registered with the Securities and Exchange Commission offering automated customer securities account transfer capabilities, the account transfer procedure, including the establishing and closing out of fail contracts, must be accomplished pursuant to the rules of and through such registered clearing agency.

(i) *Forwarding of Copy of Form G-26 to Enforcement Authority on Request.* The carrying party shall forward a copy of each customer account transfer instruction issued pursuant to paragraph (c)(i) to the enforcement authority having jurisdiction over the carrying party member, at the request of such authority.

## MSRB INTERPRETATION

See:

Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

# FORM G-26
# CUSTOMER ACCOUNT TRANSFER INSTRUCTION

Date:

Receiving Party

Carrying Party

Receiving Party
Account Number

Carrying Party
Account Number

Account Title

Tax ID or SS Number

To:

Receiving Party Name and Address

Please receive my entire account from the below indicated carrying party and remit to it the debit balance or accept from it the credit balance in my municipal securities account.

To:

Carrying Party Name and Address

Please transfer my entire municipal securities account to the above indicated receiving party, which has been authorized by me to make payment to you of the debit balance or to receive payment of the credit balance in my municipal securities account. I understand that to the extent any assets or instruments in my municipal securities account are not readily transferable, with or without penalties, such assets or instruments may not be transferred within the time frames required by rule G-26 of the Municipal Securities Rulemaking Board.

I understand that you will contact me with respect to the disposition of any assets in my municipal securities account that are nontransferable. If certificates or other instruments in my securities account are in your physical possession, I instruct you to transfer them in good deliverable form to enable such receiving firm to transfer them in its name for the purpose of sale, when and as directed by me.

Upon validation of this transfer instruction, I instruct you to cancel all open orders for my municipal securities account on your books.

Customer's Signature

Date

Customer's Signature
(If joint account)

Date

It is suggested that a copy of the customer's most recent account statement be attached.

Receiving Party Contact

Name

Phone Number

## Rule G-27: Supervision

(a) *Obligation to supervise.* Each broker, dealer and municipal securities dealer ("dealer") shall supervise the conduct of the municipal securities activities of the dealer and its associated persons to ensure compliance with Board rules and the applicable provisions of the Act and rules thereunder ("applicable rules").

(b) *Designation of principals.*

(i) *General.* Each dealer shall specifically designate one or more associated persons qualified as municipal securities principals, municipal securities sales principals, financial and operations principals in accordance with Board rules, or as general securities principals to be responsible for the supervision of the municipal securities activities of the dealer and its associated persons as required by this rule.

(ii) *Written Record.* A written record of each supervisory designation and of the designated principal's responsibilities under this rule shall be maintained and updated as required under rule G-9.

(iii) *Appropriate principal.* Each dealer shall designate a municipal securities principal as responsible for its supervision under sections (a) and (c) of this rule, except as provided in this section. A non-bank dealer shall designate a financial and operations principal as responsible for the financial reporting duties specified in rule G-3(d)(i)(A-E) and with primary responsibility for books and records under section (c)(v) below; *provided, however,* that a non-bank dealer meeting the requirements of Securities Exchange Act rule 15c3-1(a)(2)(iv), (v) or (vi) or the exemption under rule 15c3-1(b)(3) may, but is not required to, designate a financial and operations principal as responsible for such financial reporting duties and with primary responsibility for such books and records. In addition, a municipal securities sales principal may be designated as responsible for supervision under sections (c)(ii), (iii) and (vii) of this rule, to the extent the activities pertain to sales to or purchases from a customer; a general securities principal may be designated as responsible for supervision under sections (c)(v) and (vii)(A) of this rule and under rules G-3(h)(i)(G)(1), G-7(b) and G-21(e); and a financial and operations principal may be designated as responsible for supervision under section (c)(vi) of this rule.

(c) *Written supervisory procedures.* Each dealer shall adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance as required in section (a) of this rule. Such procedures shall codify the dealer's supervisory system for ensuring compliance and, at a minimum, shall establish procedures

(i) that state how a designated principal shall monitor for compliance by the dealer with all applicable rules and supervise the activities of associated persons specified in rule G-3(a)(i);

(ii) a designated principal shall follow when a customer complaint concerning the dealer's municipal securities activities is received;

(iii) for the regular and frequent review and approval by a designated principal of customer accounts introduced or carried by the dealer in which transactions in municipal securities are effected; such review shall be designed to ensure that such transactions are in accordance with all applicable rules and to detect and prevent irregularities and abuses;

(iv) for the periodic review by a designated principal of each office which engages in municipal securities activities;

(v) for the maintenance and preservation, by a designated principal, of the books and records required to be maintained and preserved by rules G-8 and G-9 of the Board;

(vi) for the supervision by a designated principal of the processing, clearance, and in the case of a non-bank dealer safekeeping of municipal securities; and

(vii) for the prompt review and written approval by a designated principal of:

(A) the opening of each customer account introduced or carried by the dealer in which transactions in municipal securities may be effected; and

(B) each transaction in municipal securities on a daily basis, including each transaction in municipal securities effected with or for a discretionary account introduced or carried by the dealer.

(d) *Review of Correspondence*

(i) *Supervision of Municipal Securities Representatives.* Each dealer shall establish procedures for the review by a designated principal of incoming and outgoing written (*i.e.*, non-electronic) and electronic correspondence of its municipal securities representatives with the public relating to the municipal securities activities of such dealer. Such procedures must be in writing and be designed to reasonably supervise each municipal securities representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available, upon request, to a registered securities association or the appropriate regulatory agency as defined in section 3(a)(34) of the Act.

(ii) *Review of correspondence.* Each dealer shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its municipal securities activities. Procedures shall include the review of incoming, written correspondence directed to municipal securities representatives and related to the dealer's municipal securities activities to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with the dealer's procedures. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provisions for the education and training of associated persons as to the dealer's procedures governing correspondence; documentation of such education and training; and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

(iii) *Retention of correspondence.* Each dealer shall retain correspondence of municipal securities representatives relating to its municipal securities activities in accordance with rules G-8(a)(xx) and G-9(b)(viii) and (xiv). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records and the retained records shall be readily available, upon request, to a registered securities association or the appropriate regulatory agency as defined in Section 3(a)(34) of the Act.

(e) *Duty to update and review written procedures.* Each dealer shall revise and update its written supervisory procedures as necessary to respond to changes in Board or other applicable rules and as other circumstances require. In addition, each dealer shall review, at least on an annual basis, its supervisory system and written supervisory procedures adopted under sections (c) and (d) of this rule to determine whether they are adequate and up-to-date and shall ensure that the dealer is in compliance with this rule.

## MSRB INTERPRETATIONS

### NOTICE CONCERNING SUPERVISORY RESPONSIBILITY OF MUNICIPAL SECURITIES PRINCIPALS AND MUNICIPAL SECURITIES SALES PRINCIPALS

December 15, 1981

The Board has received questions concerning the appropriate allocation of supervisory responsibility between municipal securities principals and the new category of municipal securities sales principals. The Board recently amended its rule G-3 to permit a person associated with a securities firm whose activities with respect to municipal securities are limited to supervising sales to and purchases from customers to qualify as a "municipal securities sales principal" ("sales principal"). The Board also amended rules G-8 on recordkeeping, G-26 on the administration of customer accounts, and G-27 on supervision to permit securities firms to designate sales principals as responsible for certain supervisory functions insofar as they relate directly to transactions in municipal securities with customers.

In particular, rule G-27 concerning supervision requires municipal securities dealers to designate at least one municipal securities principal as responsible for supervising its municipal securities activities, including the municipal securities activities of branch offices or similar locations. In addition, rule G-27 permits the municipal securities dealer to designate a sales principal (*e.g.*, a branch office manager) as responsible for the "direct supervision of sales to and purchases from customers." The rule also requires that a dealer adopt written supervisory procedures which, among other matters, reflect the delegation of supervisory authority to these personnel.

As a result of these amendments, in designating under rule G-27 one or more municipal securities principals as responsible for supervising the business and activities of the firm's associated persons, a securities firm may choose to designate a qualified sales principal with limited responsibility for the direct supervision of sales to and purchases from customers. If so, the firm's written supervisory procedures may allocate responsibility to a sales principal for reviewing and approving (to the extent that they relate to sales to and purchases from customers) the suitability of the opening of, and transactions in, customer accounts, the handling of customer complaints and other correspondence, and other matters permitted by Board rule to be reviewed or approved by a sales principal. A municipal securities principal, however, must be responsible for directly supervising the firm's other municipal securities activities such as underwriting, trading, and pricing of inventories.

With respect to the relationship between a sales principal and the designated municipal securities principal, Board rule G-27 provides that a branch office manager who acts as the sales principal for his office will be responsible for the municipal securities sales activities under his direct supervision. Rule G-27 also provides that a designated municipal securities principal will be responsible for all municipal securities activities of the branch office including those that may be under the direct supervision of a sales principal. However, the branch office manager, under the particular organizational structure of a firm, may be responsible to some other designated supervisor for the discharge of his other duties.

### SUPERVISORY PROCEDURES FOR THE REVIEW OF CORRESPONDENCE WITH THE PUBLIC

March 24, 2000

On March 16, 2000, the Securities and Exchange Commission approved amendments to rules G-8, on books and records, G-9, on preservation of records, and G-27, on supervision.1 The amendments will become effective on September 19, 2000. The amendments will allow brokers, dealers and municipal securities dealers ("dealers") to develop flexible supervisory procedures for the review of correspondence with the public. This notice is being issued to provide guidance to dealers on how to implement these rules.

#### Background

Technology has greatly expanded how communications between dealers and their customers take place. These new means of communication (*e.g.*, e-mail, Internet) will continue to significantly affect the manner in which dealers and their associated persons conduct their business. While these changes allow timely and efficient communication with customers, prospective customers, and others, the significant

changes in communications media and capacity raise questions regarding supervision, review, and retention of correspondence with the public.

In May 1996, the SEC issued an Interpretive Release on the use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisors for Delivery of Information.[2] That release expressed the views of the SEC with respect to the delivery of information through electronic media in satisfaction of requirements in the federal securities laws, but did not address the applicability of any self-regulatory organization ("SRO") rules. In its release the SEC did, however, strongly encourage the SROs to work with broker/dealer firms to adapt SRO supervisory review requirements governing communications with customers to accommodate the use of electronic communications.[3]

On December 31, 1997, the SEC approved proposed rule changes filed by the National Association of Securities Dealers ("NASD")[4] and the New York Stock Exchange ("NYSE")[5] to update rules governing supervision of communication with the public. NASD *Notice to Members 98-11* announced approval of the proposed rule change, provided guidance to firms on how to implement these rules and stated that the amendments to NASD Rules 3010 and 3110 would be effective on February 15, 1998. Over the next year, further amendments were made to NASD Rules 3010 and 3110. NASD Regulation received final SEC approval of amendments to Rule 3010 on November 30, 1998.[6] The rule amendments were effective on March 15, 1999.[7]

As amended, NASD Rule 3010(d)(1) provides that procedures for review of correspondence with the public relating to a member's investment banking or securities business be designed to provide reasonable supervision for each registered representative, be described in an organization's written supervisory procedures, and be evidenced in an appropriate manner. NASD Rule 3010(d)(2) requires each member to develop written policies and procedures for review of correspondence with the public relating to its investment banking or securities business tailored to its structure and the nature and size of its business and customers. These procedures must also include the review of incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures.

The Board has determined to adopt substantially similar rule changes. The Board believes that conforming its rule language to the language in the NASD rules will help ensure a coordinated regulatory approach to the supervision of correspondence.

**Amended Rules**

Rule G-27(d)(i), as revised, provides that procedures for review of correspondence with the public relating to a dealer's municipal securities activities be designed to provide reasonable supervision for each municipal securities representative, be described in the dealer's written supervisory procedures, and be evidenced in an appropriate manner.

Rule G-27(d)(ii) requires each dealer to develop written policies and procedures for review of correspondence with the public relating to its municipal securities activities, tailored to its structure and the nature and size of its business and customers. The rule requires that any dealer that does not conduct either an electronic or manual pre-use review will be required to:

- develop appropriate supervisory procedures;
- monitor and test to ensure these policies and procedures are being implemented and complied with;
- provide education and training to all appropriate employees concerning the dealer's current policies and procedures governing correspondence, and update this training as policies and procedures are changed; and
- maintain records documenting how and when employees are educated and trained.

The rule change states that these procedures must also include the review of incoming, written correspondence directed to municipal securities representatives and related to the dealer's municipal securities activities to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with the dealer's procedures.

It is the understanding and view of the Board that dealers possess the legal capacity to insist that mail addressed to their offices be deemed to be related to their businesses, even if marked to the attention of a particular associated person, if they advise associated persons that personal correspondence should not be received at their firms. Dealers, other than non-NASD member bank dealers, are reminded that SEC Rule 17a-4(b)(4) requires that "originals of all communications received . . . by such member, broker or dealer, relating to its business as such . . ." must be preserved for not less than three years.

The retention requirements of the amendments to rule G-27 cross reference rules G-8(a)(xx) and G-9(b)(viii) and (xiv) and state that the names of persons who prepared, reviewed and approved correspondence must be readily ascertainable from the retained records. The records must be made available, upon request, to the appropriate enforcement agency (*i.e.*, NASD or federal bank regulatory agency).

**Guidlines for Supervision and Review**

In adopting review procedures pursuant to rule G-27(d)(i), dealers must:

- specify, in writing, the dealer's policies and procedures for reviewing different types of correspondence;
- identify how supervisory reviews will be conducted and documented;
- identify what types of correspondence will be pre- or post-reviewed;
- identify the organizational position(s) responsible for conducting review of the different types of correspondence;
- specify the minimum frequency of the reviews for each type of correspondence;
- monitor the implementation of and compliance with the dealer's procedures for reviewing public correspondence; and
- periodically re-evaluate the effectiveness of the dealer's procedures for reviewing public correspondence and consider any necessary revisions.

In conducting reviews, dealers may use reasonable sampling techniques. As an example of appropriate evidence of review, e-mail related to the dealer's municipal securities activities may be

reviewed electronically and the evidence of review may be recorded electronically.

In developing supervisory procedures for the review of correspondence with the public pursuant to rule G-27(d)(ii), each dealer must consider its structure, the nature and size of its business, other pertinent characteristics, and the appropriateness of implementing uniform firm-wide procedures or tailored procedures (*i.e.*, by specific function, office/location, individual, or group of persons).

In adopting review procedures pursuant to rule G-27(d)(ii), dealers must, at a minimum:

- specify procedures for reviewing municipal securities representatives' recommendations to customers;
- require supervisory review of some of each municipal securities representative's public correspondence, including recommendations to customers;
- consider the complaint and overall disciplinary history, if any, of municipal securities representatives and other employees (with particular emphasis on complaints regarding written or oral communications with clients); and
- consider the nature and extent of training provided municipal securities representatives and other employees, as well as their experience in using communications media (although a dealer's procedures may not eliminate or provide for minimal supervisory reviews based on an employee's training or level of experience in using communications media).

Although dealers may consider the number, size, and location of offices, as well as the volume of correspondence overall or in specific areas of the organization, dealers must nonetheless develop appropriate supervisory policies and procedures in light of their duty to supervise their associated persons. The factors listed above are not exclusive and dealers must consider all appropriate factors when developing their supervisory procedures and implementing their supervisory reviews.

Supervisory policy and procedures must also:

- provide that all customer complaints, whether received via e-mail or in written form from the customer, are kept and maintained;
- describe any dealer standards for the content of different types of correspondence; and
- prohibit municipal securities representatives' and other employees' use of electronic correspondence to the public unless such communications are subject to supervisory and review procedures developed by the dealer. For example, the Board would expect dealers to prohibit correspondence with customers from employees' home computers or through third party systems unless the dealer is capable of monitoring such communications.

The method used for conducting reviews of incoming, written correspondence to identify customer complaints and funds may vary depending on the dealer's office structure. Where the office structure permits review of all correspondence, dealers should designate a municipal securities representative or other appropriate person to open and review correspondence prior to use or distribution to identify customer complaints and funds. The designated person must not be supervised or under the control of the municipal securities representative whose correspondence is opened and reviewed. Unregistered persons who have received sufficient training to enable them to identify complaints and funds would be permitted to review correspondence.

Where the office structure does not permit the review of correspondence prior to use or distribution, appropriate procedures that could be adopted include the following:

- forwarding opened incoming written correspondence related to the dealer's municipal securities activities to a designated office, or supervising branch office, for review on a weekly basis;
- maintenance of a separate log for all checks received and securities products sold, which is forwarded to the supervising branch office on a weekly basis;
- communication to clients that they can contact the dealer directly for any matter, including the filing of a complaint, and providing them with an address and telephone number of a central office of the dealer for this purpose; and
- branch examination verification that the procedures are being followed.

Regardless of the method used for initial review of incoming, written correspondence, as with other types of correspondence, rule G-27 would still require review by a designated principal of some of each municipal securities representative's correspondence with the public relating to the dealer's municipal securities activities. Given the complexity and cost of establishing appropriate systems for effectively reviewing electronic communications, some dealers may determine to conduct a pre-use or distribution review of all incoming and outgoing correspondence (written or electronic).

Dealers must continually assess the effectiveness of these supervisory systems. Education and training must be timely (prior to or concurrent with implementation of the policies and procedures) and must include all appropriate employees. Dealers may incorporate the required education and training on correspondence into their Continuing Education Firm Element Training Program (*see* rule G-3(h) on continuing education requirements). The requirement for training regarding correspondence may also apply to employees who are not included under the Continuing Education requirements.

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[1] *See* Exchange Act Release No. 42538 (March 16, 2000), 65 FR 15675 (March 23, 1999).

[2] *See* Securities Act Release No. 7288, Exchange Act Release No. 37182,Investment Company Act Release No. 21945, Investment Advisor Act Release No. 1562 (May 9, 1996), 61 FR 24644 (May 15, 1996) (File No. S7-13-96).

[3] *Id.*

[4] *See* Exchange Act Release No. 39510 (December 31, 1997), 63 FR 1131 (January 8, 1998).

[5] *See* Exchange Act Release No. 39511 (December 31, 1997), 63 FR 1135 (January 8, 1998).

[6] *See* Exchange Act Release No. 40723 (November 30, 1998), 63 FR 67496 (December 7, 1998).

[7] *See Notice to Members* 99-03 (January 1999).

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**See also:**

**Rule G-3 Interpretation – Notice Concerning Municipal Securities**

Sales Activities in Branch Affiliate and Correspondent Banks Which Are Municipal Securities Dealers, March 11, 1983.

Rule G-29 Interpretation – Interpretive Notice on Availability of Board Rules, May 20, 1998.

## Interpretive Letters

**Supervisory structure.** This is in response to your letter of December 31, 1986 and our subsequent telephone conversation. You note that there has been a recent reorganization within your bank. As a consequence, you, as the head of the dealer department, now will report to the bank officer who also is in charge of the trust department and the bank's investment portfolio, rather than directly to the bank's president as had been the case. You ask whether this arrangement might constitute a conflict of interest under trust regulations or otherwise under Board rules.

Board rule G-27 places an obligation upon a dealer to supervise its municipal securities activities. It requires a dealer to accomplish this objective by designating individuals with supervisory responsibility for municipal securities activities and requires the dealer to adopt written supervisory procedures to this end. The rule does not specify how a dealer should structure its supervisory procedures, provided that the dealer adopts an organizational structure which meets the intent of the rule. You should review your dealer's written supervisory procedures to ensure that they provide for the appropriate delegation of supervisory responsibilities, given the reorganization within the bank.

You noted that the individual to whom you will be reporting is presently qualified as a municipal securities representative but not as a municipal securities principal. Board rule G-3(a)(i)[*] defines a municipal securities principal as an associated person of a securities firm or bank dealer who is directly engaged in the management, direction or supervision of municipal securities activities. If, under the new reorganization, this individual will be designated with day-to-day responsibility for the management, direction or supervision of the municipal securities activities of the dealer, then he must be qualified as a municipal securities principal.

Finally, trust regulations are governed by the appropriate banking law and not by Board rules. Consequently, any concerns that you may have with respect to possible conflicts of interest with trust regulations should be directed to the appropriate bank regulatory agency. *MSRB interpretation of March 11, 1987.*

[*][Currently codified at rule G-3(b)(i).]

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**Review and approval of transactions.** This is in response to your letter requesting an interpretation of rule G-27(c)(ii)(B)[*] which requires that a [designated] principal promptly review and approve, in writing, each transaction in municipal securities. You state that your firm proposes to use a system of exception reports to review the firm's municipal securities transactions each day. Each trade will be reviewed by computer pursuant to parameters established by the Compliance Department. These parameters include the size of the order (in terms of dollars as well as a percentage of the customer's net worth), the customer's income, investment objectives and age. These parameters can be changed and fine-tuned as the situation dictates. Currently, the exception report will contain all purchases in excess of $25,000 or 10 percent of the customer's stated net worth and all sales in excess of $10,000. A review of the exception report would be conducted by a municipal securities principal. Oversight of the review process, and any required follow-up, would be conducted.

Rule G-27, on supervision, requires a dealer to supervise the municipal securities activities of its associated persons and the conduct of its business. In particular, rule G-27(c)(ii)(B)[*] requires that a [designated] principal promptly review and approve, in writing, each transaction in municipal securities. The Board believes that the requirement for written approval of each transaction by a [designated] principal is reasonable and necessary to promote proper supervision of the activities of municipal securities representatives. Among other purposes, these procedures enable [designated] principals to keep abreast of the firm's daily trading activity, to assess the appropriateness of mark-ups and mark-downs, and to assure that provisions for the prompt delivery of securities are being met. The exception reporting you propose would not comply with rule G-27(c)(ii)(B)[*] because it would not result in review and approval of each municipal securities transaction by a [designated] principal.[1] *MSRB interpretation of July 26, 1989.*

1 While exception report review is not appropriate in complying with rule G-27(c)(vii)(B),[*] we understand that certain dealers, with the approval of their enforcement agencies, use exception reports in their periodic review of customer accounts required by rule G-27(c)(iii).

[*][Currently codified at rule G-27(c)(vii)(B).]

**NOTE: Revised to reflect subsequent amendments.**

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**Review and approval of transactions.** This is in response to your letter in which you ask several questions concerning Board rules.

[One paragraph deleted.]*

With respect to your second question, someone qualified as both a municipal securities representative and as a municipal securities principal may review and approve his or her own transactions effected in the capacity as a representative.

With respect to your final question, rule G-27(c)(vii)(B), on supervision, requires the prompt review and written approval by a designated principal of each transaction in municipal securities on a daily basis. *MSRB interpretation of June 20, 1994.*

[*][The deleted paragraph concerned an unrelated question regarding a different Board rule and appears elsewhere in the MSRB Rule Book.]

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**Review and approval of customer accounts.** This is in response to your letter dated July 24, 1996, requesting an interpretation of rule G–27(c)(iii) on written supervisory procedures.

Rule G-27(c)(iii) requires that each municipal securities dealer adopt, maintain and enforce written supervisory procedures ensuring the "regular and frequent" review and approval by a designated principal of customer accounts introduced or carried by the dealer in which transactions in municipal securities are effected. The rule further states that such review shall be designed to ensure that such transactions are in accordance with all applicable rules and to detect and prevent irregularities and abuses.

Because circumstances vary from dealer to dealer, the Board has not specified a time period to define "regular and frequent" for purposes of rule G-27(c)(iii). As you can see, however, the purpose of this provision is to detect and prevent irregularities and abuses that may occur in customer accounts. The Board expects dealers to establish procedures that effectively obtain this objective and that are capable of compliance. While the Board has never specifically addressed "risk-focussed" methods for determining periodic account review, the Board has stated that, in determining when an account must be reviewed, a dealer might look to the volume and frequency of trading and the nature of the securities traded. The Board noted that account review guidelines based on these factors would be appropriate if they are articulated clearly in a dealer's written supervisory procedures.[1] *MSRB interpretation of August 7, 1996.*

1 Supervision Requirements, MSRB Reports, Vol. 10, No. 2 (May 1990) at 6.

See also:

Rule G-8 Interpretive Letter – Use of electronic signatures, MSRB *interpretation of February 27, 1989.*

Rule G-19 Interpretive Letter – Recommendations, MSRB *interpretation of February 17, 1998.*

Rule G-37 Interpretive Letter – Solicitation of contributions, MSRB *interpretation of November 7, 1994.*

## Rule G-28: Transactions with Employees and Partners of Other Municipal Securities Professionals

(a) *Account Instructions.* No broker, dealer, or municipal securities dealer shall open or maintain an account in which transactions in municipal securities may be effected for a customer who such broker, dealer or municipal dealer knows is employed by, or the partner of, another broker, dealer or municipal securities dealer, or for or on behalf of the spouse or minor child of such a person unless such broker, dealer, or municipal securities dealer first gives written notice with respect to the opening and maintenance of such account to the broker, dealer or municipal securities dealer by whom such person is employed or of whom such person is a partner.

(b) *Account Transactions.* No broker, dealer, or municipal securities dealer shall effect a transaction in municipal securities with or for an account subject to section (a) of this rule unless such broker, dealer, or municipal securities dealer

(i) sends simultaneously to the employing broker, dealer or municipal securities dealer a duplicate copy of each confirmation sent to the customer, and

(ii) acts in accordance with any written instructions which may be provided to the broker, dealer or municipal securities dealer by an employing broker, dealer or municipal securities dealer with respect to transactions effected with or for such account.

(c) *Exemption for Municipal Fund Securities.* The provisions of this rule shall not be applicable to transactions in municipal fund securities or to accounts that are limited to transactions in municipal fund securities.

### *MSRB INTERPRETATION*

See:

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

### *Interpretive Letter*

**Employer of customer's spouse.** This will acknowledge receipt of your letter of January 10, 1979, requesting an interpretive opinion with respect to rule G-28 of the Municipal Securities Rulemaking Board (the "Board"). Rule G-28 requires a municipal securities dealer to take certain specified actions in connection with municipal securities transactions effected for the account of customers who are employed by, or the partner of another municipal securities dealer or for or on behalf of the spouse or minor child of such a person. I understand from a subsequent conversation which we had that your principal concern is whether a municipal securities dealer must obtain information regarding the employer of a spouse of a current customer, in view of the requirements of rule G-28.

Although rule G-28 applies to the spouse or minor child of a customer who is employed by another municipal securities dealer, there is no requirement at the present time in rule G-28 or in rule G-8, the recordkeeping rule, for a municipal securities dealer to obtain information about the employment status of spouses or minor children. Accordingly, a municipal securities dealer does not have to inquire of current customers whether their spouses are employed by another municipal securities dealer. A municipal securities dealer would have to comply with rule G-28 if the dealer actually knows that a spouse is employed by another municipal securities dealer. *MSRB interpretation of March 6, 1979.*

## Rule G-29: Availability of Board Rules

Each broker, dealer and municipal securities dealer shall keep in each office in which any of the activities set forth in rule G-3(a)(i) of the Board are conducted, a copy of all rules of the Board as from time to time in effect and shall make such rules available for examination by customers promptly upon request.

### *MSRB INTERPRETATION*

INTERPRETIVE NOTICE ON AVAILABILITY OF BOARD RULES

May 20, 1998

Rule G-29, on availability of Board rules, requires dealers to keep a copy of all rules of the Board as from time to time in effect and to make such rules available for examination by customers promptly upon request. The Board's rules must be kept in each office in which any activities of a municipal securities representative are conducted (*e.g.*, underwriting, trading or sales of municipal securities).

Dealers can meet the requirements of rule G-29 by a number of different means. The Board provides dealers with a copy of the soft-cover version of the *MSRB Manual*, which contains the Board's rules, at no charge when it is printed twice a year. Additional copies of the soft-cover version are available from the Board at $7.00 each. Dealers can order the loose-leaf version of the *Manual* directly from CCH Incorporated. Dealers can also meet the requirements of the rule by having Internet access in their offices to the Board's rules at its Web site (www.msrb.org) or by using software products produced by other companies which contain the Board's rules. Regardless of the method used to ensure that a copy of the rules is available at each office, customers must be given access to such copies, whether in printed form or by viewing on screen.

In connection with rule G-29, the Board reminds dealers that rule G-27, on supervision, requires each dealer to supervise the conduct of its municipal securities business and the municipal securities activities of its associated persons to ensure compliance with Board rules. Dealers should review their supervisory procedures to ensure that they have procedures in place for making the Board's rules available and accessible to customers upon request in each office that engages in municipal securities activities. In addition, the supervisory procedures should address how the dealer will provide its offices with the most current version of the rules once they are in effect so that its securities professionals are alerted to new developments. A dealer may establish a procedure to obtain information about current rule amendments from notices posted on the Board's Web site or from notices published in *MSRB Reports*.

**NOTE: This notice was revised to reflect the $7.00 price of the MSRB *Rule Book* as of January 1, 1999.**

See also:

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

## Rule G-30: Prices and Commissions

(a) *Principal Transactions.* No broker, dealer or municipal securities dealer shall purchase municipal securities for its own account from a customer or sell municipal securities for its own account to a customer except at an aggregate price (including any mark-down or mark-up) that is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the broker, dealer or municipal securities dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction, the expense involved in effecting the transaction, the fact that the broker, dealer, or municipal securities dealer is entitled to a profit, and the total dollar amount of the transaction.

(b) *Agency Transactions.* No broker, dealer or municipal securities dealer shall purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount, taking into consideration all relevant factors, including the availability of the securities involved in the transaction, the expense of executing or filling the customer's order, the value of the services rendered by the broker, dealer or municipal securities dealer, and the amount of any other compensation received or to be received by the broker, dealer, or municipal securities dealer in connection with the transaction.

### *MSRB INTERPRETATIONS*

#### INTERPRETIVE NOTICE ON PRICING OF CALLABLE SECURITIES

August 10, 1979

The Municipal Securities Rulemaking Board (the "Board") has recently been considering various matters relating to transactions in municipal securities which may be called prior to maturity. In this connection, the Board filed with the Securities and Exchange Commission on June 6, 1979 certain proposed amendments to rule G-15 on customer confirmations. (See Notice G-15:79:4). These proposed amendments would require that additional information be shown on customer confirmations for transactions in callable securities. The Board also has a continuing concern in this area regarding the pricing of callable securities in sale transactions with customers. As explained below, the Board believes that certain pricing practices in such transactions may violate rule G-30, which requires municipal securities professionals to effect transactions at a fair and reasonable price.

The Board is concerned primarily with the situation in which a municipal securities dealer sells callable securities to customers on the basis of a stated yield to a specified call feature, whether the sale is effected on the basis of a yield price or dollar price. In such cases, the dealer affecting the transaction may do so at a yield appropriate for securities of a comparable quality with a maturity date the same as, or close to, the date of possible exercise of the call feature. The securities are sold at a price which, in effect, assumes that the specific call feature will be exercised. If the call provision is not exercised, however, the customer may realize at maturity a yield on the securities which is substantially less than the yield of non-callable securities of similar quality and maturity. In certain instances, this differential may be quite significant.

The Board therefore believes that a municipal securities dealer in pricing securities on the basis of yield to a specified call feature should take into account the possibility that the call feature may not be exercised. Accordingly, the price to be paid by a customer should reflect this possibility and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in such manner may constitute a violation of rule G-30, since the price may not be "fair and reasonable" in the event the call feature is not exercised. The fact that a customer in these circumstances may realize a yield in excess of the yield at which the transaction was effected does not relieve a municipal securities professional of its responsibility under rule G-30.

#### REPUBLICATION OF SEPTEMBER 1980, REPORT ON PRICING

October 3, 1984

In September 1980, the Board issued a report on the establishment of pricing guidelines under rule G-30 on prices and commissions. At that time the Board discussed the relevant factors in determining the fairness of prices and specifically declined to adopt pricing guidelines. The Board is reprinting its Report on Pricing in response to inquiries indicating confusion whether there are pricing guidelines in effect for the municipal securities industry.

**Report on Pricing**

September 26, 1980

Rule G-30 requires municipal securities professionals to effect transactions with customers at fair and reasonable prices. In a notice dated January 4, 1980, the Board indicated its concern that additional guidance under the rule might be necessary and suggested that one possible course would be to develop specific numeric guidelines. The Board solicited the views of interested parties in the Notice regarding the desirability of taking such a course. As a point of departure for discussion, a "band" of 1 point to 2 ½ points was put forth as a possible guideline.

In addition to soliciting written comments, the Board also held several open meetings at which prepared statements were presented, and the Board discussed the subject directly with the audiences. These open meetings were held at the Dealer Bank Association Annual Meeting in Rancho Mirage, California (January 31), New York City (March 12), Kansas City, Missouri (April 14), and Seattle, Washington (July 16).

After considering the comments of the industry and other interested persons in response to the Notice, the Board is of the view that setting specific numeric guidelines would not be feasible, in view of the heterogeneous nature of municipal securities transactions and municipal securities dealers. The Board believes that its goal in rule G-30 of promoting customer protection in the pricing area can be achieved through other means. The actions which the Board intends to take are set forth below.

The Board believes that the comment process has served several worthwhile purposes. First, the Notice resulted in focusing the attention of the industry on the matter of pricing practices. The Board is of the view that one salutary effect of this has been to increase the sensitivity of individual municipal securities dealers to this important issue. Second, the comments of the industry served to identify and highlight various factors which may be relevant in making pricing determinations. Third, the comments provided important insights into pricing practices of the industry which should increase the understanding of the regulatory agencies and thereby prove valuable to them in conducting examinations. Finally, the comments were important in helping the Board decide on the actions it would take in the pricing area.

### Comments on Pricing Proposal

The Board was extremely gratified by the extent of the response to the Notice. The Board received over 100 comment letters from different types of municipal securities dealers and from all sections of the country, as well as from other regulatory bodies and industry trade organizations. The comment letters in general reflected substantial deliberation and great care in preparation. In addition, commentators at the open meetings and at other meetings provided valuable input to the Board on this subject. The Board wishes to take this opportunity to express its appreciation to all of these commentators.

Most of the commentators expressed opposition to the idea of developing specific numeric guidelines. They suggested that such guidelines would be impractical, inappropriate and unworkable in light of the heterogeneous nature of the municipal markets. In this regard, the commentators emphasized the many differences in the types of municipal securities transactions, the size of transactions, the quality and maturities of municipal securities, the nature of the services provided by municipal securities dealers and the pricing practices of municipal securities dealers in different areas. Many commentators also suggested that specific numeric guidelines would either be too restrictive and thus adversely affect the market for certain types of securities (*e.g.*, local non-rated issues), or be too liberal and thus encourage prices higher than those which would result from the operation of market forces.

Although the majority of the commentators expressed opposition to the establishment of guidelines, several commentators expressed support for them. They suggested that guidelines were necessary to provide municipal securities professionals and the regulatory agencies with greater certainty as to what constitutes a "fair and reasonable" price under rule G-30. Certain commentators endorsed the concept of pricing guidelines as a means of ensuring equal regulation of all participants in the municipal markets.

Several commentators expressed support for the concept of guidelines, but suggested that the Board should adopt different benchmarks or separate sets of benchmarks for different size transactions or types of securities.[1] Others suggested that the benchmarks should be limited to "riskless" transactions, contemporaneous transactions, or both.

Many commentators acknowledged that there may be a need to augment rule G-30, but opposed the development of pricing guidelines. These commentators suggested a variety of alternative approaches, several of which the Board intends to pursue.

As indicated above, the Board believes that the comment process was of value because, among other reasons, it provided important insights into the pricing practices of the industry which should increase the understanding of the regulatory agencies and prove valuable to them in conducting examinations. In this connection, the Board intends to provide to the regulatory agencies copies of all the written comments and the transcripts of the open meetings. The Board will also provide copies of these materials to any other interested parties, upon request.

### Relevant Factors in Determining the Fairness of Prices

Rule G-30 requires municipal securities professionals to charge customers fair and reasonable prices, taking into account all relevant factors, including several specifically enumerated in the rule. The factors cited in the rule are "the best judgment of the [municipal securities professional] as to the fair market value of the securities at the time of the transaction..., the expense involved in effecting the transaction, the fact that the [municipal securities professional] is entitled to a profit, and the total dollar amount of the transaction." In addition, the Board has identified and discussed in notices on Rule G-30 a number of other factors which might be relevant in determining the fairness and reasonableness of prices in municipal securities transactions. These factors include the availability of the security in the market, the price or yield of the security, the maturity of the security, and the nature of the professional's business. *See* Notices dated September 20, 1977 and October 28, 1978.

Of the many possible relevant factors, the Board continues to be firmly of the view that the resulting yield to a customer is the most important one in determining the fairness and reasonableness of price in any given transaction. Such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market. This point was stressed in the Notice.

In the Notice, the Board specifically requested comment from the industry on the relevance of the factors previously identified by the Board, and solicited suggestions of other possible factors to be considered in making pricing determinations.

Many commentators expressed agreement with the Board's position that yield is of paramount importance in making pricing determinations, some of them even suggesting that it should be the only test. They emphasized the importance of comparing yields in view of the fact that most municipal securities are traded on a yield basis and suggested that focusing on yield, rather than on the amount of compensation, is appropriate.[2]

Other factors noted by commentators included the rating of the securities involved in a transaction, the fact that there may be an active sinking fund for the securities, and the trading history. This last factor could encompass such matters as the degree of market activity for the securities and the existence or non-existence of market-makers in the securities.

The single factor which was cited most often by commentators concerned the right of municipal securities dealers to be compensated for services provided to customers. The general thrust of these comments was that municipal securities dealers often expend considerable time, effort, and money in providing services to a customer, and that this ought to be taken into account in considering the fairness and reasonableness of prices in given transactions. These services may include researching credits, maintaining markets in, and current information about issues previously sold to customers, and other similar activities.

The Board believes that all of the additional factors identified by the commentators and described above may be relevant in making pricing determinations in particular cases.

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[1] One common misunderstanding shared by several commentators was that the pricing policy of the National Association of Securities Dealers, Inc. (the "NASD") for corporate securities (the so-called 5% policy) applies to municipal securities transactions. As a general matter, the NASD's rules of fair practices do not apply to municipal securities transactions. Accordingly, the "5% policy" does not apply to municipal securities transactions.

[2] The Board notes that the amendments to rule G-15 on customer confirmations which are scheduled to become effective on December 1, 1980 will significantly expand the yield information made available to customers with respect to their municipal securities transactions. The Board believes that this will assure broad dissemination of yield information on various types of securities, enhance a customer's ability to compare yields among securities, and promote the use of yield information for purposes of price evaluation.

## INTERPRETIVE NOTICE ON COMMISSIONS AND OTHER CHARGES, ADVERTISEMENTS AND OFFICIAL STATEMENTS RELATING TO MUNICIPAL FUND SECURITIES

December 19, 2001

The Municipal Securities Rulemaking Board ("MSRB") has received various inquiries regarding commissions, disclosures (including delivery of disclosure materials to the MSRB) and advertisements relating to municipal fund securities, particularly in connection with sales of interests in so-called Section 529 college savings plans.[1] The nature of the commissions and other program fees that may exist with respect to municipal fund securities may differ significantly from such charges that typically may exist for traditional debt securities sold in the municipal securities market. In many

cases, commissions and other fees may more closely resemble those charged in connection with investment company securities registered under the Investment Company Act of 1940 (the "Investment Company Act"). [2] Although commissions and fees charged by brokers, dealers and municipal securities dealers ("dealers") effecting transactions in municipal fund securities are subject to MSRB rules, the nature and level of fees and charges collected by other parties in connection with such securities generally are not subject to regulation. However, under certain circumstances, a dealer selling municipal fund securities may be obligated to disclose to customers such fees and charges collected by other parties.

**Amount of Dealer's Commissions or Service Charges**

Rule G-30(b), on prices and commissions in agency transactions, prohibits dealers from selling municipal securities to a customer for a commission or service charge in excess of a fair and reasonable amount. In assessing the fairness and reasonableness of the commission or service charge, the rule permits the dealer to take into consideration all relevant factors, including the availability of the securities involved in the transaction, the expense of executing or filling the customer's order, the value of the services rendered by the dealer, and the amount of any other compensation received or to be received by the dealer in connection with the transaction. The MSRB has received inquiries as to whether the sales charge schedule set out in Rule 2830 of the National Association of Securities Dealers, Inc. ("NASD") applies to or otherwise is indicative of the levels of commissions and other fees that dealers may charge in connection with sales of municipal fund securities.

MSRB rules, not those of the NASD, apply to sales by dealers of municipal securities, including municipal fund securities. NASD Rule 2830 provides that no member firm may offer or sell shares in investment companies registered under the Investment Company Act if the sales charges are excessive. The NASD rule then sets forth various levels of aggregate sales charges to which member firms must conform, depending upon the nature of the investment company's sales charges, in order to ensure that such sales charges are not deemed excessive. The MSRB notes that the NASD derives its authority for the sales charge provisions of Rule 2830 from Section 22(b)(1) of the Investment Company Act, which expressly exempts such provisions from the limitation that Section 15A(b)(6) of the Securities Exchange Act of 1934 (the "Exchange Act") places on the NASD's ability to adopt rules that "impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by its members." In sharp contrast, no exemption exists from the limitations that Section 15B(b)(2)(C) of the Exchange Act places on the MSRB's ability to adopt rules that "impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by municipal securities brokers or municipal securities dealers." The MSRB believes that it could not, by rule or interpretation, in effect impose such a schedule for the sale of municipal fund securities.

Nonetheless, the MSRB believes that the charges permitted by the NASD under its Rule 2830 in connection with the sale of registered investment company securities may, depending upon the facts and circumstances, be a significant factor in determining whether a dealer selling municipal fund securities is charging a commission or other fee that is fair and reasonable. For example, the MSRB believes that charges for municipal fund securities transactions in excess of those permitted for comparable mutual fund shares under NASD Rule 2830 may be presumed to not meet the fair and reasonable standard under MSRB rule G-30(b), although the totality of the facts and circumstances relating to a particular transaction in municipal fund securities may rebut such presumption. Further, depending upon the specific facts and circumstances, a sales charge for a transaction in a municipal fund security that would be deemed in compliance with NASD Rule 2830 if charged in connection with a transaction in a substantially identical registered investment company security often will be in compliance with rule G-30(b).

However, the NASD schedule is not dispositive nor is it always the principal factor in determining compliance with rule G-30. The MSRB believes that the factors enunciated in rule G-30(b) and other relevant factors must be given due weight in determining whether a commission is fair and reasonable. These factors include, but are not limited to, the value of the services rendered by the dealer and the amount of any other compensation received or to be received by the dealer in connection with the transaction from other sources (such as the issuer). A dealer may not exclusively rely on the fact that its commissions fall within the NASD schedule, particularly where commission levels in the marketplace for similar municipal fund securities sold by other dealers providing similar levels of services are generally substantially lower than those charged by such dealer, taking into account any other compensation.

**Disclosure of Program Fees and Charges of Other Parties**

MSRB rules do not explicitly require disclosure by dealers of fees and charges received by other parties to a transaction. These can include, among other things, administrative fees of the issuer, investment adviser and other parties payable from trust assets or directly by the customer. However, depending upon the facts and circumstances, certain MSRB rules may have the practical effect of requiring some level of disclosure of such fees and charges to the extent that they are material. For example, rule G-32(a)(i) generally obligates the dealer to provide an official statement to its customer in connection with sales of municipal fund securities. Although MSRB rules do not govern the content of the disclosures included by the issuer in the official statement, the MSRB believes that an official statement prepared by an issuer of municipal fund securities that is in compliance with Exchange Act Rules 10b-5 and 15c2-12 generally would provide disclosure of any fees or other charges imposed in connection with such securities that are material to investors. The MSRB further believes that, in most respects, the disclosures provided by the issuer in the official statement would provide the dealer with the type of information it is required to disclose to customers under the MSRB's fair dealing rule, rule G-17.

**Advertisements**

Dealer advertisements of municipal fund securities must comply with the requirements of rule G-21.[3] This rule prohibits dealers from publishing advertisements concerning municipal securities which they know or have reason to know are materially false or misleading. The MSRB has previously stated that any use of historical yields in an advertisement would be subject to this prohibition. Thus, a dealer advertisement of municipal fund securities that refers to yield typically would require a description of the nature and significance of the yield shown in the advertisement in order to assure that such advertisement is not false or misleading. Further, depending upon the facts and circumstances, a dealer may be required to disclose information regarding a fee or other charge relating to municipal fund securities that may have a material effect on such advertised yield, to the extent that such disclosure is necessary to ensure that the advertisement is not materially false or misleading with respect to such yield.

The MSRB understands that advertisements and other sales material relating to registered investment company securities are, depending upon the nature of the advertisement, subject to the requirements of Securities Act Rule 156, on investment company sales literature, Securities Act Rule 482, on advertising by an investment company as satisfying requirements of section 10, and NASD Rule 2210, on communications with the public (including IM-2210-3, on use of rankings in investment companies advertisements and sales literature), among others. The MSRB notes that both Securities Act Rule 156(a) and NASD Rule 2210(d)(1)(A) include general standards for advertisements that are substantially the same as the standard set forth in MSRB rule G-21. As a result, the MSRB believes that a dealer advertisement of municipal fund securities that would be compliant

with Securities Act Rules 156 and 482 if such securities were registered investment company securities also would be in compliance with MSRB rule G-21. Further, the MSRB believes that a dealer advertisement of municipal fund securities that would be compliant with NASD Rule 2210 and IM-2210-3 if such securities were registered investment company securities also would be in compliance with MSRB rule G-21.

**Submission of Official Statements to the MSRB**

Dealers selling municipal fund securities are subject to the requirement under rule G-36 that they submit copies of the official statement, together with completed Form G-36(OS), to the MSRB. In some cases, a dealer that has been engaged by an issuer of municipal fund securities to serve as its primary distributor ("primary distributor") has in turn entered into relationships with one or more other dealers to provide further channels for distribution. These other dealers may include dealers that effect transactions directly with customers ("selling dealers") or dealers that provide "wholesale" distribution services but do not effect transactions directly with customers ("intermediary dealers").

The MSRB believes that, regardless of whether a formal syndicate or similar account has been formed among a primary distributor, the selling dealers and any intermediary dealers in a multi-tiered distribution system for a particular offering of municipal fund securities, the primary distributor for such offering has the responsibility set forth in rule G-36(f) to undertake all actions required under the provisions of rule G-36 and the corresponding recordkeeping requirements under rule G-8(a)(xv). These obligations include, but are not limited to, the submission of official statements (including amendments and up-dates) and completed Form G-36(OS) to the MSRB on a timely basis. The MSRB further believes that any selling or intermediary dealers for such offering that might be considered underwriters of the securities may rely upon the primary distributor to undertake these actions to the same extent as if they had in fact formed an underwriting syndicate as described in rule G-36(f).

[1] Section 529 college savings plans are higher education savings plan trusts established by states under section 529(b) of the Internal Revenue Code as "qualified state tuition programs" through which individuals make investments for the purpose of accumulating savings for qualifying higher education costs of beneficiaries.

[2] Municipal fund securities are exempt from the registration and other provisions of the Investment Company Act.

[3] Rule G-21 defines advertisement as any material (other than listings of offerings) published or designed for use in the public, including electronic, media or any promotional literature designed for dissemination to the public, such as notices, circulars, reports, market letters, form letters, telemarketing scripts or reprints or excerpts of the foregoing. The term does not apply to official statements but does apply to abstracts or summaries of official statements, offering circulars and other similar documents prepared by dealers.

**See also:**

**Rule G-17 Interpretations – Application of Board Rules to Transactions in Municipal Securities Subject to Secondary Market Insurance or Other Credit Enhancement Features,** March 6, 1984.

**– Notice Concerning the Application of Board Rules to Put Option Bonds,** September 30, 1985.

## *Interpretive Letters*

**Factors in pricing.** This is in response to your letter concerning the pricing of municipal securities by a syndicate or selling group member. You ask about the appropriateness of mark-ups when market conditions have improved and also about prices for sales to institutional versus retail customers.

Rule G-30(a) prohibits a dealer from executing any customer transaction except at an aggregate price (including any mark-up or mark-down) that is fair and reasonable, taking into account all relevant factors, including the best judgment of the dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction, the expense involved in effecting the transaction, the fact that the dealer is entitled to a profit, and the total dollar amount of the transaction. Rule G-30 does not specifically mention new offering prices which may be set by the syndicate[1] or the issuer. Compliance with rule G-30 is thus determined by whether the price to a customer is fair and reasonable, taking into account all relevant factors. The Board's 1980 "Report on Pricing" provides guidance in making this judgment.[2]

> In its Report, the Board stated that, of the many possible relevant factors,
>
> the resulting yield to the customer is the most important one in determining the fairness and reasonableness of price in any given municipal securities transaction. Such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and the block size then available in the market.

"Improved market conditions," in this sense, may thus be a relevant factor in determining a fair and reasonable price.

You ask about the pricing of bonds for institutional customers and for retail customers. Rule G-30 specifically states that the total dollar amount of the transaction is a relevant factor in determining a fair and reasonable price. To the extent that institutional transactions are often larger transactions than retail transactions, this factor may enter in to the fair and reasonable pricing of retail versus institutional transactions. *MSRB interpretation of November 29, 1993.*

[1] Syndicate members should, of course, be aware of any syndicate documents regarding the offering of securities at a specific offering price.

[2] I have enclosed a copy of the Report. Over the years, the Board has stated that this list of relevant factors is not all-inclusive, and that other factors may play a role in determining whether a particular price is fair and reasonable. Such other factors (which are in addition to the factors cited in the rule) include the availability of the security, the price or yield, maturity, and the nature of the professional's business.

**Differential re-offering prices.** This is in response to your letter in which you ask us to provide interpretive guidance on MSRB rules G-21, G-30 and G-32 in the context of a proposed new system (the "System") to be established by your client (the "Company") for pricing and distribution of primary market municipal securities to retail investors. You provide a description of the System, including a discussion of incremental changes through various versions of the System. We have included below a brief summary of the MSRB's understanding of certain key features of the System that may be relevant in responding to your questions. **This should not be construed as meaning that the MSRB has "approved" the System, or even reviewed the System description which you provided, except for the limited purpose of addressing your specific questions on the three rules noted above. The MSRB expresses no views and has not considered whether the System as you describe it, or whether a broker-dealer using the System, would be in compliance with MSRB rules or other applicable law, rules or regulations, beyond the specific statements set forth herein on these three rules.**

As you describe it, the System consists of an internet-based electronic primary market order matching process that will provide (1) electronic notices ("Electronic Notices") to registered representatives at subscribing broker-dealer firms and (2) an ability to establish a range of acceptable reoffering prices for each order of primary market municipal securities. Registered representatives will provide to the System profiles ("Retail Inquiries") that describe the features of municipal securities that the registered representative's customers wish to purchase. The System

will then automatically advise the registered representatives of the availability for purchase of a new municipal security issue that matches the Retail Inquiry by sending an Electronic Notice by fax or e-mail. The Company intends to register with the Securities and Exchange Commission as a broker-dealer prior to charging subscription fees for the services provided by the System. We understand that, for purposes of the System, a retail investor is characterized solely by the size of the order, rather than by the identity of an investor as a retail or institutional customer.

Municipal securities available for purchase through the System will be sold using a structure that establishes a range of acceptable retail reoffering prices. For each new issue, the underwriter and the issuer will establish a maximum and minimum yield and a maximum and minimum price to be entered into the System. For all Retail Inquiries that match the basic parameters of the issue (*e.g.*, maturity, rating, state of issuer), the System will send an Electronic Notice to each registered representative that adjusts the price to include the least of the registered representative's desired mark-up, the maximum mark-up established by the registered representative's broker-dealer firm, or the maximum issue mark-up established by the underwriter. In the System's initial stages, a registered representative may place an order for amounts up to $500,000 to purchase the securities upon receiving an Electronic Notice. You note that use of the System will permit sales of municipal securities of the same maturity and order size to different buyers at different prices.

You state that you believe that the business and operating plan for the System will be in compliance with all published MSRB rules and that broker-dealers subscribing to the System will not violate any MSRB rules by virtue of their use of the System. You request clarification regarding the applicability of certain provisions of rules G-21, G-30 and G-32 to broker-dealers using the System. As noted above, the MSRB cannot provide an "approval" of a proposed system or of its use by broker-dealers. We can, however, provide some guidance regarding your specific rule-related interpretive requests. Since the application of rules to particular factual situations is, by its nature, fundamentally dependent upon the specific facts and circumstances, you should be cognizant of the precise nature of our guidance and of the potential for seemingly small factual variances resulting in different conclusions regarding compliance with our rules.

**Rule G-30, on Prices and Commissions**

You ask us whether we view use of the System by broker-dealers to establish a range of reoffering prices (instead of a single reoffering price) as compliant with the requirement under rule G-30, on prices and commissions, that municipal securities prices be fair and reasonable. We cannot provide you with assurance that under all circumstances prices charged to customers by broker-dealers using the System will comply with rule G-30. However, the following discussion should provide some guidance in assessing whether broker-dealers using the System will be able to comply with rule G-30.

Rule G-30(a) provides that no broker-dealer shall sell municipal securities to a customer in a principal transaction except at a price that is fair and reasonable, taking into consideration all relevant factors.[1] The rule cites, as relevant factors, the best judgment of the broker-dealer as to the fair market value of the securities at the time of the transaction, the expense involved in effecting the transaction, the fact that the broker-dealer is entitled to a profit, and the total dollar amount of the transaction.[2] In addition, the MSRB has identified a number of other factors which might be relevant in determining the fairness and reasonableness of prices in municipal securities transactions. These additional factors include, but are not limited to, the availability of the security in the market, the price or yield of the security, the maturity of the security, and the nature of the professional's business.[3] The MSRB firmly believes that the resulting yield to the customer is the most important factor in determining the fairness and reasonableness of a price in any given transaction. The MSRB previously has stated that such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market.

Although a comparative yield assessment is the most important factor in determining whether a transaction price is fair and reasonable, rule G-30 states that other facts and circumstances of a specific transaction may also enter into the final determination of whether the transaction price is fair and reasonable. Thus, rule G-30 clearly contemplates the possibility that, depending upon the facts and circumstances of two contemporaneous transactions in identical securities, both transactions may be priced in compliance with rule G-30 even though the prices are not identical. It is not possible to state a specific percentage of variance between prices on contemporaneous transactions that would create a presumption of a violation of rule G-30 with respect to the higher priced transaction since a number of different factors may be relevant to the individual transactions.[4] However, the degree to which price variances may occur without raising the presumption of a rule G-30 violation generally would parallel the level of variance in the relevant factors under rule G-30 from transaction to transaction in the same security. For example, a large difference in the par value of two transactions could potentially justify a larger price difference than would a small difference in the par value of the two transactions.

The MSRB has stated that, although rule G-30 does not specifically mention new issue offering prices which may be set by the syndicate or the issuer, compliance with rule G-30 in this context also is determined by whether the price of a municipal security is fair and reasonable, taking into account all relevant factors.[5] As noted above, a comparative yield assessment is the most important factor in determining the fairness and reasonableness of a transaction price. Although it is the ultimate responsibility of the broker-dealer effecting a transaction with a customer to ensure that the price is in compliance with rule G-30, the issuer and underwriter may help broker-dealers using the System to avoid possible violations of rule G-30 by carefully reviewing the ranges of yields and prices entered by the underwriter into the System to ensure that the net yield to customers[6] would be comparable to that of similar securities regardless of where within the established ranges a transaction is executed by a broker-dealer using the System.

**Rule G-32, on Disclosures in Connection with New Issues**

You provide us with a sample of proposed language to be included in the official statement for new issue municipal securities to be sold using the System. This language indicates the lowest price at which any of the securities in the new issue are offered and also indicates a range of maximum prices at which the securities are offered based on various lot sizes of the securities sold in a particular transaction. The language further states that, subject to the practices of each broker-dealer firm in the selling group, investors may have purchased the securities at prices lower than those shown in the range of maximum prices included in the official statement. Finally, the language provides a specific dollar amount representing the total compensation paid to the underwriter as representative of the selling group. You ask us whether inclusion of such language in the official statement by issuers using the System complies with rule G-32.

Rule G-32(a)(ii) provides that, in connection with new issue municipal securities purchased by the underwriter in a negotiated sale, any broker-dealer selling such securities to a customer must deliver to the customer by no later than settlement information regarding, among other things, the underwriting spread and the initial offering price for each maturity in the issue, including maturities that are not reoffered.[7] The MSRB has stated that the obligation

to disclose the underwriting spread requires that the broker-dealer disclose the difference between the initial offering price of the new issue and the amount paid by the underwriter to the issuer, expressed either in dollars or points per bond.[8] The MSRB has prohibited broker-dealers from merely disclosing to customers the offering prices and amount paid to the issuer and describing how the underwriting spread can be calculated from these figures.[9] The MSRB has stated that initial offering prices may be expressed either in terms of dollar price or yield.[10]

The MSRB recognizes that disclosure of initial offering prices and underwriting spread is more complicated in circumstances where securities of the same maturity may be offered at a number of different prices, as compared to the typical situation where each maturity is stated to be offered at a single price. The MSRB believes that, under these circumstances, the initial offering prices and underwriting spread may be expressed as a range of values.

In expressing the initial offering prices as a range of values, broker-dealers must ensure that the prices at which the securities are initially offered to customers will fall within the expressed range. At the same time, the MSRB believes that the disclosure of a range of prices must not be misleading to customers. For example, a range that implies that a market may exist at prices where in fact no transactions are likely to occur could be misleading. In addition, a range that includes prices that are not fair and reasonable for purposes of rule G-30 could mislead customers with regard to what would in fact constitute a fair and reasonable price. These and other practices arising in connection with the disclosure of a range of initial offering prices could constitute violations of rule G-17[11] and would not satisfy the disclosure obligation under rule G-32. Broker-dealers are cautioned, when using a range to disclose initial offering prices, to make such range as narrow as reasonably possible in order to avoid violations of rules G-17 and G-32. For example, if broker-dealers have established discrete price ranges for specific securities within the issue (*e.g.*, separate maturities) or for specific types of transactions (*e.g.*, different lot sizes), they should include such discrete ranges in the disclosure made to customers. The initial offering price range must be expressed either in terms of dollar prices or yields.

In expressing the underwriting spread as a range of values, the range must be no broader than would be obtained by calculating the lowest possible spread based on all of the lowest initial offering price values and the highest possible spread based on all of the highest initial offering price values. This range should be further refined based on specific information available to the broker-dealer (*e.g.*, minimum or maximum spreads agreed to between the issuer and the underwriter, fixed components of the gross spread, known levels of transactions at particular prices, etc.).[12] Broker-dealers may show this spread range either as a range of a total amount or as a listing of the components of the spread range. If components of the spread range are listed, that portion of the range which represents compensation to the underwriter must be clearly identified as such. The spread range must be expressed either in dollars or points per bond.

**Rule G-21, on Advertising**

You state that you do not believe that Electronic Notices constitute advertisements within the meaning of rule G-21, which sets forth certain requirements with respect to advertisements of municipal securities. An advertisement is defined as any material (other than listings of offerings) published or designed for use in the public, including electronic, media or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter, telemarketing script or reprint or excerpt of the foregoing. The rule covers communications that are intended to reach a broad segment of the public rather than individually tailored communications between two specific parties and communications between broker-dealers. Thus, if the use of Electronic Notices is limited in the manner you describe in your letter, it appears that such Electronic Notices would not constitute advertisements within the meaning of rule G-21. However, we express no opinion as to whether Electronic Notices might constitute advertisements if they were to be disseminated to investors.

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I must emphasize once again that the guidance provided in this letter cannot be considered an "approval" of the System. Further, this guidance cannot be considered to provide or imply that broker-dealers using the System will, under all circumstances, be in compliance with the rules discussed herein. Nor can this guidance be considered to provide or imply that the operation of the System or the use of the System by broker-dealers is in compliance with any other rules of the MSRB or the laws, rules or regulations of any other entity. MSRB *interpretation of December 11, 2001.*

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[1] In the case of an agency transaction, rule G-30 prohibits a broker-dealer from selling a municipal security to a customer for a commission or service charge in excess of a fair and reasonable amount, taking into consideration all relevant factors. In addition, rule G-18, on execution of transactions, requires that a broker-dealer in an agency transaction make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions. Since we understand that broker-dealers that use the System ultimately will effect transactions with their customers on a principal basis, we do not address potential compliance issues with respect to agency transactions arising under rules G-18 and G-30.

[2] With respect to total dollar amount of a transaction, the MSRB has stated that, to the extent that institutional transactions are often larger than retail transactions, this factor may enter into the fair and reasonable pricing of retail versus institutional transactions. *See* Rule G-30 Interpretive Letter – Factors in pricing, November 29, 1993, MSRB *Rule Book* (July 1, 2001) at 163 (the "Pricing Letter").

[3] *See* Rule G-30 Interpretation – Republication of September 1980 Report on Pricing, MSRB *Rule Book* (July 1, 2001) at 161 (the "Pricing Report").

[4] Of course, the existence of a variance in the prices of two contemporaneous sale transactions in the same security would be less likely to raise a presumption that the higher priced transaction violates rule G-30 if the yields for both transactions are generally higher than for most other comparable securities in the market.

[5] *See* Pricing Letter. It is worth noting that the rules of the National Association of Securities Dealers regarding fixed-price offerings do not apply to transactions in municipal securities. The MSRB is not aware of any law or regulation which purports to require fixed-price offerings for new issue municipal securities. *See* Rule G-11 Interpretive Letter – Fixed-price offerings, March 16, 1984, MSRB *Rule Book* (July 1, 2001) at 60.

[6] The net yield to a customer is based on actual money paid by the customer, including the effect of any remuneration paid to the broker-dealer, other than certain miscellaneous transaction fees. *See* Rule G-15 Interpretation – Notice Concerning Flat Transaction Fees, June 13, 2001, MSRB *Rule Book* (July 1, 2001) at 114; Rule G-15 Interpretation – Notice Concerning Confirmation Disclosure of Miscellaneous Transaction Charges, May 14, 1990, MSRB *Rule Book* (July 1, 2001) at 113.

[7] This information may be disclosed in the official statement if it is delivered to the customer in a timely manner at or prior to settlement. This information may also be provided in a separate written statement.

[8] Spread may be shown as a single figure or as a listing of the components of the spread. If components are listed, the portion of the proceeds representing compensation to the underwriter must be clearly identified as such. *See* Rule G-32 Interpretation – Notice Regarding the Disclosure Obligations of Brokers, Dealers and Municipal Securities Dealers in Connection with New Issue Municipal Securities Under Rule G-32, MSRB *Rule Book* (July 1, 2001) at 166 (the "Disclosure Notice"); Rule G-32 Interpretive Letter – Disclosure of underwriting spread, March 9, 1981, MSRB *Rule Book* (July 1, 2001) at 173.

[9] *See* Disclosure Requirements for New Issue Securities: Rule G-32, MSRB *Reports*, Vol. 7, No. 2 (March 1987) at 11.

[10] *See* Disclosure Notice; Rule G-32 Interpretive Letter – Disclosures in connection with new issues, December 22, 1993, MSRB *Rule Book* (July 1, 2001) at 174.

[11] Rule G-17 requires broker-dealers to deal fairly with all persons and not to engage in any deceptive, dishonest or unfair practice.

[12] Of course, if the new issue has been fully sold and all initial offering prices are known at the time the disclosure information is prepared, an exact amount rather than a range should be used in disclosing the underwriting spread.

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**See also:**

**Rule G-8 Interpretive Letter – Time of receipt and execution of orders,** MSRB *interpretation of April 20, 1987.*

Rule G-11 Interpretive Letter – Fixed-price offerings, *MSRB interpretation of March 16, 1984.*

Rule G-15 Interpretive Letters –Callable securities: pricing to mandatory sinking fund calls, *MSRB interpretation of April 30, 1986.*

– Disclosure of pricing: calculating the dollar price of partially prerefunded bonds, *MSRB interpretation of May 15, 1986.*

Rule G-17 Interpretive Letter – Put option bonds: safekeeping, pricing, *MSRB interpretation of February 18, 1983.*

Rule G-21 Interpretive Letter – Disclosure obligations, *MSRB interpretation of May 21, 1998.*

Rule G-25 Interpretive Letter – Retroactive price adjustment for early redemption, *MSRB interpretation of January 31, 1986.*

## Rule G-31: Reciprocal Dealings with Municipal Securities Investment Companies

No broker, dealer, or municipal securities dealer shall solicit transactions in municipal securities with or for the account of an investment company as defined in the Investment Company Act of 1940, as compensation or in return for sales by such broker, dealer, or municipal securities dealer of participations, shares, or units in such investment company.

## Rule G-32: Disclosures in Connection with New Issues

(a) *Customer Disclosure Requirements.* No broker, dealer or municipal securities dealer shall sell, whether as principal or agent, any new issue municipal securities to a customer unless such broker, dealer or municipal securities dealer delivers to the customer no later than the settlement of the transaction:

(i) a copy of the official statement in final form prepared by or on behalf of the issuer or, if an official statement in final form is not being prepared by or on behalf of the issuer, a written notice to that effect together with a copy of an official statement in preliminary form, if any; *provided, however,* that:

(A) if a customer who participates in a periodic municipal fund security plan or a non-periodic municipal fund security program has previously received a copy of the official statement in final form in connection with the purchase of municipal fund securities under such plan or program, a broker, dealer or municipal securities dealer may sell additional shares or units of the municipal fund securities under such plan or program to the customer if such broker, dealer or municipal securities dealer sends to the customer a copy of any new, supplemented, amended or "stickered" official statement in final form, by first class mail or other equally prompt means, promptly upon receipt thereof; provided that, if the broker, dealer or municipal securities dealer sends a supplement, amendment or sticker without including the remaining portions of the official statement in final form, such broker, dealer or municipal securities dealer includes a written statement describing which documents constitute the complete official statement in final form and stating that the complete official statement in final form is available upon request; or

(B) if an official statement in final form is being prepared for new issue municipal securities issued in a primary offering that qualifies for the exemption set forth in paragraph (iii) of section (d)(1) of Securities Exchange Act Rule 15c2-12, a broker, dealer or municipal securities dealer may sell such new issue municipal securities to a customer if such broker, dealer or municipal securities dealer:

(1) delivers to the customer no later than the settlement of the transaction a copy of an official statement in preliminary form, if any, and written notice that the official statement in final form will be sent to the customer within one business day following receipt thereof by the broker, dealer or municipal securities dealer, and

(2) sends to the customer a copy of the official statement in final form, by first class mail or other equally prompt means, no later than the business day following receipt thereof by the broker, dealer or municipal securities dealer;

(C) if two or more customers share the same address, a broker, dealer or municipal securities dealer may satisfy the delivery obligations set forth in this section (a)(i) by complying with the requirements set forth in Rule 154 of the Securities Act of 1933, on delivery of prospectuses to investors at the same address. In addition, any such broker, dealer or municipal securities dealer shall comply with paragraph (c) of Rule 154, on revocation of consent, if subject to the delivery requirements in section (a)(i)(A) of this rule, concerning a customer who participates in a periodic municipal fund security plan or a non-periodic municipal fund security program; and

(ii) in connection with a negotiated sale of new issue municipal securities, the following information concerning the underwriting arrangements:

(A) the underwriting spread, if any

(B) the amount of any fee received by the broker, dealer or municipal securities dealer as agent for the issuer in the distribution of the securities; *provided, however,* that if a broker, dealer or municipal securities dealer selling municipal fund securities provides periodic statements to the customer pursuant to rule G-15(a)(viii) in lieu of individual transaction confirmations, this paragraph (ii)(B) shall be deemed to be satisfied if the broker, dealer or municipal securities dealer provides this information to the customer at least annually and provides information regarding any change in such fee on or prior to the sending of the next succeeding periodic statement to the customer; and

(C) except with respect to an issue of municipal fund securities, 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, including maturities that are not reoffered.

(b) *Inter-Dealer Disclosure Requirements.* Every broker, dealer or municipal securities dealer shall send, upon request, the documents and information referred to in section (a) to any broker, dealer or municipal securities dealer to which it sells new issue municipal securities no later than the business day following the request or, if an official statement in final form is being prepared but has not been received from the issuer or its agent, no later than the business day following such receipt. Such items shall be sent by first class mail or other equally prompt means, unless the purchasing broker, dealer or municipal securities dealer arranges some other method of delivery and pays or agrees to pay for such delivery.

(c) *Responsibility of Managing Underwriters, Sole Underwriters and Financial Advisors.*

(i) *Managing Underwriters and Sole Underwriters.* When an official statement in final form is prepared by or on behalf

of an issuer, the managing underwriter or sole underwriter, upon request, shall send to all brokers, dealers and municipal securities dealers that purchase the new issue municipal securities an official statement in final form and other information required by paragraph (a)(ii) of this rule and not less than one additional official statement in final form per $100,000 par value of the new issue purchased by the broker, dealer or municipal securities dealer and sold to customers. Such items shall be sent no later than the business day following the request or, if an official statement in final form is being prepared but has not been received from the issuer or its agent, no later than the business day following such receipt. Such items shall be sent by first class mail or other equally prompt means, unless the purchasing broker, dealer or municipal securities dealer arranges some other method of delivery and pays or agrees to pay for such delivery. In addition, the managing underwriter or sole underwriter, upon request, shall provide all purchasing brokers, dealers and municipal securities dealers with instructions on how to order additional copies of the official statement in final form directly from the printer.

(ii) *Financial Advisors*. A broker, dealer or municipal securities dealer that, acting as financial advisor, prepares an official statement in final form on behalf of an issuer, shall make that official statement in final form available to the managing underwriter or sole underwriter promptly after the issuer approves its distribution.

(d) *Definitions*.

For purposes of this rule, the following terms have the following meanings:

(i) The term "new issue municipal securities" shall mean municipal securities that are sold by a broker, dealer or municipal securities dealer during the issue's underwriting period, but shall not include commercial paper.

(ii) The term "underwriting period" shall mean:

(A) for securities purchased from an issuer by a syndicate, the period defined in paragraph (a)(ix) of rule G-11, on sales of new issue municipal securities during the underwriting period; and

(B) for securities purchased from an issuer by one broker, dealer or municipal securities dealer, the period commencing with the first submission to the broker, dealer or municipal securities dealer of an order for the purchase of the securities or the purchase of such securities from the issuer, whichever first occurs, and ending at such time as the following two conditions both are met: (1) the issuer delivers the securities to the broker, dealer or municipal securities dealer, and (2) the broker, dealer or municipal securities dealer no longer retains an unsold balance of the securities purchased from the issuer or 21 calendar days elapse after the date of the first submission of an order for the securities, whichever first occurs.

(iii) the term "official statement" shall mean a document prepared by the issuer or its representatives setting forth, among other matters, information concerning the issuer and the proposed issue of securities. A notice of sale shall not be deemed to be an "official statement" for purposes of this rule.

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

## MSRB INTERPRETATIONS

### NOTICE REGARDING THE DISCLOSURE OBLIGATIONS OF BROKERS, DEALERS AND MUNICIPAL SECURITIES DEALERS IN CONNECTION WITH NEW ISSUE MUNICIPAL SECURITIES UNDER RULE G-32

November 19, 1998

In July 1998, the Securities and Exchange Commission ("SEC") approved two sets of amendments to rule G-32, on disclosures in connection with new issues. The first set of amendments permits brokers, dealers and municipal securities dealers ("dealers") that sell new issue variable rate demand obligations qualifying for the exemption provided under subparagraph (d)(1)(iii) of Securities Exchange Act Rule 15c2-12 to deliver the preliminary official statement, rather than the final official statement, to customers by settlement.[1] The second set of amendments strengthens the rule's existing requirements regarding dissemination of official statements to dealers purchasing new issue municipal securities and incorporates a longstanding Board interpretation regarding disclosure to customers of initial offering prices in negotiated underwritings.[2] In view of these recent amendments and the continuing concerns of the Board and the enforcement agencies that some dealers may have inadequate procedures in place to ensure compliance with rule G-32,[3] the Board is publishing this notice to review the requirements of the rule and to emphasize the importance of full and timely compliance.

**Purpose and Structure of Rule G-32**

Rule G-32 is designed to ensure that a customer who purchases new issue municipal securities is provided with all available information relevant to his or her investment decision by settlement of the transaction. The rule obligates all dealers selling new issue municipal securities to provide to their customers purchasing the securities certain disclosure materials by settlement. To effectuate this primary obligation, the rule further obligates all dealers that sell new issue municipal securities to other dealers, as well as the managing or sole underwriter for such securities, to provide to such purchasing dealers these disclosure materials so as to permit the purchasing dealers to comply with their primary delivery obligations to their own customers. Finally, the rule provides that a dealer that prepares an official statement in final form on behalf of an issuer while serving in the capacity of financial advisor to such issuer must make the official statement available to the underwriters promptly after the issuer approves its distribution. Compliance with each prong of the rule is crucial to ensure that the primary purpose of the rule is fulfilled.

**New Issue Municipal Securities and the Underwriting Period**

Rule G-32 applies to the sale of all new issue municipal securities.

These are defined in section (c)(i)[*] as any municipal securities (other than commercial paper[4]) that are sold by any dealer during the issue's underwriting period. Once the underwriting period has ended for an issue of municipal securities, the requirements of rule G-32 no longer apply to transactions in such municipal securities.

The underwriting period for an issue of municipal securities begins with the first submission to the underwriters of an order from a potential customer to purchase the securities or the purchase by the underwriters of the securities from the issuer (*i.e.*, the execution of the purchase contract in a negotiated sale or the award of the securities in a competitive sale), whichever occurs first. The underwriting period ends upon delivery by the issuer of the securities to the underwriters (*i.e.*, the bond closing) if the underwriters no longer retain an unsold balance at such time. If, however, the issue is not sold out by the bond closing, the underwriting period continues until the underwriters no longer retain an unsold balance; provided that, in the case of an issue underwritten by a sole underwriter, if the bond closing has occurred and the underwriter retains an unsold balance 21 calendar days after the first submission of an order, the underwriting period nonetheless ends after such 21st day.[5]

**Delivery obligations to customers**

A dealer selling new issue municipal securities to a customer is required to deliver (not merely send) certain information to such customer prior to settlement of the transaction. The Board has previously noted that the required information will be presumed to have been delivered to the customer if it was sent at least three business days prior to settlement.[6]

Official Statements. With only two exceptions, a dealer violates section (a) of rule G-32 if it sells, either as principal or agent, a new issue municipal security to a customer but fails to deliver an official statement in final form[7] to such customer by no later than settlement of that transaction. Dealers should note that this obligation differs from the obligation imposed by SEC Rule 15c2-12(b)(4) in that rule G-32 mandates that any dealer selling new issue municipal securities (not just participating underwriters of the offering) must deliver (not just send) the official statement to the customer by settlement, regardless of whether the customer has requested a copy of the official statement.[8]

The first exception under rule G-32 arises where the issuer is not preparing an official statement in final form. In that case, the dealer must deliver to the customer by no later than settlement a written notice that an official statement in final form is not being prepared, together with a copy of a preliminary official statement, if one has been prepared.[9] This exception is not available in cases where the official statement in final form is in the process of being prepared but is not yet available at the time that a dealer wishes to settle a transaction with a customer. Thus, in such a case, a dealer would violate rule G-32(a) by settling a customer transaction without delivery of the official statement in final form, even if a preliminary official statement is delivered by settlement and the official statement in final form is delivered to the customer as soon as it becomes available.

The second exception applies solely to municipal securities issued in a primary offering that qualifies for the exemption set forth in SEC Rule 15c2-12(d)(1)(iii) ("Exempt VRDOs"),[10] but only if an official statement in final form is being prepared.[11] This exception permits a dealer to deliver a preliminary official statement to a customer by settlement in substitution for the official statement in final form so long as (1) the dealer provides written notice to the customer by settlement that the official statement in final form will be sent within one business day following its receipt by the dealer and (2) the dealer sends the official statement in final form to the customer within one business day of its receipt.[12] The Board believes, however, that if the official statement in final form is available in sufficient time to permit delivery to the customer by settlement, it would be in the dealer's best interest to make such delivery by settlement, as it would be required to do for any other new issue municipal securities. This would permit the dealer to satisfy its delivery obligation with a single delivery of the official statement in final form, rather than two separate deliveries of the preliminary and final official statements, thereby reducing the dealer's compliance burden.[13]

Additional Disclosures for Negotiated Underwritings. Where the underwriters have purchased an issue of municipal securities from the issuer in a negotiated sale, any dealer (not just syndicate or selling group members) selling such securities to a customer during the underwriting period is required to deliver to such customer prior to settlement, in addition to the official statement, information concerning (A) the underwriting spread;[14] (B) the amount of any fee received by such dealer as agent for the issuer in the distribution of the securities, if applicable;[15] and (C) the initial offering price for each maturity in the issue, including the initial offering price of maturities that are not reoffered.[16] The obligation to make these further disclosures may be satisfied by inclusion by the issuer of such information in the official statement in final form and the delivery of such official statement to the customer by settlement. However, should the issuer elect not to include any such information in the official statement or if an official statement that includes this information is not delivered to the customer by settlement, a dealer selling such securities during the underwriting period must nevertheless provide such information in writing to the customer by settlement (for example, in a confirmation or other writing delivered to the customer by settlement). For example, if a dealer delivers a preliminary official statement to a customer at settlement for a new issue Exempt VRDO and any of the required disclosure information is left blank or is noted as preliminary and subject to change (with the expectation of the information being completed or finalized in the official statement in final form to be delivered after settlement), then disclosure of such information would be required in a separate writing delivered at or prior to settlement.

## DELIVERY OBLIGATIONS TO PURCHASING DEALERS

Dealers selling new issue municipal securities to other dealers, and dealers serving as managing or sole underwriters for such new issues, are also required to deliver the official statement and the additional disclosures for negotiated underwritings, if applicable, to dealers purchasing such securities during the underwriting period.

Obligations of Selling Dealers. If a dealer sells a new issue municipal security to another dealer, the selling dealer is obligated under rule G-32(a)[†] to send to the purchasing dealer, upon request, (i) the official statement in final form (or if no official statement in final form is being prepared, a written notice to that effect, together with a copy of a preliminary official statement, if one has been prepared) and (ii) if the underwriters originally purchased the securities from the issuer in a negotiated sale, the additional disclosures described above required in connection with a negotiated underwriting. The official statement and the additional disclosures related to negotiated underwritings, if applicable, must be sent by the selling dealer to the purchasing dealer within one business day of the purchasing dealer's request, provided that, if the official statement in final form is being prepared but has not yet been received from the issuer or its agent, then the official statement in final form and the additional disclosures must be sent no later than the business day following such receipt.[17] These items must be sent by first class mail or other equally prompt means, unless the purchasing dealer arranges some other method of delivery and pays or agrees to pay for such alternate delivery method. This obligation applies with respect to all requests to a selling dealer made by a dealer purchasing new issue municipal securities from such selling dealer during the underwriting period, even where the selling dealer did not participate as a syndicate or selling group member for the underwriting of the new issue municipal securities.

Obligations of Managing and Sole Underwriters. If an official state-

ment in final form is prepared in connection with an issue of municipal securities, the dealer serving as managing underwriter or sole underwriter for such issue is obligated under rule G-32(b)(i)[‡] to send to any dealer purchasing such securities during the underwriting period, upon request, (i) one copy of the official statement in final form plus one additional copy per $100,000 par value purchased by such purchasing dealer for resale to customers and (ii) if the underwriters originally purchased the securities from the issuer in a negotiated sale, the required additional disclosures. Managing and sole underwriters also are required to provide purchasing dealers, upon request, with instructions on how to order copies of the official statement in final form from the printer. The official statement and the additional disclosures related to negotiated underwritings, if applicable, must be sent by the managing or sole underwriter to the purchasing dealer within one business day of the purchasing dealer's request, provided that, if the official statement in final form is being prepared but has not yet been received from the issuer or its agent,[18] then the official statement in final form and the additional disclosures must be sent no later than the business day following such receipt. These items must be sent by first class mail or other equally prompt means, unless the purchasing dealer arranges some other method of delivery and pays or agrees to pay for such alternate delivery method. This obligation applies with respect to all requests to the managing or sole underwriter made by purchasing dealers during the underwriting period, even where the managing or sole underwriter did not sell the new issue municipal securities to the purchasing dealer.

Obligations of Dealers Acting as Financial Advisors. Rule G-32(b)(ii)[▪] provides that, if a dealer that acts as financial advisor to an issuer prepares an official statement in final form on behalf of such issuer, such dealer must make that official statement available to the managing or sole underwriter promptly after the issuer approves distribution of the official statement in final form. This provision is designed to ensure that, once the official statement is completed and approved by the issuer for distribution, dealers acting as financial advisors will be obligated to commence the dissemination process promptly.[19]

Implications for Inter-Dealer Dissemination. The provisions of rule G-32 relating to dissemination among dealers of official statements and the additional disclosures related to negotiated underwritings is designed to ensure that a dealer selling a new issue municipal security to a customer has a reliable and timely source for obtaining such items for delivery to the customer by settlement. In the case of a syndicate member that purchases a new issue municipal security in an underwriting, the rule, in conjunction with The Bond Market Association's Standard Agreement Among Underwriters, will effectively obligate the managing underwriter to send the official statement in final form (in the required quantity) and the additional disclosures to the syndicate member within one business day of its receipt from the issuer.[20] If for any reason such syndicate member needs to obtain a copy of the official statement more rapidly than by means of first class mail, it may arrange with the managing underwriter for delivery of the official statement by an alternate means so long as the requesting syndicate member covers the cost of such delivery.

For a non-syndicate member that purchases a new issue municipal security from the syndicate or from any other dealer, both the dealer that sold the security to the non-syndicate member and the managing or sole underwriter is obligated, if requested by such non-syndicate member, to send the official statement in final form and the additional disclosures within one business day of such request. If for any reason such non-syndicate member needs to obtain a copy of the official statement more rapidly than by means of first class mail, it may arrange with the dealer that is fulfilling the request for delivery of the official statement by an alternate means so long as the requesting non-syndicate member covers the cost of such delivery. Dealers purchasing new issue municipal securities from another dealer are advised that the obligation of the selling dealer or of the managing or sole underwriter to send an official statement to such purchasing dealer only takes effect upon the request of the purchasing dealer. Therefore, unless the purchasing dealer already has a copy of the official statement or has an alternate source for receiving it and the additional disclosures, such dealer will need to take the affirmative step of requesting such items from the selling dealer or the managing or sole underwriter.

A dealer that sells a new issue municipal security to a customer is not relieved of its obligation to deliver by settlement the official statement in final form and the additional disclosures related to negotiated underwriters because either the dealer from which it acquired the security or the managing or sole underwriter for the issue fails to fulfill its obligation to send these items to such dealer upon request. Such dealer may need to obtain the official statement in final form from other available sources. Such other sources of official statements include, but are not limited to, the nationally recognized municipal securities information repositories, other information vendors, or the Board's Municipal Securities Information Library® (MSIL®) system.[21] Similarly, a managing or sole underwriter or a dealer selling a new issue municipal security cannot fulfill its obligation to send the official statement in final form and the additional disclosures to a purchasing dealer upon request by referring such dealer to such other sources of official statements.

## RECORDKEEPING

Rule G-8(a)(xiii) requires that each dealer make and keep a record of all deliveries of official statements and of the additional disclosures related to negotiated underwritings made to purchasers of new issue municipal securities.[22] Although the rule does not obligate a dealer to maintain such records in any given manner, such records must provide an adequate basis for the audit of such information. To this end, NASD Regulation, Inc. has noted:

> Some firms establish a file containing a copy of the customer's new issue municipal purchase confirmation and/or a mailing label to demonstrate compliance with Rule G-8. However, NASD Regulation does not view this approach as adequately demonstrating compliance with MSRB Rule G-8. Instead, an adequate record of the delivery of new issue municipal securities disclosure information should, at a minimum, contain the following:
>
> - customer name;
> - security description;
> - settlement date(s);
> - type of disclosure sent (preliminary or final Official Statement);
> - date the required disclosure was sent; and
> - name of person(s) sending the disclosures.
>
> At times, a firm assigns the new issue municipal securities disclosure function to a third party vendor. As a result, the member [dealer] does not maintain "a record of delivery" of the new issue disclosure. Nevertheless, from a regulatory perspective, the firm remains fully responsible for disclosure. When firms have assigned the new issue disclosure function to a third party, NASD Regulation expects that the compliance review process will include, at a minimum, periodic test to assure that the new issue disclosures are being made at or before settlement.[23]

Dealers should consult with the applicable enforcement agency regarding the adequacy of their recordkeeping under rule G-8(a)(xiii).

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1 *See MSRB Reports*, Vol. 18, No. 2 (Aug. 1998) at 15-17.

2 *See MSRB Reports*, Vol. 18, No. 2 (Aug. 1998) at 19-21.

3 *See MSRB Reports*, Vol. 17, No. 2 (June 1997) at 23-24; *see also* NASD Regulation, Inc., "Municipal Securities Update – Disclosure to Purchasers of New Issue Securities," *Regulatory & Compliance Alert*, Vol. 12, No. 3 (Sept. 1998) at 19-20.

4 The exception for commercial paper applies solely to true commercial paper issues (*i.e.*, not to variable rate demand obligations with a nominal long maturity and having a so-

called "commercial paper" mode).

[5] *See* rules G-32(c)(ii) [currently codified at rule G-32(d)(ii)] and G-11(a)(ix).

[6] *See MSRB Reports*, Vol. 7, No. 2 (March 1987) at 12.

[7] Rule G-32 defines official statement as a document prepared by the issuer or its representatives setting forth, among other matters, information concerning the issuer and the proposed issue of securities. This definition is, of necessity, broader than the definition set forth in SEC Rule 15c2-12(f)(3) for the term "final official statement" since rule G-32 applies to all issues of municipal securities (other than commercial paper issues), not just those issues subject to SEC Rule 15c2-12. However, the Board believes that, in the case of new issue municipal securities subject to SEC Rule 15c2-12, the official statement in final form for purposes of rule G-32 would be the same as the final official statement for purposes of SEC Rule 15c2-12.

[8] SEC Rule 15c2-12(b)(4) provides that an underwriter participating in an offering subject to the Rule must send a copy of the final official statement to a potential customer within one business day of a request until the earlier of (i) 90 days from the end of the underwriting period or (ii) the time when the official statement is available from a nationally recognized municipal securities information repository, but in no case less than 25 days following the end of the underwriting period.

[9] Since SEC Rule 15c2-12(3) provides that an underwriter participating in an offering subject to the Rule must contract with the issuer to receive final official statements, the Board expects that a final official statement will be prepared for all such offerings and therefore delivery of preliminary official statements for such issues would never satisfy the delivery obligation under rule G-32(a).

[10] A primary offering qualifies for this exemption if the municipal securities are in authorized denominations of $100,000 or more and, at the option of the holder thereof, may be tendered to the issuer or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption or purchase by the issuer or its designated agent.

[11] If an official statement in final form is not being prepared, then the first exception described above would apply.

[12] *See MSRB Reports*, Vol. 18, No. 2 (Aug. 1998) at 15-17. If no preliminary official statement is prepared for such issue, then the dealer must still provide written notice by settlement that an official statement in final form will be sent within one business day of receipt.

[13] In addition, ensuring that the official statement in final form, rather than merely the preliminary official statement, is in the possession of the customer by settlement may help to avoid potential liabilities that could result if there are any material differences between the preliminary official statement and the official statement in final form. The fact that rule G-32 permits a dealer to deliver the preliminary official statement, rather than the official statement in final form, to a customer by settlement in this specific situation does not in any way limit or reduce the dealer's disclosure obligations under the federal securities laws, including in particular the dealer's obligation under rule G-17 to disclose, at or before execution of a transaction, all material facts concerning the transaction which could affect the customer's investment decision and not omit any material facts which would render other statements misleading.

[14] This provision obligates a dealer to disclose the gross spread (*i.e.*, the difference between the initial offering price and the amount paid to the issuer), expressed either in dollars or points per bond. The underwriting spread may be shown either as a total amount or as a listing of the components of the gross spread. If components of the gross spread are listed, that portion of the proceeds which represents compensation to the underwriters must be clearly identified as such. For example, the Board believes that use of the terms "underwriters' discount" or "net to underwriters" would be acceptable but that the term "bond discount" is confusing and, therefore, inappropriate. *See MSRB Reports*, Vol. 7, No. 2 (March 1987) at 13.

[15] If no fee is received by the dealer for acting as an agent for the issuer in the distribution of the securities, the dealer need not affirmatively state that no such fee was received but may instead omit any statement regarding such fee.

[16] The initial offering price may be expressed either in terms of dollar price or yield.

[17] Thus, if a purchasing dealer requests a copy of the official statement in final form from a selling dealer before the issuer has delivered the official statement to the underwriters, then the obligation of the selling dealer to send the official statement is deferred until the business day after the underwriters receive the official statement from the issuer.

[18] The Board is of the view that an underwriter that prepares an official statement on behalf of an issuer would be deemed to have received the official statement from the issuer immediately upon such issuer approving the distribution of the completed official statement in final form (*i.e.*, when the issuer releases the completed official statement for distribution).

[19] The Board urges issuers that utilize the services of non-dealer financial advisors to hold such financial advisors to the same standards for prompt delivery of official statements to the underwriters.

[20] The Bond Market Association's Standard Agreement Among Underwriters provides that syndicate members must place orders for the official statement by the business day following the date of execution of the purchase contract and states that any syndicate member that fails to place such an order will be assumed to have requested the quantity required under rule G-32(b)(i)[currently codified at rule G-32(c)(i)]. *See* The Bond Market Association, *Agreement Among Underwriters – Instructions, Terms and Acceptance* (Oct. 1, 1997) at ¶ 3. Thus, except in the rare instances where an official statement in final form is completed and available for distribution on the date of sale, syndicate members will have made or have been deemed to have made their requests for official statements by the time the managing underwriter receives the official statement from the issuer, thereby obligating the managing underwriter to send the official statement to syndicate members within one business day of receipt.

[21] Municipal Securities Information Library and MSIL are registered trademarks of the Board.

[22] Rule G-9(b)(x) provides that these records must be preserved for a period of not less than 3 years.

[23] NASD Regulation, Inc., "Municipal Securities Update – Disclosure to Purchasers of New Issue Securities," *Regulatory & Compliance Alert*, Vol. 12, No. 3 (Sept. 1998) at 19-20. The views of the bank regulatory agencies regarding adequacy of any particular record-keeping practice for the purpose of demonstrating compliance with rule G-8 may differ.

[*] [Currently codified at rule G-32(d)(i).]

[†] [Currently codified at rule G-32(b).]

[‡] [Currently codified at rule G-32(c)(i).]

[¤] [Currently codified at rule G-32(c)(ii).]

## NOTICE REGARDING ELECTRONIC DELIVERY AND RECEIPT OF INFORMATION BY BROKERS, DEALERS AND MUNICIPAL SECURITIES DEALERS

November 20, 1998

On May 9, 1996, the Securities and Exchange Commission (the "SEC") issued an interpretative release expressing its views on the use of electronic media for delivery of information by, among others, brokers and dealers.[1] The SEC stated that brokers, dealers and others may satisfy their delivery obligations under federal securities laws by using electronic media as an alternative to paper-based media within the framework established in the SEC's October 1995 interpretive release on the use of electronic media for delivery purposes.[2] The SEC also indicated that an electronic communication from a customer to a broker or dealer generally would satisfy the requirements for written consent or acknowledgment under the federal securities laws.

The Municipal Securities Rulemaking Board (the "Board") is publishing this notice to address the use by brokers, dealers and municipal securities dealers ("dealers") of electronic media to deliver and receive information under Board rules.[3] The Board will permit dealers to transmit documents electronically that they are required or permitted to furnish to customers under Board rules provided that they adhere to the standards set forth in the SEC Releases and summarized below.[4] Dealers also may receive consents and acknowledgments from customers electronically in satisfaction of required written consents and acknowledgments. Furthermore, the Board believes that the standards applied by the SEC to communications with customers should also apply to communications among dealers and between dealers and issuers. However, although it is the Board's goal ultimately to permit dealers to make required submissions of materials to the Board electronically if possible, this notice does not affect existing requirements for the submission of materials to the Board, its designees and certain other entities to which information is required to be delivered under Board rules.[5]

Dealers are urged to review the SEC Releases in their entirety to ensure that they comply with all aspects of the SEC's electronic delivery requirements. Although the examples provided in the SEC Releases are based on SEC rules, the examples nonetheless provide important guidance as to the intended application of the standards set out by the SEC with respect to electronic communications.

### Electronic Communications from Dealers to Customers

General. According to the standards established by the SEC, dealers may use electronic media to satisfy their delivery obligations to customers under Board rules, provided that the electronic communication satisfies the following principles:[6]

1. *Notice* – The electronic communication should provide timely and

adequate notice to customers that the information is available electronically.[7] Since certain forms of electronic delivery may not always provide a likelihood of notice that recipients have received information that they may wish to review, dealers should consider supplementing such forms of electronic communication with a separate communication, providing notice similar to that provided by delivery in paper through the postal mail, that information has been sent electronically that the recipients may wish to review.[8]

*2. Access* – Customers who are provided information through electronic delivery should have access to that information comparable to the access that would be provided if the information were delivered in paper form.[9] The use of a particular electronic medium should not be so burdensome that intended recipients cannot effectively access the information provided.[10] A recipient should have the opportunity to retain the information through the selected medium (*e.g.*, by downloading or printing the information) or have ongoing access equivalent to personal retention.[11] Also, as a matter of policy, the SEC believes that a person who has a right to receive a document under the federal securities laws and chooses to receive it electronically should be provided with a paper version of the document upon specific request or if consent to receive documents electronically is revoked.[12]

*3. Evidence to Show Delivery* – Dealers must have reason to believe that electronically delivered information will result in the satisfaction of the delivery requirements under the federal securities laws. Dealers should consider the need to establish procedures to ensure that applicable delivery obligations are met, including recordkeeping procedures to evidence such satisfaction.[13] Such procedures should also be designed to ensure the integrity and security of information being delivered so as to ensure that it is the information that was intended to be delivered.[14] Dealers may be able to evidence satisfaction of delivery obligations, for example, by:

(1) obtaining the intended recipient's informed consent[15] to delivery through a specified electronic medium and ensuring that the recipient has appropriate notice and access;

(2) obtaining evidence that the intended recipient actually received the information, such as by an electronic mail return-receipt[16] or by confirmation that the information was accessed, downloaded, or printed; or

(3) disseminating information through certain facsimile methods (e.g., faxing information to a customer who has requested the information and has provided the telephone number for the fax machine).

Personal Financial Information. The SEC has noted, and the Board agrees, that special precautions are appropriate when dealers are delivering information to customers that is specific to that particular customer's personal financial information, including but not limited to information contained on confirmations and account statements.[17] In transmitting such personal financial information, dealers should consider the following factors:

*1. Confidentiality and Security* – Dealers sending personal financial information through electronic means or in paper form should take reasonable precautions to ensure the integrity, confidentiality, and security of that information. Dealers transmitting personal financial information electronically must tailor those precautions to the medium used in order to ensure that the information is reasonably secure from tampering or alteration.

*2. Consent* – Unless a dealer is responding to a request for information that is made through electronic media or the person making the request specifies delivery through a particular electronic medium, the dealer should obtain the intended recipient's informed consent prior to delivering personal financial information electronically. The customer's consent may be made either by a manual signature or by electronic means.

**Electronic Communications from Customers to Dealers**

Consistent with the position taken by the SEC, dealers may rely on consents and acknowledgments received from customers by electronic means for purposes of Board rules. In relying on such communications from customers, dealers must be cognizant of their responsibilities to prevent, and the potential liability associated with, unauthorized transactions. In this regard, the SEC states, and the Board agrees, that dealers should have reasonable assurance that the communication from a customer is authentic.

**Electronic Transmission of Non-Required Communications**

The 1996 SEC Release states that the above standards are intended to permit dealers to comply with their delivery obligations under federal securities laws when using electronic media. While compliance with the guidelines is not mandatory for the electronic delivery of non-required information that, in some cases, is being provided voluntarily to customers, the Board believes adherence to the guidelines should be considered, especially with respect to delivery of personal financial information.

**Electronic Communications Among Dealers and Between Dealers and Issuers**

The Board believes that the standards applied by the SEC to communications with customers should also apply to mandated communications among dealers and between dealers and issuers. Thus, a dealer that undertakes communications required under Board rules with other dealers and with issuers in a manner that conforms with the principles stated above relating to customer communications will have met its obligations with respect to such communications. In addition, a dealer may rely on consents and acknowledgments received from other dealers or issuers by electronic means for purposes of Board rules, provided that the dealer should have reasonable assurance that the communication from such other party is authentic. However, any Board rule that explicitly requires that a dealer enter into a written agreement with another party will continue to require that such agreement be in written form.[18] Financial information, as well as other privileged or confidential information, relating to another dealer or an issuer (or relating to another person or entity contained in a transmission between a dealer and another dealer or an issuer) should be transmitted using precautions similar to those used by a dealer in transmitting personal financial information to a customer.

**Rules to Which this Notice Applies**

Set forth below is a list of current Board rules to which dealers may apply the guidance provided in this notice. The Board believes that the list sets forth all of the rules that require or permit communications among dealers and between dealers and customers and issuers.[19] The summaries provided of the delivery obligations under the listed rules is intended for ease of reference only and are not intended to be complete statements of all the requirements under such rules.

- Rule G-8, on books and records to be made by dealers, prohibits dealers from obtaining or submitting for payment a check, draft or other form of negotiable paper drawn on a customer's checking, savings, share or similar account without the customer's express written authorization.
- Rule G-10, on delivery of investor brochure, requires dealers to deliver a copy of the investor brochure to a customer upon receipt of a complaint by the customer.
- Rule G-11, on sales of new issue municipal securities during the underwriting period, requires certain communications between

senior syndicate managers and other members of the syndicate.[20]

- Rule G-12, on uniform practice, provides for confirmation of inter-dealer transactions and certain other inter-dealer communications.[21]
- Rule G-15, on confirmation, clearance and settlement of transactions with customers, provides for confirmation of transactions with customers and the provision of additional information to customers upon request.[22]
- Rule G-19, on suitability of recommendations and transactions and discretionary accounts, requires that dealers obtain certain information from their customers in connection with transactions and recommendations and also receive customer authorizations with respect to discretionary account transactions.
- Rule G-22, on control relationships, requires certain disclosures from a dealer effecting a transaction for a customer in municipal securities with respect to which such dealer has a control relationship and customer authorization of such transaction with respect to discretionary accounts.
- Rule G-23, on activities of financial advisors, requires that, under certain circumstances, dealers acting as financial advisors to issuers provide various disclosures to issuers and customers and receive certain consents and acknowledgments from issuers.[23]
- Rule G-24, on use of ownership information obtained in fiduciary or agency capacity, requires a dealer seeking to use for its own purposes information obtained while acting in a fiduciary or agency capacity for an issuer or other dealer to receive consents to the use of such information.
- Rule G-25, on improper use of assets, provides that put options and repurchase agreements will not be deemed to be guaranties against loss if their terms are provided in writing to customers with or on the transaction confirmation.
- Rule G-26, on customer account transfers, provides for written notice from customers requesting account transfers between dealers and the use of Form G-26 to effect such transfer.[24]
- Rule G-28, on transactions with employees and partners of other municipal securities professionals, requires that a dealer opening an account for a customer who is an employee or partner of another dealer must provide notice and copies of confirmations to such other dealer and permits such other dealers to provide instructions for handling of transactions with such customer.
- Rule G-29, on availability of Board rules, provides that dealers must make available to customers for examination promptly upon request a copy of the Board's rules required to be kept in their offices.[25]
- Rule G-32, on disclosures in connection with new issues, requires dealers selling new issue municipal securities to customers to deliver official statements[26] and certain other information by settlement and requires selling dealers, managing underwriters and certain dealers acting as financial advisors to deliver such materials to dealers purchasing new issue municipal securities, upon request.[27]
- Rule G-34, on CUSIP numbers and new issue requirements, requires underwriters to communicate information regarding CUSIP numbers and initial trade date to syndicate and selling group members.[28]
- Rule G-38, on consultants, requires dealers to provide certain information to issuers regarding consulting arrangements.[29]
- Rule G-39, on telemarketing, prohibits certain telemarketing calls without the prior consent of the person being called.[30]

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1 See Securities Act Release No. 7288, Exchange Act Release No. 37182 (May 9, 1996), 61 FR 24644 (May 15, 1996) (the "1996 SEC Release").

2 See Securities Act Release No. 7233, Exchange Act Release No. 36345 (October 6, 1995), 60 FR 53458 (October 13, 1995) (the "1995 SEC Release" and, together with the 1996 SEC Release, the "SEC Releases").

3 This notice has been filed with the SEC as File No. SR-MSRB-98-12.

4 The Board also reminds dealers that the SEC indicated in the 1996 SEC Release that dealers may fulfill their obligation to deliver to customers, upon request, preliminary official statements and final official statements in connection with primary offerings of municipal securities subject to SEC Rule 15c2-12 by electronic means, subject to the guidelines set forth in the 1996 SEC Release. See 1996 SEC Release at note 47.

5 For example, this notice does not apply to any requirements that dealers supply the Board with written information pursuant to Board rules A-12, A-14, A-15, G-36, G-37 and G-38. The Board has begun the planning process for electronic submission of information required under rule A-15 and of Form G-37/G-38 under rules G-37 and G-38. At such time as electronic submission becomes available, the Board will publish notice thereof and of the procedures to be used for such submission. Although submission of Forms G-36(OS) and G-36(ARD) under rule G-36 could also be made electronically by means similar to those which the Board may develop for Form G-37/G-38, such electronic submission is complicated by the requirement that Forms G-36(OS) and G-36(ARD) be accompanied by an official statement or advance refunding document, as appropriate. Given the current debate and lack of consensus among the various sectors of the municipal securities industry regarding electronic formatting of disclosure materials, and since the Board does not have the authority to dictate the format of issuer documents, the Board believes that any further action regarding electronic submissions under rule G-36 should await resolution of these issues. Finally, the Board does not at this time anticipate permitting electronic submission of information required under rules A-12 and A-14 since such information must be accompanied by payment of certain required fees.

Electronic submission of information under rule G-14 will continue to be governed by rule G-14 and associated Transaction Reporting Procedures. In addition, this notice does not alter the current submission standards applicable to the Board's Continuing Disclosure Information (CDI) System of the Municipal Securities Information Library® (MSIL®) system. The Municipal Securities Information Library and MSIL are registered trademarks of the Board.

Furthermore, submission of information to the Board's designees or certain other designated entities under Board rules must continue to be done in accordance with the procedures established by such designees or other entities. Board rules in which such requirements currently appear include rules G-7 (with respect to information required to be filed with the appropriate enforcement agencies), G-12 and G-15 (with respect to information to be submitted to registered clearing agencies and registered securities depositories),G-26 (with respect to customer account transfer instructions (other than Form G-26) required by registered clearing agencies), G-34 (with respect to information to be submitted to the Board's designee for assignment of CUSIP numbers and to registered securities depositories) and G-37 (with respect to application to the appropriate enforcement agencies for exemptions from the ban on municipal securities business).

6 Dealers that structure their deliveries in accordance with the principles set forth in this notice can be assured, except where otherwise noted, that they have satisfied their delivery obligations under Board rules. However, as the SEC stated in the 1995 SEC Release, the three enumerated principles are not the only factors relevant to determining whether the legal requirements pertaining to delivery of documents have been satisfied. Consistent with the SEC's view, the Board believes that, if a dealer develops a method of electronic delivery that differs from the principles discussed herein, but provides assurance comparable to paper delivery that the required information will be delivered, that method may satisfy delivery obligations. See 1995 SEC Release, text following note 22. For example, a dealer can satisfy its obligation to send a confirmation to a customer under rule G-15 by electronic means in a manner that meets the principles set forth in this notice. In addition, dealers may continue to deliver confirmations electronically through the OASYS Global system established by Thomson Financial Services, Inc. on the conditions described in the Board's *Notice Concerning Use of the OASYS Global Trade Confirmation System to Satisfy Rule G-15(a)*, dated June 6, 1994, without specifically complying with the principles described in this notice. See MSRB *Reports*, Vol. 14, No. 3 (June 1994) at 37. See also 1996 SEC Release, note 38, and 1995 SEC Release, note 12. Also, rule G-29 provides that dealers must make available to customers for examination promptly upon request a copy of the Board's rules required to be kept in their offices. Dealers may continue to comply with such requirement by giving customers access to the rules either in printed form or by viewing the rules on screen from the Board's Internet web site (www.msrb.org) or from software products produced by other companies. See *Interpretive Notice on Availability of Board Rules*, dated May 20, 1998, in MSRB *Reports*, Vol. 18, No. 2 (August 1998) at 37.

7 See 1996 SEC Release, text at note 20.

8 See 1996 SEC Release, text at note 21, and 1995 SEC Release, text at note 23. The SEC notes, for example, that if information is provided by physically delivering material (such as a diskette or CD-ROM) or by electronic mail, such communication itself generally should be sufficient notice. However, if information is made available electronically through a passive delivery system, such as an Internet web site, separate notice would be necessary to satisfy the delivery requirements unless the dealer can otherwise evidence that delivery to the customer has been satisfied. 1996 SEC Release, note 21.

[9] The SEC states that, regardless of whether information is delivered in paper form or by electronic means, it should convey all material and required information. For example, if a paper document is required to present information in a certain order, then the information delivered electronically should be in substantially the same order. 1996 SEC Release, text at note 14.

[10] The SEC notes, for example, that if a customer must proceed through a confusing series of ever-changing menus to access a required document so that it is not reasonable to expect that access would generally occur, this procedure would likely be viewed as unduly burdensome. In that case, the SEC would deem delivery not to have occurred unless delivery otherwise could be shown. 1995 SEC Release, note 24.

[11] *See* 1996 SEC Release, note 22 and accompanying text, and 1995 SEC Release, notes 25-26 and accompanying text.

[12] *See* 1996 SEC Release, note 17 and accompanying text, and 1995 SEC Release, note 27 and accompanying text.

[13] *See* 1996 SEC Release, text following note 22, and 1995 SEC Release, note 22 and text at note 28. The Board is of the view that dealers that choose to deliver information to customers electronically should consider establishing systems and procedures for providing paper copies or using alternate electronic means in a timely manner should the primary electronic media fail for any reason.

[14] *See* 1996 SEC Release, text at note 25, and 1995 SEC Release, note 22. Dealers also should consider the need for systems and procedures to deter or detect misconduct by firm personnel in connection with the delivery of information, whether by electronic or paper means. 1996 SEC Release, text at note 16.

[15] In order for a consent to be an informed consent, the SEC has stated that the consent should specify the electronic medium or source through which the information will be delivered and the period during which the consent will be effective, describe the information that will be delivered using such means, and disclose the potential for the customer to incur costs in accessing the information. *See* 1996 SEC Release, note 23, and 1995 SEC Release, note 29.

[16] To the extent that material is distributed as an attachment to an electronic mail transmission, dealers must have a reasonable basis for believing that the attachment will in fact be transmitted along with the electronic mail transmission and that the attachment will be received by the recipient in an accessible format.

[17] In addition, the Board believes that other information that is privileged or confidential, regardless of whether such information is financial in nature, should be accorded the same precautions as is personal financial information.

[18] For example, the written agreements required under rules G-20(c), G-23(c) and G-38(b) must continue to be entered into in paper form.

[19] Unless otherwise provided in connection with the adoption by the Board of any new rules or amendments to existing rules that require or permit communications among dealers and between dealers and customers, issuers and others, the guidance provided in this notice would also apply to any such communications.

[20] Rule G-11 also requires that syndicate members furnish certain information to others, upon request. The Board believes that, solely for purposes of this requirement under rule G-11, such information may be provided to others by electronic means so long as the standards established in this notice with respect to electronic deliveries to customers are met.

[21] *See*, however, note 5 above with respect to information to be submitted to registered clearing agencies and registered securities depositories.

[22] *See*, however, note 5 above with respect to information to be submitted to registered clearing agencies and registered securities depositories. *See also* note 6 above regarding alternate electronic means previously reviewed by the Board.

[23] *See*, however, note 18 above and accompanying text regarding the written agreement to be entered into between a dealer acting as financial advisor and the issuer.

[24] *See*, however, note 5 above with respect to use of customer account transfer instructions (other than Form G-26).

[25] *See* note 6 above regarding alternate electronic means previously reviewed by the Board.

[26] The Board believes that dealers must be particularly cautious in delivering official statements by electronic means since they may present special challenges in ensuring that they are received by customers and other dealers without material omissions or distortions in formatting (for example, tables in which data is more than negligibly misaligned) that may cause such materials not to meet the standard for electronically transmitted information comparable to information delivered in paper form. *See* note 9 above and accompanying text.

[27] The Board believes that, to the extent that rule G-32(b)(i) [currently codified at rule G-32(c)(i).] obligates a managing or sole underwriter to provide, upon request, multiple copies of the official statement to a dealer with respect to new issue municipal securities sold by such dealer to customers, such obligation must continue to be met with paper copies of the official statement unless the purchasing dealer has consented to electronic delivery of the official statement in lieu of delivery of multiple paper copies. *Compare* 1995 SEC Release, example 11.

[28] *See*, however, note 5 above with respect to information to be submitted to the Board's designee with respect to CUSIP number assignment and to registered securities depositories.

[29] *See*, however, note 18 above and accompanying text regarding the written agreement to be entered into between a dealer and its consultant and note 5 above with respect to submission of Form G-37/G-38 to the Board.

[30] Although the person receiving such telemarketing call may in many cases not be a customer, the Board believes that, solely for purposes of this provision of rule G-39, such consent may be accepted by the dealer by electronic means so long as the standards established in this notice with respect to electronic communications from customers to dealers are met.

## INTERPRETATION ON THE APPLICATION OF RULES G-32 AND G-36 TO NEW ISSUE OFFERINGS THROUGH AUCTION PROCEDURES

March 26, 2001

Traditionally, brokers, dealers and municipal securities dealers ("dealers") have underwritten new issue municipal securities through syndicates in which one dealer serves as the managing underwriter. In some cases, a single dealer may serve as the sole underwriter for a new issue. Typically, these underwritings are effected on an "all-or-none" basis, meaning that the underwriters bid on the entire new issue. In addition, new issues are occasionally sold to two or more underwriters that have not formed a syndicate but instead each underwriter has purchased a separate portion of the new issue (in effect, each underwriter serving as the sole underwriter for its respective portion of the new issue).

In the primary market in recent years, some issuers have issued their new offerings through an electronic "auction" process that permits the taking of bids from both dealers and investors directly. In some cases, these bids may be taken on other than an all-or-none basis, with bidders making separate bids on each maturity of a new issue. The issuer may engage a dealer as an auction agent to conduct the auction process on its behalf. In addition, to effectuate the transfer of the securities from the issuer to the winning bidders and for certain other purposes connected with the auction process, the issuer may engage a dealer to serve in the role of settlement agent or in some other intermediary role.

Although the Municipal Securities Rulemaking Board (the "MSRB") has not examined all forms that these auction agent, settlement agent or other intermediary roles (collectively referred to as "dealer-intermediaries") may take, it believes that in most cases such dealer-intermediary is effecting a transaction between the issuer and each of the winning bidders. The MSRB also believes that in many cases such dealer-intermediary may be acting as an underwriter, as such term is defined in Rule 15c2-12(f)(8) under the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1] A dealer-intermediary that is effecting transactions in connection with such an auction process has certain obligations under rule G-32. If it is also an underwriter with respect to an offering, it has certain additional obligations under rules G-32 and G-36.

### Application of Rule G-32, on Disclosures in Connection with New Issues

Rule G-32(a) generally requires that any dealer (*i.e.*, not just the underwriter) selling municipal securities to a customer during the issue's underwriting period must deliver the official statement in final form, if any, to the customer by settlement of the transaction. Any dealer selling a new issue municipal security to another dealer is obligated under rule G-32(b) to send such official statement to the purchasing dealer within one business day of request. In addition, under rule G-32(c), the managing or sole underwriter for new issue municipal securities is obligated to send to any dealer purchasing such securities (regardless of whether the securities were purchased from such managing or sole underwriter or from another dealer), within one business day of request, one official statement plus one additional copy per $100,000 par value of the new issue municipal securities sold by such dealer to customers. Where multiple underwriters underwrite a new issue without forming an underwriting syndicate, each underwriter is considered a sole underwriter for purposes of rule G-32 and therefore each must undertake the official statement delivery obligation described in the preceding sentence.

If a dealer-intermediary is involved in an auction or similar process of primary offering of municipal securities in which all or a portion of the securities are sold directly to investors that have placed winning bids with the issuer, the dealer-intermediary is obligated under rule G-32(a) to deliver an official statement to such investors by settlement of their purchases. If all or a portion of the securities are sold to other dealers that have placed winning bids with the issuer, the dealer-intermediary is obligated under rule G-32(b) to send an official statement to such purchasing dealers within one business day of a request. Further, to the extent that the dealer-intermediary is an underwriter, such dealer-intermediary typically would have the obligations of a sole underwriter under rule G-32(c) to distribute the official statement to any other dealer that subsequently purchases the securities during the underwriting period and requests a copy. Any dealer that has placed a winning bid in a new issue auction would have the same distribution responsibility under rule G-32(c), to the extent that it is acting as an underwriter.

The MSRB views rule G-32 as permitting one or more dealer-intermediaries involved in an auction process to enter into an agreement with one or more other dealers that have purchased securities through a winning bid in which the parties agree that one such dealer (*i.e.*, a dealer-intermediary or one of the winning bidders) will serve in the role of managing underwriter for purposes of rule G-32. In such a case, such single dealer (rather than all dealers individually) would have the responsibility for distribution of official statements to the marketplace typically undertaken by a managing or sole underwriter under rule G-32(c).[2] Such an agreement may be entered into by less than all dealers that have purchased securities through the auction process. All dealers that agree to delegate this duty to a single dealer may rely on such delegation to the same extent as if they had in fact formed an underwriting syndicate.

### Application of Rule G-36, on Delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to the MSRB

Rule G-36 requires that the managing or sole underwriter for most primary offerings send the official statement and Form G-36(OS) to the MSRB within certain time frames set forth in the rule. In addition, if the new issue is an advance refunding and an advance refunding document has been prepared, the advance refunding document and Form G-36(ARD) also must be sent to the MSRB by the managing or sole underwriter. Where multiple underwriters underwrite an offering without forming an underwriting syndicate, the MSRB has stated that each underwriter would have the role of sole underwriter for purposes of rule G-36 and therefore each would have a separate obligation to send official statements, advance refunding documents and Forms G-36(OS) and G-36(ARD) to the MSRB.[3]

To the extent that the dealer-intermediary in an auction or similar process of primary offering of municipal securities is an underwriter for purposes of the Exchange Act, such dealer-intermediary would have obligations under rule G-36. If all or a portion of the securities are sold directly to investors that have placed winning bids with the issuer, the dealer-intermediary would be obligated to send the official statement and Form G-36(OS) (as well as any applicable advance refunding document and Form G-36(ARD)) to the MSRB with respect to the issue or portion thereof purchased by investors. If all or a portion of the securities are sold to other dealers that have placed winning bids with the issuer, the dealer-intermediary and each of the purchasing dealers (to the extent that they are underwriters for purposes of the Exchange Act) also typically would be separately obligated to send such documents to the MSRB with respect to the issue or portion thereof purchased by dealers.

To avoid duplicative filings under rule G-36, the MSRB believes that one or more dealer-intermediaries involved in an auction process may enter into an agreement with one or more other dealers that have purchased securities through a winning bid in which the parties agree that one such dealer (*i.e.*, a dealer-intermediary or one of the winning bidders) will serve in the role of managing underwriter for purposes of rule G-36. In such a case, such single dealer (rather than all dealers individually) would have the responsibility for sending the official statement, advance refunding document and Forms G-36(OS) and G-36(ARD) to the MSRB.[4] Such an agreement may be entered into by less than all dealers that have purchased securities. All dealers that agree to delegate this duty to a single dealer may rely on such delegation to the same extent as if they had in fact formed an underwriting syndicate.

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[1] Questions regarding whether an entity acting in an intermediary role is effecting a transaction or whether a dealer acting in such an intermediary role for a particular primary offering of municipal securities would constitute an underwriter should be addressed to staff of the Securities and Exchange Commission.

[2] Each dealer that is party to this agreement would be required to inform any dealer seeking copies of the official statement from such dealer under rule G-32(c) of the identity of the dealer that has by agreement undertaken this obligation or, in the alternative, may fulfill the request for official statements. In either case, the dealer would be required to act promptly so as either to permit the dealer undertaking the distribution obligation to fulfill its duty in a timely manner or to provide the official statement itself in the time required by the rule. Such agreement would not affect the obligation of a dealer that sells new issue securities to another dealer to provide a copy of the official statement to such dealer upon request as required under rule G-32(b), nor would it affect the obligation to deliver official statements to customers as required under rule G-32(a).

[3] *See* Rule G-36 Interpretive Letter – Multiple underwriters, MSRB interpretation of January 30, 1998, *MSRB Rule Book* (January 1, 2001) at 189.

[4] The dealer designated to act as managing underwriter for purposes of rule G-36 would be billed the full amount of any applicable underwriting assessment due under rule A-13, on underwriting and transaction assessments. Such dealer would be permitted, in turn, to bill each other dealer that is party to the agreement for its share of the assessment.

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See also:

**Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market,** January 18, 2001.

**Rule G-15 Interpretation – Notice Concerning Stripped Coupon Municipal Securities,** March 13, 1989.

## *Interpretive Letters*

**Furnishing of official statements: duplication of copies.** [It] is the Board's position that if an official statement is made available by an issuer, it is incumbent upon municipal securities dealers to see that their customers receive copies of the official statement. A municipal securities dealer cannot avoid the rule on the grounds that the issuer did not supply a sufficient number of official statements for distribution. The dealer in such a case has to bear the burden of reproducing the official statement. *MSRB interpretation of March 7, 1979.*

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**Disclosure of underwriting spread.** Under subparagraph (a)(ii) of the rule, in the case of a negotiated sale, the dealer must furnish certain specified information about the underwriting arrangements, including the "underwriting spread." The Board has interpreted this provision to require that the gross spread (*i.e.*, the difference between the initial reoffering prices and the amount paid to the issuer) be shown. The Board has also indicated that the gross spread may be expressed either in dollars or in points per bond.

The Board recently issued an interpretation of rule G-32(a)(ii) to the effect that the underwriting spread may be expressed either as a total

amount or as a listing of the components of the gross spread. Thus, for example, the following disclosure would meet the requirements of the rule:

| *Application of Proceeds* | |
|---|---|
| Construction Costs | $120,000,000 |
| Underwriter's discount[1] | 2,500,000 |
| Legal expenses | 200,000 |
| Printing and Miscellaneous expenses | 300,000 |
| Principal amount of bonds | 123,000,000 |

Should you have any questions concerning this interpretation, please call me. MSRB *interpretation of March 9, 1981.*

[1] If a dealer expresses the underwriting spread as a listing of the components of the gross spread, that portion of the proceeds which represents compensation to the underwriters must, in the Board's view, be clearly identified as such. Thus, use of the terms "underwriter's discount" or "net to underwriters" would be acceptable; the term "bond discount," however, is confusing and is, therefore, inappropriate.

**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.

See also:

**Rule G-15 Interpretive Letter – Callable securities: pricing to call and extraordinary mandatory redemption features,** MSRB *interpretation of February 10, 1984.*

**Rule G-30 Interpretive Letter – Differential re-offering prices,** MSRB *interpretation of December 11, 2001.*

## Rule G-33: Calculations

(a) *Accrued Interest.* Accrued interest shall be computed in accordance with the following formula:

$$\text{Interest} = \text{Rate} \times \text{Par Value of Transaction} \times \frac{\text{Number of Days}}{\text{Number of Days in Year}}$$

For purposes of this formula, the "number of days" shall be deemed to be the number of days from the previous interest payment date (from the dated date, in the case of first coupons) up to, but not including, the settlement date. The "number of days" and the "number of days in year" shall be counted in accordance with the requirements of section (e) below.

(b) *Interest-Bearing Securities*

(i) *Dollar Price.* For transactions in interest-bearing securities effected on the basis of yield the resulting dollar price shall be computed in accordance with the following provisions:

(A) *Securities Paying Interest Solely at Redemption.* Except as otherwise provided in this section (b), the dollar price for a transaction in a security paying interest solely at redemption shall be computed in accordance with the following formula:

$$P = \left[\frac{RV + \left(\frac{DIR}{B} \bullet R\right)}{1 + \left(\frac{DIR - A}{B} \bullet Y\right)}\right] - \left[\frac{A}{B} \bullet R\right]$$

For purposes of this formula the symbols shall be defined as follows:

"A" is the number of accrued days from the beginning of the interest payment period to the settlement date (computed in accordance with the provisions of section (e) below);

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"DIR" is the number of days from the issue date to the redemption date (computed in accordance with the provisions of section (e) below);

"P" is the dollar price of the security for each $100 par value (divided by 100);

"R" is the annual interest rate (expressed as a decimal);

"RV" is the redemption value of the security per $100 par value (divided by 100); and

"Y" is the yield price of the transaction (expressed as a decimal).

(B) Securities with Periodic Interest Payments. Except as otherwise provided in this section (b), the dollar price for a transaction in a security with periodic interest payments shall be computed as follows:

(1) for securities with six months or less to redemption, the following formula shall be used:

$$P = \left[\frac{\frac{RV}{100} + \frac{R}{M}}{1 + \left(\frac{E - A}{E} \bullet \frac{Y}{M}\right)}\right] - \left[\frac{A}{B} \bullet R\right]$$

For purposes of this formula the symbols shall be defined as follows:

"A" is the number of accrued days from the beginning of the interest payment period to the settlement date (computed in accordance with the provisions of section (e) below);

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"E" is the number of days in the interest payment period in which the settlement date falls (computed in accordance with the provisions of section (e) below);

"M" is the number of interest payment periods per year standard for the security involved in the transaction;

"P" is the dollar price of the security for each $100 par value (divided by 100);

"R" is the annual interest rate (expressed as a decimal);

"RV" is the redemption value of the security per $100 par value; and

"Y" is the yield price of the transaction (expressed as a decimal).

(2) for securities with more than six months to redemption, the following formula shall be used:

$$P = \left[\frac{RV}{\left(1+\frac{Y}{2}\right)_{exp}^{N-1+\frac{E-A}{E}}}\right] + \left[\sum_{K=1}^{N}\frac{100 \bullet \frac{R}{2}}{\left(1+\frac{Y}{2}\right)_{exp}^{K-1+\frac{E-A}{E}}}\right] - \left[100 \bullet \frac{A}{B} \bullet R\right]$$

For purposes of this formula the symbols shall be defined as follows:

"A" is the number of accrued days from beginning of the interest payment period to the settlement date (computed in accordance with the provisions of section (e) below);

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"E" is the number of days in the interest payment period in which the settlement date falls (computed in accordance with the provisions of section (e) below);

"N" is the number of interest payments (expressed as a whole number) occurring between the settlement date and the redemption date, including the payment on the redemption date;

"P" is the dollar price of the security for each $100 par value;

"R" is the annual interest rate (expressed as a decimal);

"RV" is the redemption value of the security per $100 par value; and

"Y" is the yield price of the transaction (expressed as a decimal).

For purposes of this formula the symbol "exp" shall signify that the preceding value shall be raised to the power indicated by the succeeding value; for purposes of this formula the symbol "K" shall signify successively each whole number from "1" to "N" inclusive; for purposes of this formula the symbol "sigma" shall signify that the succeeding term shall be computed for each value "K" and that the results of such computations shall be summed.

(ii) *Yield.* Yields on interest-bearing securities shall be computed in accordance with the following provisions:

(A) *Securities Paying Interest Solely at Redemption.* The yield of a transaction in a security paying interest solely at redemption shall be computed in accordance with the following formula:

$$Y = \left[\frac{\left(RV + \left(\frac{DIR}{B} \bullet R\right)\right) - \left(P + \left(\frac{A}{B} \bullet R\right)\right)}{P + \left(\frac{A}{B} \bullet R\right)}\right] \bullet \left[\frac{B}{DIR - A}\right]$$

For purposes of this formula the symbols shall be defined as follows:

"A" is the number of accrued days from the beginning of the interest payment period to the settlement date (computed in accordance with the provisions of section (e) below);

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"DIR" is the number of days from the issue date to the redemption date (computed in accordance with the provisions of section (e) below);

"P" is the dollar price of the security for each $100 par value (divided by 100);

"R" is the annual interest rate (expressed as a decimal);

"RV" is the redemption value of the security per $100 par value (divided by 100); and

"Y" is the yield on the investment if the security is held to redemption (expressed as a decimal).

(B) *Securities with Periodic Interest Payments.* The yield of a transaction in a security with periodic interest payments shall be computed as follows:

(1) for securities with six months or less to redemption, the following formula shall be used:

$$Y = \left[\frac{\left(\frac{RV}{100} + \frac{R}{M}\right) - \left(P + \left(\frac{A}{E} \bullet \frac{R}{M}\right)\right)}{P + \left(\frac{A}{E} \bullet \frac{R}{M}\right)}\right] \bullet \left[\frac{M \bullet E}{E - A}\right]$$

For purposes of this formula the symbols shall be defined as follows:

"A" is the number of accrued days from the beginning of the interest payment period to the settlement date (computed in accordance with the provisions of section (e) below);

"E" is the number of days in the interest payment period in which the settlement date falls (computed in accordance with the provisions of section (e) below);

"M" is the number of interest payment periods per year standard for the security involved in the transaction;

"P" is the dollar price of the security for each $100 par value (divided by 100);

"R" is the annual interest rate (expressed as decimal);

"RV" is the redemption value of the security per $100 par value; and

"Y" is the yield on the investment if the security is held to redemption (expressed as a decimal).

(2) for securities with more than six months to redemption the formula set forth in item (2) of subparagraph (b)(i)(B) shall be used.

(c) *Discounted Securities.*

(i) *Dollar Price.* For transactions in discounted securities, the dollar price shall be computed in accordance with the following provisions:

(A) The dollar price of a discounted security, other than a discounted security traded on a yield-equivalent basis, shall be computed in accordance with the following formula:

$$P = [RV] - \left[ DR \bullet RV \bullet \frac{DSM}{B} \right]$$

For purposes of this formula the symbols shall be defined as follows:

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"DR" is the discount rate (expressed as a decimal);

"DSM" is the number of days from the settlement date of the transaction to the maturity date (computed in accordance with the provisions of section (e) below);

"P" is the dollar price of the security for each $100 par value; and "RV" is the redemption value of the security per $100 par value.

(B) The dollar price of a discounted security traded on a yield-equivalent basis shall be computed in accordance with the formula set forth in subparagraph (b)(i)(A).

(ii) *Return on Investment.* The return on investment for a discounted security shall be computed in accordance with the following provisions:

(A) The return on investment for a discounted security, other than a discounted security traded on a yield-equivalent basis, shall be computed in accordance with the following formula:

$$IR = \left[ \frac{RV - P}{P} \right] \bullet \left[ \frac{B}{DSM} \right]$$

For purposes of this formula the symbols shall be defined as follows:

"B" is the number of days in the year (computed in accordance with the provisions of section (e) below);

"DSM" is the number of days from the settlement date of the transaction to the maturity date (computed in accordance with the provisions of section (e) below);

"IR" is the annual return on investment if the security is held to maturity (expressed as a decimal);

"P" is the dollar price of the security for each $100 par value; and

"RV" is the redemption value of the security per $100 par value.

(B) The yield of a discounted security traded on a yield-equivalent basis shall be computed in accordance with the formula set forth in subparagraph (b)(ii)(A).

(d) *Standards of Accuracy; Truncation.*

(i) *Intermediate Values.* All values used in computations of accrued interest, yield, and dollar price shall be computed to not less than ten decimal places.

(ii) *Results of Computations.* Results of computations shall be presented in accordance with the following:

(A) Accrued interest shall be truncated to three decimal places, and rounded to two decimal places immediately prior to presentation of total accrued interest amount on the confirmation;

(B) Dollar prices shall be truncated to three decimal places immediately prior to presentation of dollar price on the confirmation and computation of extended principal; and

(C) Yields shall be truncated to four decimal places, and rounded to three decimal places, *provided, however*, that for purposes of confirmation display as required under rule G-15(a) yields accurate to the nearest .05 percentage points shall be deemed satisfactory.

Numbers shall be rounded, where required, in the following manner: if the last digit after truncation is five or above, the preceding digit shall be increased to the next highest number, and the last digit shall be discarded.

(e) *Day Counting.*

(i) *Day Count Basis.* Computations under the requirements of this rule shall be made on the basis of a thirty-day month and a three-hundred-sixty-day year, or, in the case of computations on securities paying interest solely at redemption, on the day count basis selected by the issuer of the securities.

(ii) *Day Count Formula.* For purposes of this rule, computations of day counts on the basis of a thirty-day month and a three-hundred-sixty-day year shall be made in accordance with the following formula.

$$\text{Number of Days} = (Y2 - Y1)\,360 + (M2 - M1)\,30 + (D2 - D1)$$

For purposes of this formula the symbols shall be defined as follows:

"M1" is the month of the date on which the computation period begins;

"D1" is the day of the date on which the computation period begins;

"Y1" is the year of the date on which the computation period begins;

"M2" is the month of the date on which the computation period ends;

"D2" is the day of the date on which the computation period ends; and

"Y2" is the year of the date on which the computation period ends.

For purposes of this formula, if the symbol "D2" has a value of "31," and the symbol "D1" has a value of "30" or "31," the value of the symbol "D2" shall be changed to "30." If the symbol "D1" has a value of "31," the value of the symbol "D1" shall be changed to "30." For purposes of this rule time periods shall be computed to include the day specified in the rule for the beginning of the period but not to include the day specified for the end of the period.

## MSRB INTERPRETATIONS

### NOTICE ON RECENTLY EFFECTIVE CHANGES IN CALCULATIONS RULE

May 31, 1984

The Municipal Securities Rulemaking Board has recently received a number of inquiries from members of the municipal securities industry and others concerning certain of the provisions of rule G-33 on calculations. In particular, such persons have inquired concerning the acceptability under the rule of the practice of interpolation as a method of determining dollar price from yield. Such persons have also asked whether the rule permits a dealer effecting a transaction at a yield price equal to the interest rate on the securities to presume that the dollar price on the transaction is "100."

The Board wishes to remind members of the industry that both of these practices are no longer permissible. Board rule G-33 generally requires that yields and dollar prices on transactions effected by municipal securities brokers and dealers be computed in accordance with the formulas prescribed in the rule directly to the settlement date of the transaction. Subparagraph (b)(i)(C) of the rule permitted, until January 1, 1984, the use of the dollar price "100" as the presumed result on transactions in securities with a redemption value of par effected at a yield price equal to the interest rate on the securities. Subparagraph (b)(i)(D) of the rule permitted, until January 1, 1984, the use of interpolation as a method of deriving a dollar price. Since the effectiveness of both of these provisions lapsed as of January 1, 1984, therefore, these practices are no longer in compliance with the requirements of the rule; dollar prices on all transactions effected on a yield basis (including transactions effected on a yield basis equal to the interest rate) should therefore be computed directly to the settlement date of the transaction.

The Board notes that the rule continues to permit a municipal securities broker or dealer to effect a transaction in dollar price terms. Therefore, a dealer wishing to offer or sell a security at par may continue to effect the transaction on a direct dollar price basis at a price of "100."

### NOTICE OF INTERPRETATION CONCERNING PRICE CALCULATION FOR SECURITIES WITH AN INITIAL NON-INTEREST PAYING PERIOD: RULE G-33

August 25, 1986

The Board has adopted a method for calculating the price of securities for which there are no scheduled interest payments for an initial period, generally for several years, after which periodic interest payments are scheduled. These securities, known by such names as "Growth and Income Securities," and "Capital Appreciation/Future Income Securities," function essentially as "zero coupon" securities for a period of time after issuance, accruing interest which is payable only upon redemption. On a certain date after issuance ("the interest commencement date"), the securities begin to accrue interest for semi-annual payment.

In March 1986, the Board published for comment a proposed method of calculating price from yield for such securities.[1] The Board received five comments on the proposed method, four expressing support for the method and one expressing no opinion. The commentators generally noted that the proposed method appeared to be accurate and could be used on bond calculators commonly available in the industry. The Board has adopted the proposed method of calculation, set forth below, as an interpretation of rule G-33 on calculations.

The general formula for calculating the price of securities with periodic interest payments is contained in rule G–33(b)(i)(B)(2). For securities with periodic payments, but with an initial non–interest paying period, this formula also is used.[2] For settlement dates occurring prior to the interest commencement date the price is computed by means of the following two-step process. First, a hypothetical price of the securities at the interest commencement date is calculated using the interest commencement date as the hypothetical settlement date,[3] the interest rate ("R" in the formula) for the securities during the interest payment period and the yield ("Y" in the formula) at which the securities are sold. This hypothetical price is computed to not less than six decimal places, and then is used as the redemption value ("RV" in the formula) in a second calculation using the G-33(b)(i)(B)(2) formula, with the interest commencement date as the redemption date, the actual settlement date for the transaction as the settlement date, and a value of zero for R, the interest rate. The resultant price, using the formula in G-33(b)(i)(B)(2), is the correct price of the securities.[4]

The price of such securities for settlement dates occurring after the interest commencement date, of course, should be calculated as for any other securities with periodic interest payments.[5]

1 MSRB Reports, Vol. 6, No. 2 (March 1986) at 13.

2 This interpretation is not meant to apply to securities which have a long first coupon period, but which otherwise are periodic interest paying securities.

3 For settlement dates less than 6 months to the hypothetical redemption date, the formula in rule G-33(b)(ii)(B)(1) should be used in lieu of the formula in rule G-33(b)(ii)(B)(2).

4 Rule G-12(c)(v)(I) and G-15(a)(i)(I) [currently codified at rule G-15(a)(i)(A)(5)(c)] require that securities be priced to the lowest of price to call, price to par option, or price to maturity. Thus, the redemption date used for this calculation method should be the date of an "in whole" refunding call if this would result in a lower dollar price than a computation to maturity.

5 The formula in G-33(b)(i)(B)(1) should be used for calculations in which settlement date is six months or less to redemption date.

See also:

**Rule G-17 Interpretation – Transactions in Municipal Securities with Non-Standard Features Affecting Price/Yield Calculations,** June 12, 1995.

## *Interpretive Letters*

**Day counting: securities dated on the 15th of a month.** I am writing in response to your letter of May 26, 1982 in which you inquire as to the correct day count for calculation purposes on a security which is dated on the 15th of a month and pays interest on the first of a following month. In your letter you pose the example of a security dated on June 15, 1982 and paying interest on July 1, 1982, and you inquire whether the July 1, 1982 coupon on such security should have a value of 15 or 16 days of accrued interest.

As you know, Board rule G-33 provides the following formula for use on computations of day counts on securities calculated on a "30/360" day basis:

**Number of Days =**
**(Y2-Y1) 360 + (M2-M1) 30 + (D2-D1)**

In this formula, the variables "Yl," "M1," and "D1" are defined as the year, month, and day, respectively, of the date on which the computation period begins (June 15, 1982, in your example), and "Y2," "M2," and "D2" as the year, month, and day of the date on which the computation period ends (July 1, 1982, in your example). In the situation you present, therefore, the number of days in the period would correctly be computed as follows:

**Number of Days =**
**(1982-1982) 360 + (7-6) 30 + (1-15)**

or

**Number of Days = (0) 360 + (1) 30 + (-14)**

or

**Number of Days =**
**0 + 30 + (-14)**

or

**Number of Days = 16 days**

If figured correctly, therefore, the coupon for such a period should have a value of 16 days of accrued interest. If the coupon is for a longer period of time, this particular portion of that longer period would still correctly be counted as 16 days (*e.g.*, the day count on a coupon for the period June 15 to September 1 would correctly be figured as 76 days, consisting of 16 days for the period June 15 to July 1, and 30 days each for the months of July and August).

The error of computing the day count for such a period as 15 days apparently arises from an assumption that, on a security dated on the 15th of a month, accrued interest is owed only for the "second half" of that month. In reality, of course, the 15th of a month is not the first day of the "second half" of that month, but rather is the last day of the "first half" of that month (since a 30-day month consists of two 15-day half-months, the first half being from the 1st to the 15th, and the second half being from the 16th to the 30th). Again, it can clearly be seen that the correct day count for such a period is 16 days. *MSRB interpretation of June 2, 1982.*

**Day counting: day counts on notes.** As I indicated in my letter of October 4, your September 27 letter regarding the inclusion on a customer confirmation of information with respect to the day count method used on a transaction was referred to the Board for its consideration at the December meeting. In your letter you noted that Board rule G-33 on calculations requires that

> [c]omputations under the requirements of [the] rule shall be made on the basis of a thirty-day month and a three-hundred-sixty-day year, or, in the case of computations on securities paying interest solely at redemption, on the day count basis selected by the issuer of the securities.

You indicated that your bank has recently experienced problems with transactions in municipal notes ("securities paying interest solely at redemption") on which the issuer has selected a day count basis other than the traditional "30/360" basis, with the problems resulting from one party to the transaction using an incorrect day count method. You suggested that this type of problem could be partially alleviated by requiring that a municipal securities dealer selling a security on which an unusual day count method is used specify the day count method on the confirmation of the transaction.

The Board shares your concern that a failure to identify the day count method used on a particular security may subsequently cause problems in completing a transaction. Therefore, the Board believes that the parties to a transaction should exchange information at the time of trade concerning any unusual day count method used on the securities involved in the transaction. Since the party selling the securities is more likely to be aware of the unusual day count, it would be desirable that sellers take steps to ensure that they advise the contra-par-

ties on transactions of the method to be used.

The Board does not, however, believe that it would be appropriate to require that this information be stated on the confirmation. The Board reached this determination based on its perception that the space available on the confirmation for the details of the securities description is quite limited and its belief that information regarding the day count method may not be sufficiently material to warrant its inclusion in the securities description. *MSRB interpretation of December 9, 1982.*

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**Use of formulas: annual interest securities.** I am writing in response to your letter of June 1, 1983 regarding the appropriate method of calculating yield and dollar price on periodic-interest municipal securities which pay interest on an annual, rather than the more customary semi-annual, basis. You note in your letter that Board rule G-33 requires the use for purposes of computations of yield and dollar price on such securities of a formula which presumes semi-annual payment of interest (i.e., that formula set forth in subparagraph (b)(i)(B)(2) of the rule). You suggest that the rule should be amended to require the use of a formula that recognizes the annual interest payment cycle on the securities.

As I indicated to you in our previous telephone conversation on this subject, the industry has traditionally disregarded the unusual nature of the interest payment cycle on these securities when computing yields and dollar prices on them, and has followed the practice of using the standard formula for computing yield and dollar price on a security paying interest on a semi-annual basis for these purposes. As a result of this traditional practice, all of the calculators presently available for use by industry members when computing yields and dollar prices have been designed in accordance with the assumption that all periodic-interest municipal securities pay interest on a semi-annual basis; these calculator models cannot be used to compute yields and dollar prices on such securities on any other basis. Therefore, the adoption of a requirement that yields and dollar prices on securities which pay interest on an annual basis be computed by means of a formula which recognizes the annual nature of the interest payment cycle, such as you suggest, would render all of the existing calculator models obsolete, and require that all industry members incur the cost of purchasing new calculator equipment capable of performing such computations (equipment which does not, to my knowledge, exist as of yet).

It is because of the substantial compliance expense that would have been imposed on the industry that the Board declined to adopt a requirement such as you suggest at the time rule G-33 was promulgated, even though it recognized that the requirement that was adopted mandated the use of a formula that would produce slightly less accurate results. *MSRB interpretation of June 6, 1983.*

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[1] "Notice of Filing of Rule G-33 on Calculations," MSRB Manual at ¶ 10,188.

## Rule G-34: CUSIP Numbers and New Issue Requirements

(a) *New Issue Securities.*

(i) *Assignment of CUSIP Numbers.*

(A) Except as otherwise provided in this section (a), each broker, dealer or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall apply in writing to the Board or its designee for assignment of a CUSIP number or numbers to such new issue. The broker, dealer or municipal securities dealer shall make such application as promptly as possible, but in no event later than, in the case of negotiated sales, a time sufficient to ensure assignment of a CUSIP number or numbers on or prior to the business day on which the contract to purchase the securities from the issuer is executed: or, in the case of competitive sales, the date of award. A broker, dealer or municipal securities dealer acting as a financial advisor to an issuer in connection with a competitive sale of an issue shall ensure that application for a CUSIP number or numbers is made in sufficient time to permit assignment of CUSIP numbers prior to the date of award. The broker, dealer or municipal securities dealer shall provide to the Board or its designee the following information:

(1) complete name of issue and series designation, if any;

(2) interest rate(s) and maturity date(s) (*provided, however*, that, if the interest rate is not established at the time of application, it may be provided at such time as it becomes available);

(3) dated date;

(4) type of issue (*e.g.*, general obligation, limited tax or revenue);

(5) type of revenue, if the issue is a revenue issue;

(6) details of all redemption provisions;

(7) the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to the debt service on all or part of the issue (and, if part of the issue, an indication of which part); and

(8) any distinction(s) in the security or source of payment of the debt service on the issue, and an indication of the part(s) of the issue to which such distinction(s) relate.

(B) The information required by subparagraph (i)(A) of this section (a) shall be provided in accordance with the provisions of this subparagraph. At the time application is made the broker, dealer or municipal securities dealer making such application shall provide to the Board or its designee a copy of a notice of sale, official statement, legal opinion, or other similar documentation prepared by or on behalf of the issuer, or portions of such documentation, reflecting the information required by subparagraph (i)(A) of this section (a). Such documentation may be submitted in preliminary form if no final documentation is available at the time of application. In such event the final documentation, or the relevant portions of such documentation, reflecting any changes in the information required by subparagraph (i)(A) of this section (a) shall be submitted when such documentation becomes available. If no such documentation, whether in preliminary or final form, is available at the time application for CUSIP number assignment is made, such copy shall be provided promptly after the documentation becomes available.

(C) The provisions of paragraph (i) of this section (a) shall not apply with respect to any new issue of municipal securities on which the issuer or a person acting on behalf of the issuer has submitted an application for assignment of a CUSIP number or numbers to such issue to the Board or its designee.

(D) In the event that the proceeds of the new issue will be used, in whole or in part, to refund an outstanding issue or issues of municipal securities in such a way that part but not all of the outstanding issue or issues previously assigned a single CUSIP number is to be refunded to one or more redemption date(s) and price(s) (or all of an outstanding issue is to be refunded to more than one redemption date and price), the broker, dealer or municipal securities dealer shall apply in writing to the Board or its designee for a reassignment of a CUSIP number to each part of the outstanding issue refunded to a particular redemption date and price and shall provide to the Board or its designee the following information on the issue or issues to be refunded:

(1) the previously assigned CUSIP number of each such part or issue;

(2) for each such CUSIP number, the redemption dates and prices, to be established by the refunding;

(3) for each such redemption date and price, a designation of the portion of such part or issue (*e.g.*, the designation of use of proceeds, series, or certificate numbers) to which such redemption date and price applies.

The broker, dealer or municipal securities dealer also shall provide documentation supporting the information provided pursuant to the requirements of this subparagraph (D).

(ii) *Application for Depository Eligibility, CUSIP Number Affixture and Initial Communications.* Each broker, dealer or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue ("underwriter") shall carry out the following functions:

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

(1) an issue of municipal securities that fails to meet the criteria for depository eligibility at all depositories that accept municipal securities for deposit; or

(2) any new issue maturing in 60 days or less.

(B) The underwriter, prior to the delivery of such securities to any other person, shall affix to, or arrange to have affixed to, the securities certificates of such new issue the CUSIP number assigned to such new issue. If more than one CUSIP number is assigned to the new issue, each such number shall be affixed to the securities certificates of that part of the issue to which such number relates.

(C) The underwriter, on initial trade date, shall communicate the following information to syndicate and selling group members:

(1) the CUSIP number or numbers assigned to the issue and descriptive information sufficient to identify the CUSIP number corresponding to each part of the issue assigned a specific CUSIP number; and

(2) the initial trade date. For purposes of this subparagraph (a)(ii)(C), initial trade date shall mean, for competitive issues, either the date of award, or the first date allocations are made to syndicate or selling group members, whichever date is later, and, for negotiated issues, either the date on which the contract to purchase the securities from the issuer is executed, or the first date allocations are made to syndicate or selling group members, whichever date is later.

(D) For any new issue of municipal securities eligible for comparison through the automated comparison facilities of a registered clearing agency under section (f) of rule G-12, the underwriter shall provide the registered securities clearing agency responsible for comparing when, as and if issued transactions with:

(1) final interest rate and maturity information about the new issue as soon as it is available; and

(2) the settlement date of the new issue as soon as it is known and shall immediately inform the registered clearing agency of any changes in such settlement date.

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

(b) *Secondary Market Securities.*

(i) Each broker, dealer, or municipal securities dealer that, in connection with a sale or an offering for sale of part of a maturity of an issue of municipal securities, acquires or arranges for the acquisition of a transferable instrument applicable to such part which alters the security or source of payment of such part shall apply in writing to the Board or its designee for the assignment of a CUSIP number to designate the part of the maturity of the issue which is the subject of the instrument when traded with the instrument attached. Such instruments shall include (A) insurance with respect to the payment of debt service on such portion, (B) a put option or tender option, (C) a letter of credit or guarantee, or (D) any other similar device. This paragraph (i) shall not apply with respect to any part of an outstanding maturity of an issue of municipal securities with respect to which a CUSIP number that is applicable to such part when traded with an instrument which alters the security or source of payment of such part has already been assigned.

(ii) Each broker, dealer or municipal securities dealer, in connection with a sale or an offering for sale of part of a maturity of an issue of municipal securities which is assigned a CUSIP number that no longer designates securities identical with respect to all features of the issue listed in items (1) through (8) of subparagraph (a)(i)(A) of this rule, shall apply in writing to the Board or its designee for a new CUSIP number or numbers to designate the part or parts of the maturity which are identical with respect to items (1) through (8) of subparagraph (a)(i)(A).

(iii) The broker, dealer or municipal securities dealer shall make the application required under this section (b) as promptly as possible, and shall provide to the Board or its designee:

(A) the previously assigned CUSIP number;

(B) all information on the features of the maturity of the issue listed in items (1) through (8) of subparagraph (a)(i)(A) of this rule and documentation of the features of such maturity sufficient to evidence the basis for CUSIP number assignment; and,

(C) if the application is based on an instrument affecting the source of payment or security for a part of a maturity of an issue, information on the nature of the instrument, including the name of any party obligated with respect to debt service under the terms of such instrument and documentation sufficient to evidence the nature of the instrument.

(c) *Exemptions.* The provisions of this rule shall not apply to an issue of municipal securities (or for the purpose of section (b) any part of an outstanding maturity of an issue) which (i) does not meet the eligibility criteria for CUSIP number assignment or (ii) consists entirely of municipal fund securities.

## MSRB INTERPRETATIONS

### NOTICE CONCERNING CUSIP NUMBERS FOR CALLABLE MULTI-SERIES GOS: RULE G-34

November 13, 1989

Rule G-34 requires underwriters and dealers participating in the placement of a new issue of municipal securities to ensure that an application is made for CUSIP numbers for the new issue.[1] The CUSIP Service Bureau assigns CUSIP numbers to reflect the differences in securities that are relevant to trading and investment decisions.[2] In addition, Board rules G-12 and G-15 require that CUSIP numbers appear on confirmations of transactions and that the securities delivered on those transactions match the CUSIP numbers appearing on the confirmations.[3]

Recently, certain questions have arisen about the proper method for assignment of CUSIP numbers to certain general obligation securities that have been issued in multiple series. In these issues, the issuer uses the proceeds from each series to fund a separate project, but the project itself offers bondholders no additional security for payment beyond that provided by the full faith and credit of the issuer. Securities within multiple series may be identical with respect to dated date, maturity, security and source of payment. However, an individual series may be called, in whole or part, at the option of the issuer, based on the series designation. In addition, the securities are subject to certain mandatory redemption features, which are exercisable by series and which are dependent upon the status of the project funded by the series.

Underwriters have encountered confusion as to whether each series within these issues should be assigned separate CUSIP numbers or whether the CUSIP number assignment for the issues should ignore the series designation. The Board wishes to clarify that, because of the possibility that the securities will be subject to early redemption by series designation, separate CUSIP numbers for each series are required.

The Board previously has indicated that a designation of multiple "purposes" for general obligation debt does not require separate CUSIP numbers for each purpose if the securities otherwise are identical.[4] Accordingly, there are a number of outstanding multi-series general obligation issues which are assigned one CUSIP number for each maturity and which are traded, cleared, and settled without regard to series designation. While the Board does not wish to change this general rule, it believes that separate CUSIP number assignment is required for those multi-series issues which can be called by series. The Board notes that the probability of a partial or "in-whole" redemption of a series has the potential to become a significant factor to investors and that it therefore is necessary to preserve distinctions among the various series when trading, clearing and settling these securities.

The Board has consulted with the CUSIP Service Bureau in this matter and the Service Bureau has agreed to assign separate CUSIP numbers to multi-series general obligation issues which can be called by series. Dealers serving as underwriters for these issues therefore should not request the Service Bureau to ignore the series designation when assigning numbers to these issues.

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1 The rule applies to all issues eligible for CUSIP number assignment. This includes nearly all new issue securities over three months in maturity.

2 CUSIP numbers are assigned to municipal issues by their issuer title, dated date, interest rate, and maturity date. Municipal securities which are identical as to these four elements are assigned different numbers if there is a further distinction between the securities involving any of the following:

(1) the call features (*i.e.*, whether or not securities are callable, date or terms of call feature, etc.);

(2) any limitation of the pledge on a general obligation bond (*e.g.*, limited tax versus full faith and credit);

(3) any distinction in the secondary security or the source of payment of a revenue bond;

(4) the identity of any entity, besides the issuer, obligated on the debt service of the securities (*e.g.*, two pollution control revenue bonds secured by different corporate obligors); and

(5) any distinction in the secondary security or the source of payment of a general obligation bond.

3 Certain exceptions to these rules exist for securities which have not been assigned CUSIP numbers and instances in which the CUSIP number on a confirmation and the CUSIP number assigned to securities differ only because of a transposition or transcription error.

4 See *MSRB Reports* Vol. 2, No. 1, (January 1982), p. 3. Of course, if specific portions of a general obligation issue are additionally backed by the revenues from various issuer activity or proceeds from various projects (so-called "double-barrelled" issues), separate CUSIP numbers are required to reflect these distinctions.

See also:

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

### *Interpretive Letter*

See:

**Rule G-15 Interpretive Letter – Securities description: revenue securities,** *MSRB interpretation of December 1, 1982.*

## Rule G-35: Arbitration

*Arbitration Involving Bank Dealers.*

As of January 1, 1998, every bank dealer (as defined in rule D-8) shall be subject to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. ("NASD") for every claim, dispute or controversy arising out of or in connection with the municipal securities activities of the bank dealer acting in its capacity as such. For purposes of this rule, each bank dealer shall be subject to, and shall abide by, the NASD's Code of Arbitration Procedure, including any amendments thereto, as if the bank dealer were a "member" of the NASD.

### *MSRB INTERPRETATION*

See:

Rule G-17 Interpretation – Notice of Interpretation Requiring Dealers to Submit to Arbitration as a Matter of Fair Dealing, March 6, 1987.

## Rule G-36: Delivery of Official Statements, Advance Refunding Documents and Forms G-36(OS) and G-36(ARD) to Board or its Designee

(a) *Definitions.* For purposes of this rule, the following items have the following meanings:

(i) The term "final official statement" shall mean a document or documents defined in Securities Exchange Act rule 15c2-12(f)(3).

(ii) The term "primary offering" shall mean an offering defined in Securities Exchange Act rule 15c2-12(f)(7).

(iii) The term "advance refunding documents" shall mean the refunding escrow trust agreement or its equivalent.

(b) *Delivery Requirements for Issues Subject to Securities Exchange Act Rule 15c2-12.*

(i) Each broker, dealer or municipal securities dealer that acts as an underwriter in a primary offering of municipal securities subject to Securities Exchange Act rule 15c2-12 shall send to the Board or its designee, within one business day after receipt of the official statement from the issuer or its designated agent, but no later than 10 business days after any final agreement to purchase, offer, or sell the municipal securities, the final official statement and completed Form G-36(OS) prescribed by the Board, including the CUSIP number or numbers for the issue.

(ii) If the issue advance refunds an outstanding issue of municipal securities, each broker, dealer or municipal securities dealer that acts as an underwriter in such issue also shall send to the Board or its designee, within five business days of delivery of the securities by the issuer to the broker, dealer, or municipal securities dealer, the advance refunding document and completed Form G-36(ARD) prescribed by the Board, including reassigned CUSIP number or numbers for the refunded issue, if any.

*(c) Delivery Requirements for Issues not Subject to Securities Exchange Act Rule 15c2-12.*

(i) Subject to paragraph (iii) below, each broker, dealer, or municipal securities dealer that acts as an underwriter in a primary offering of municipal securities not subject to Securities Exchange Act rule 15c2-12 for which an official statement in final form is prepared by or on behalf of the issuer shall send to the Board or its designee, by the later of one business day after delivery of the securities by the issuer to the broker, dealer, or municipal securities dealer or one business day after receipt of the official statement in final form from the issuer or its designated agent, the official statement in final form and completed Form G-36(OS) prescribed by the Board, including the CUSIP number or numbers for the issue.

(ii) if the issue advance refunds an outstanding issue of municipal securities and both an official statement in final form and an advance refunding document are prepared by or on behalf of the issuer, each broker, dealer, or municipal securities dealer that acts as an underwriter in such issue also shall send to the Board or its designee, within five business days of delivery of the securities by the issuer to the broker, dealer, or municipal securities dealer, the advance refunding document and completed Form G-36(ARD) prescribed by the Board, including reassigned CUSIP number or numbers for the refunded issue, if any.

(iii) This section shall not apply to a primary offering of municipal securities, regardless of the amount of the issue, if:

(A) the issue qualifies for an exemption set forth in paragraph (1)(i) of section (d) of Securities Exchange Act rule 15c2-12; or

(B) the issue consists of commercial paper that qualifies for an exemption set forth in paragraph (1)(ii) of section (d) of Securities Exchange Act rule 15c2-12, but only if the official statement in final form, if any, used in connection with such offering: (1) has previously been properly submitted to the Board or its designee in connection with a prior primary offering and (2) has not been supplemented, amended or "stickered" subsequent to such prior submission.

(d) *Amended Official Statements.* In the event a broker, dealer, or municipal securities dealer provides to the Board or its designee an official statement pursuant to sections (b) or (c), above, and the official statement is amended or "stickered" by the issuer during the underwriting period, such broker, dealer, or municipal securities dealer must send to the Board or its designee, within one business day after receipt of the amended official statement from the issuer or its designated agent, the amended official statement and an amended Form G-36(OS) as prescribed by the Board, including: the CUSIP number or numbers for the issue; the fact that the official statement previously had been sent to the Board or its designee and that the official statement has been amended.

(e) *Cancellation of Issue.* In the event a broker, dealer or municipal securities dealer provides to the Board or its designee the documents and written information referred to in sections (b) or (c), above, but the issue is later cancelled, the broker, dealer, or municipal securities dealer shall notify the Board or its designee of this fact promptly in writing.

(f) *Underwriting Syndicate.* In the event a syndicate or similar account has been formed for the underwriting of a primary offering of municipal securities, the managing underwriter shall take the actions required under the provisions of this rule

and comply with the recordkeeping requirements of rule G-8(a)(xv).

(g) *Method of Submission.* A broker, dealer or municipal securities dealer that submits documents or forms required to be sent to the Board or its designee pursuant to section (b), (c) or (d) above shall either:

(i) send two copies of each such document or form to the Board or its designee by certified or registered mail, or some other equally prompt means that provides a record of sending; or

(ii) submit an electronic version of each such document or form to the Board or its designee in such format and manner specified in the current *Form G-36 Manual.*

## MSRB INTERPRETATIONS

See:

Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market, January 18, 2001.

Rule G-30 Interpretation – Interpretive Notice on Commissions and Other Changes, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001.

Rule G-32 Interpretation – Interpretation on the Application of Rules G-32 and G-36 to New Issue Offerings through Auction Procedures, March 26, 2001.

### *Interpretive Letters*

**Current Refundings.** This is in response to your letter of July 10, 1991. You note that, pursuant to recently adopted amendments to rule G-36, underwriters are required to deliver advance refunding documents (i.e., escrow agreements) to the Board. You state that, under Section 149(d)(5) of the Internal Revenue Code of 1986, as amended, an advance refunding issue is one which will be issued more than 90 days before the redemption of the refunded bonds. Escrow deposits customarily are made of U.S. government obligations or other highly-rated securities which are sufficient to pay principal and interest to retire the bonds being refunded over some period of time. You note, however, that for current refundings, there also are short-term escrows established for periods of less than 90 days which involve the investment of bond proceeds in permitted defeasance securities until the first permitted redemption date. You ask whether it is necessary to file Form G-36(ARD) and the related documents when the escrow period is less than 90 days. The Board has reviewed your request and has authorized this response.

Rule G-36 requires underwriters, among other things, to provide advance refunding documents to the Board. The purpose of this requirement is so these documents will be available through the Board's Municipal Securities Information Library(TM) (MSIL(TM)) system,[1] to the holders of the refunded issues, as well as dealers and customers effecting transactions in such issue. In general, municipal securities industry participants consider advance refunding issues as those issued more than 90 days before the redemption of the refunded bonds. The current refunding issues you describe would not be considered advance refunding issues. Thus, rule G-36 does not require underwriters to provide the Board with escrow agreements for current refundings. *MSRB Interpretation of August 8, 1991.*

[1] Municipal Securities Information Library and MSIL are trademarks of the Board.

**Multiple underwriters.** This is in response to your letter in which you ask us whether a dealer that serves in the capacity as settlement agent for an issuer, as described in your letter, is obligated to file Form G-36(OS) in connection with a primary offering of municipal securities sold and delivered in the manner described in your letter.

Board rule G-36 obligates an underwriter in any primary offering of municipal securities that is subject to Rule 15c2-12 promulgated by the Securities and Exchange Commission to send to the Board, within one business day after receipt of the final official statement from the issuer, but no later than 10 business days after any final agreement to purchase, offer or sell the municipal securities, two copies of the final official statement and two copies of completed Form G-36 (OS).[1] In the event a syndicate or similar account has been formed for the underwriting of a primary offering, the managing underwriter is obligated to undertake, on behalf of the syndicate or account, the duty of sending the official statement and Form G-36(OS) to the Board.[2]

The obligation to comply with the requirements of rule G-36 and the related recordkeeping requirements of rule G-8(a)(xv) attaches to all underwriters in a primary offering that is subject to rule G-36. The only circumstance in which these rules permit an underwriter to depend upon another party to fulfill such obligation is when another underwriter has taken on the duties of a managing underwriter for a syndicate or similar account formed for the particular underwriting, in which case the rules place responsibility for compliance on such managing underwriter. Thus, in any primary offering in which more than one dealer is serving as underwriter (within the meaning of federal securities laws) for the same municipal securities without having formed an underwriting syndicate or similar account, each such underwriter (regardless of its stated capacity as settlement agent or otherwise) is individually obligated to comply with the requirements of rule G-36 and the related recordkeeping requirements of rule G-8(a)(xv). *MSRB interpretation of January 30, 1998.*

[1] Rule G-36 also obligates an underwriter in any primary offering of municipal securities that is not subject to SEC Rule 15c2-12 (other than a limited placement within the meaning of SEC Rule 15c2-12(d)(1)(i)) for which the issuer has prepared an official statement in final form to send to the Board, within one business day after delivery of the securities by the issuer to the underwriters, two copies of the official statement in final form and two copies of completed Form G-36(OS).

[2] The managing underwriter is also required to undertake all recordkeeping duties imposed under rule G-8(a)(xv) in connection with rule G-36.

## FORM G-36 MANUAL

Instructions for completing Forms G-36(OS) and G-36(ARD) are contained in the **Form G-36 Manual**. You can view the **Form G-36 Manual** online at the MSRB's website (www.msrb.org). Click on the link entitled Form G-36 Submissions and then click on the link to the **Form G-36 Manual**.

DO NOT STAPLE THIS FORM

# MSRB FORM G-36(OS) – FOR OFFICIAL STATEMENTS

## SECTION I – MATERIALS SUBMITTED

A. THIS FORM IS SUBMITTED IN CONNECTION WITH **(check one):**

1. ☐ A FINAL OFFICIAL STATEMENT RELATING TO A PRIMARY OFFERING OF MUNICIPAL SECURITIES **(enclose two (2) copies)**

   (a) DATE RECEIVED FROM ISSUER:_____ (b) DATE SENT TO MSRB:_____

2. ☐ AN AMENDED OFFICIAL STATEMENT WITHIN THE MEANING OF RULE G-36(d) **(enclose two (2) copies)**

   (a) DATE RECEIVED FROM ISSUER:_____ (b) DATE SENT TO MSRB:_____

B. IF MATERIALS SUBMITTED WITH THIS FORM CONSIST OF MORE THAN ONE DOCUMENT (*e.g.*, preliminary official statement and wrap, even if physically attached), PLEASE CHECK HERE: ☐

C. IF THIS FORM AMENDS PREVIOUSLY SUBMITTED FORM WITHOUT CHANGING MATERIALS SUBMITTED, PLEASE CHECK HERE **(include copy of original Form G-36(OS))**: ☐

## SECTION II – IDENTIFICATION OF ISSUE(S)

**Each issue must be listed separately. If more space is needed to list additional issues, please include on separate sheet and check here:** ☐

A. NAME OF ISSUER:_____ STATE:_____
DESCRIPTION OF ISSUE:_____ DATED DATE:_____

B. NAME OF ISSUER:_____ STATE:_____
DESCRIPTION OF ISSUE:_____ DATED DATE:_____

C. NAME OF ISSUER:_____ STATE:_____
DESCRIPTION OF ISSUE:_____ DATED DATE:_____

## SECTION III – TRANSACTION INFORMATION

A. LATEST FINAL MATURITY DATE OF ALL SECURITIES IN OFFERING:_____

B. DATE OF FINAL AGREEMENT TO PURCHASE, OFFER OR SELL SECURITIES (Date of Sale):_____

C. ACTUAL OR EXPECTED DATE OF DELIVERY OF SECURITIES TO UNDERWRITER(S) (Bond Closing):_____

D. IF THESE SECURITIES ADVANCE REFUND ALL OR A PORTION OF ANOTHER ISSUE, PLEASE CHECK HERE: ☐

**A separate Form G-36(ARD) and copies of the advance refunding documents must be submitted for each issue advance refunded.**

## SECTION IV – UNDERWRITING ASSESSMENT INFORMATION

**This information will be used by the MSRB to compute any rule A-13 underwriting assessment that may be due on this offering. The managing underwriter will be sent an invoice if a rule A-13 assessment is due on the offering.**

A. MANAGING UNDERWRITER:_____ SEC REG. NUMBER:_____

B. TOTAL PAR VALUE OF ALL SECURITIES IN OFFERING: $_____

C. PAR AMOUNT OF SECURITIES UNDERWRITTEN (if different from amount shown in item B above): $_____

D. CHECK ALL THAT APPLY:

1. ☐ At the option of the holder thereof, all securities in this offering may be tendered to the issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by the issuer or its designated agent.

2. ☐ At the option of the holder thereof, all securities in this offering may be tendered to the issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every two years until maturity, earlier redemption, or purchase by the issuer or its designated agent.

3. ☐ This offering is exempt from SEC Rule 15c2-12 under section (d)(1)(i) of that rule. Section (d)(1)(i) of SEC Rule 15c2-12 states that an offering is exempt from the requirements of the rule if the securities offered have authorized denominations of $100,000 or more and are sold to no more than 35 persons each of whom the participating underwriter believes: (1) has the knowledge and expertise necessary to evaluate the merits and risks of the investment; and (2) is not purchasing for more than one account, or with a view toward distributing the securities.



CONTINUED ON OTHER SIDE

## SECTION V – CUSIP INFORMATION

**MSRB rule G-34 requires that CUSIP numbers be assigned to each new issue of municipal securities unless the issue is ineligible for CUSIP number assignment under the eligibility criteria of the CUSIP Service Bureau.**

A CUSIP-9 NUMBERS OF ISSUE(S)

| Maturity Date | CUSIP Number | Maturity Date | CUSIP Number | Maturity Date | CUSIP Number |
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B. IF ANY OF THE ABOVE SECURITIES HAS A "CUSIP-6" BUT NO "CUSIP-9", CHECK HERE AND LIST THEM BELOW: ☐
**(Please see instructions in Form G-36 Manual)**

LIST ALL CUSIP-6 NUMBERS ASSIGNED: _____

State the reason why such securities have not been assigned a "CUSIP-9": _____

C. IF ANY OF THESE SECURITIES IS INELIGIBLE FOR CUSIP NUMBER ASSIGNMENT, PLEASE CHECK HERE: ☐

State the reason why such securities are ineligible for CUSIP number assignment: _____

## SECTION VI – MANAGING UNDERWRITER'S CERTIFICATION AND SIGNATURE

**THE UNDERSIGNED CERTIFIES THAT THE MATERIALS ACCOMPANYING THIS FORM ARE AS DESCRIBED IN SECTION I ABOVE AND THAT ALL OTHER INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT. THE UNDERSIGNED ACKNOWLEDGES THAT SAID MATERIALS WILL BE PUBLICLY DISSEMINATED.**

**ON BEHALF OF THE MANAGING UNDERWRITER IDENTIFIED IN SECTION IV ABOVE**

**SIGNED:** _____

NAME: _____
**(PRINT – Must be an employee or officer of the managing underwriter)**

FAX: _____ PHONE: _____
**(Include phone and fax numbers at which you are most likely to be reached to expedite processing of this form and accompanying materials)**

**NOTE:**

1. **Please refer to Form G-36 Manual for detailed instructions for completing this form.**
2. **All items on this form must be completed or noted as inapplicable. INCOMPLETE SUBMISSIONS WILL BE RETURNED FOR CORRECTION.**
3. **Two properly completed copies of this form and two copies of the official statement or amended official statement must be included to be considered sent to the MSRB within the meaning of rule G-36.**
4. **Submit this form and accompanying materials to the MSRB, MSIL System, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314-3412.**

DO NOT STAPLE THIS FORM

# MSRB FORM G-36(ARD) – FOR ADVANCE REFUNDING DOCUMENTS

## SECTION I – MATERIALS SUBMITTED

**Submission is not required if there is no refunding issue or the refunding issue effects a current refunding (*i.e.*, the issue refunded will mature or be redeemed in 90 days or less from the date of issuance of the refunding issue).**

A. THIS FORM IS SUBMITTED IN CONNECTION WITH THE FOLLOWING ADVANCE REFUNDING DOCUMENT(S) (refunding escrow trust agreement or equivalent) PREPARED FOR THE ADVANCE REFUNDING OF OUTSTANDING MUNICIPAL SECURITIES **(enclose 2 copies)**:

1. TITLE OF ADVANCE REFUNDING DOCUMENT(S): _____

2. DATE OF ADVANCE REFUNDING DOCUMENT(S): _____

3. DATE RECEIVED FROM ISSUER: _____ DATE SENT TO MSRB: _____

B. IF MATERIALS SUBMITTED WITH THIS FORM CONSIST OF MORE THAN ONE DOCUMENT, PLEASE CHECK HERE: ☐

C. IF THIS FORM AMENDS PREVIOUSLY SUBMITTED FORM, CHECK HERE **(include copy of original Form G-36(ARD))**: ☐

## SECTION II – REFUNDED ISSUE INFORMATION

**A separate form must be completed for each issue advance refunded. Provide original CUSIP information for refunded issue in Section IV. Provide CUSIP information for any new CUSIP numbers assigned to all or any portion of the refunded issue in Section V.**

A. NAME OF ISSUER: _____ STATE: _____

DESCRIPTION OF ISSUE: _____ DATED DATE: _____

B. IF ONE OR MORE MATURITIES OF THE REFUNDED ISSUE IS BEING REFUNDED IN PART, PLEASE CHECK HERE: ☐

## SECTION III – REFUNDING ISSUE INFORMATION

**Each issue must be listed separately. If more space is needed to list additional issues, please include on separate sheet and check here:** ☐
**Provide CUSIP information for refunding issue in Section VI.**

A. NAME OF ISSUER: _____ STATE: _____

DESCRIPTION OF ISSUE: _____ DATED DATE: _____

B. NAME OF ISSUER: _____ STATE: _____

DESCRIPTION OF ISSUE: _____ DATED DATE: _____

C. DATE OF DELIVERY OF REFUNDING ISSUE(S) TO UNDERWRITER(S) (Bond Closing): _____

D. NUMBER OF ISSUES REFUNDED: _____ **(A separate form must be filed for each issue advance refunded.)**

## SECTION IV – ORIGINAL CUSIP INFORMATION FOR REFUNDED (OUTSTANDING) ISSUE

| Maturity Date | CUSIP Number | Maturity Date | CUSIP Number | Maturity Date | CUSIP Number |
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IF ANY OF THE REFUNDED SECURITIES DID NOT HAVE A CUSIP NUMBER, PLEASE CHECK HERE: ☐



CONTINUED ON OTHER SIDE

## SECTION V – NEW CUSIP INFORMATION FOR REFUNDED (OUTSTANDING) ISSUE

| Maturity Date | New CUSIP Number | Maturity Date | New CUSIP Number | Maturity Date | New CUSIP Number |
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MSRB rule G-34 requires that, in the event that part but not all of a single maturity of an outstanding issue previously assigned a single CUSIP number is to be refunded or all of a single maturity of an outstanding issue previously assigned a single CUSIP number is to be refunded to more than one redemption date or price, new CUSIP numbers must be assigned to each part or maturity of the outstanding issue refunded to a particular redemption date, unless such securities are ineligible for CUSIP number reassignment under the eligibility criteria of the CUSIP Service Bureau.

## SECTION VI – CUSIP INFORMATION FOR REFUNDING (NEW) ISSUE

| Maturity Date | CUSIP Number | Maturity Date | CUSIP Number | Maturity Date | CUSIP Number |
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IF ANY OF THE REFUNDING SECURITIES IS INELIGIBLE FOR CUSIP NUMBER ASSIGNMENT, PLEASE CHECK HERE: ☐

## SECTION VII – MANAGING UNDERWRITER'S CERTIFICATION AND SIGNATURE

A. MANAGING UNDWRITER:_____ SEC REG. NUMBER:_____

B. **THE UNDERSIGNED CERTIFIES THAT THE MATERIALS ACCOMPANYING THIS FORM ARE AS DESCRIBED IN ITEM A OF SECTION I ABOVE AND THAT ALL OTHER INFORMATION CONTAINED HEREIN IS TRUE AND CORRECT.**

**ON BEHALF OF THE MANAGING UNDERWRITER IDENTIFIED ABOVE**

**SIGNED:** _____

NAME: _____
**(PRINT – Must be an employee or officer of the managing underwriter)**

FAX:_____ PHONE: _____
**(Include phone and fax numbers at which you are most likely to be reached to expedite processing of this form and accompanying materials)**

**NOTE:**

1. **Please refer to Form G-36 Manual for detailed instructions for completing this form.**
2. **All items on this form must be completed or noted as inapplicable. INCOMPLETE SUBMISSIONS WILL BE RETURNED FOR CORRECTION.**
3. **Two properly completed copies of this form and two copies of the advance refunding document must be included to be considered sent to the MSRB within the meaning of rule G-36.**
4. **Submit this form and accompanying materials to MSRB, MSIL System, 1900 Duke Street, Suite 600, Alexandria, Virginia 22314-3412.**

## 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)(i) 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 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.

(ii) For an individual designated as a municipal finance professional solely pursuant to subparagraph (B) of paragraph (g)(iv) of this rule, the provisions of paragraph (b)(i) shall apply to contributions made by such individual to officials of an issuer prior to becoming a municipal finance professional only if such individual solicits municipal securities business from such issuer.

(iii) For an individual designated as a municipal finance professional solely pursuant to subparagraphs (C), (D) or (E) of paragraph (g)(iv) of this rule, the provisions of paragraph (b)(i) shall apply only to contributions made during the six months prior to the individual becoming a municipal finance professional.

(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 dealer 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) Except as otherwise provided in paragraph (e)(ii), each broker, dealer or municipal securities dealer shall, by the last day of the month following the end of each calendar quarter (these dates correspond to January 31, April 30, July 31 and October 31) send to the Board Form G-37/G-38 setting forth, in the prescribed format, the following information:

(A) for contributions to officials of issuers (other than a contribution made by a municipal finance professional or a non-MFP executive officer to an official of an issuer for whom such person is entitled to vote if all contributions by such person to such official of an issuer, in total, do not exceed $250 per election) and payments to political parties of states and political subdivisions (other than a payment made by a municipal finance professional or a non-MFP executive officer to a political party of a state or a political subdivision in which such person is entitled to vote if all payments by such person to such political party, in total, do not exceed $250 per year) made by the persons and entities described in subclause (2) of this clause (A):

(1) the name and title (including any city/county/state or political subdivision) of each official of an issuer and political party receiving contributions or payments during such calendar quarter, listed by state;

(2) the contribution or payment amount made and the contributor category of each of the following persons and entities making such contributions or payments during such calendar quarter:

(a) the broker, dealer or municipal securities dealer;

(b) each municipal finance professional;

(c) each non-MFP executive officer; and

(d) each political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional;

(B) a list of issuers with which the broker, dealer or municipal securities dealer has engaged in municipal securities business during such calendar quarter, listed by state, along with the type of municipal securities business;

(C) any information required to be included on Form G-37/G-38 for such calendar quarter pursuant to para-

graph (e)(iii);

(D) any information required to be disclosed pursuant to section (e) of rule G-38;

(E) such other identifying information required by Form G-37/G-38; and

(F) whether any contribution listed in this paragraph (e)(i) is the subject of an automatic exemption pursuant to section (j) of this rule, and the date of such automatic exemption.

The Board shall make public a copy of each Form G-37/G-38 received from any broker, dealer or municipal securities dealer.

(ii)(A) No broker, dealer or municipal securities dealer shall be required to send Form G-37/G-38 to the Board for any calendar quarter in which either:

(1) such broker, dealer or municipal securities dealer has no information that is required to reported pursuant to clauses (A) through (D) of paragraph (e)(i) for such calendar quarter; or

(2) subject to clause (B) of this paragraph (e)(ii), such broker, dealer or municipal securities dealer has not engaged in municipal securities business, but only if such broker, dealer or municipal securities dealer:

(a) had not engaged in municipal securities business during the seven consecutive calendar quarters immediately preceding such calendar quarter; and

(b) has sent to the Board completed Form G-37x setting forth, in the prescribed format, (i) a certification to the effect that such broker, dealer or municipal securities dealer did not engage in municipal securities business during the eight consecutive calendar quarters immediately preceding the date of such certification, (ii) certain acknowledgments as are set forth in said Form G-37x regarding the obligations of such broker, dealer or municipal securities dealer in connection with Forms G-37/G-38 and G-37x under this paragraph (e)(ii) and rule G-8(a)(xvi), and (iii) such other identifying information required by Form G-37x; provided that, if a broker, dealer or municipal securities dealer has engaged in municipal securities business subsequent to the submission of Form G-37x to the Board, such broker, dealer or municipal securities dealer shall be required to submit a new Form G-37x to the Board in order to again qualify for an exemption under this subclause (A)(2). The Board shall make public a copy of each Form G-37x received from any broker, dealer or municipal securities dealer.

(B) If for any calendar quarter a broker, dealer or municipal securities dealer has met the requirements of clause (A)(2) of this paragraph (e)(ii) but has information that is required to be reported pursuant to clause (D) of paragraph (e)(i), then such broker, dealer or municipal securities dealer shall be required to send Form G-37/G-38 to the Board for such quarter setting forth only such information as is required to be reported pursuant to clauses (D) and (E) of paragraph (e)(i).

(iii) If a broker, dealer or municipal securities dealer engages in municipal securities business during any calendar quarter after not having reported on Form G-37/G-38 the information described in clause (A) of paragraph (e)(i) for one or more contributions or payments made during the two-year period preceding such calendar quarter solely as a result of clause (A)(2) of paragraph (e)(ii), such broker, dealer or municipal securities dealer shall include on Form G-37/G-38 for such calendar quarter all such information (including year and calendar quarter of such contributions or payments) not so reported during such two-year period.

(iv) A broker, dealer or municipal securities dealer that submits Form G-37/G-38 or Form G-37x to the Board shall either:

(A) send two copies of such form to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending; or

(B) submit an electronic version of such form to the Board in such format and manner specified in the current *Instructions for Form G-37/G-38 and Form G-37x*.

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

(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.

(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), provided, however, that sales activities with natural persons shall not be considered to be municipal securities representative activities for purposes of this subparagraph (A); (B) any associated person who solicits municipal securities business, as defined in paragraph (vii); (C) any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any persons described in subparagraphs (A) or (B); (D) any associated person who is a supervisor of any person described in subparagraph (C) up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or (E) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G-1) executive or management committee or similarly situated officials, if any; provided, however, that, if the only associated persons meeting the definition of municipal finance professional are those described in this subparagraph (E), the broker, dealer or municipal securities dealer shall be deemed to have no municipal finance professionals.

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

(v) The term "non-MFP 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); provided, however, that if no associated person of the broker, dealer or municipal securities dealer meets the definition of municipal finance professional, the broker, dealer or municipal securities dealer shall be deemed to have no non-MFP executive officers.

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

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

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

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

(B) the offer or sale of a primary offering of municipal securities on behalf of any issuer (*e.g.*, 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 in which the dealer was chosen to provide such services on other than a competitive bid basis; or

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

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

(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 25, 1994.

(i) A registered securities association with respect to a broker, dealer or municipal securities dealer who is a member of such association, or the appropriate regulatory agency as defined in Section 3(a)(34) of the Act with respect to any other broker, dealer or municipal securities dealer, upon application, may exempt, conditionally or unconditionally, a broker, dealer or municipal securities dealer who is prohibited from engaging in municipal securities business with an issuer pursuant to section (b) of this rule from such prohibition. In determining whether to grant such exemption, the registered securities association or appropriate regulatory agency shall consider, among other factors:

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

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

(iii) whether, at the time of the contribution, the contributor was a municipal finance professional or otherwise an employee of the broker, dealer or municipal securities dealer, or was seeking such employment;

(iv) the timing and amount of the contribution which resulted in the prohibition;

(v) the nature of the election (*e.g*, federal, state or local); and

(vi) the contributor's apparent intent or motive in making the contribution which resulted in the prohibition, as evidenced by the facts and circumstances surrounding such contribution.

(j) Automatic Exemptions.

(i) A broker, dealer or municipal securities dealer that is prohibited from engaging in municipal securities business with an issuer pursuant to section (b) of this rule as a result of a contribution made by a municipal finance professional may exempt itself from such prohibition, subject to subparagraphs (ii) and (iii) of this section, upon satisfaction of the following requirements: (1) the broker, dealer or municipal securities dealer must have discovered the contribution which resulted in the prohibition on business within four months of the date of such contribution; (2) such contribution must not have exceeded $250; and (3) the contributor must obtain a return of the contribution within 60 calendar days of the date of discovery of such contribution by the broker, dealer or municipal securities dealer.

(ii) A broker, dealer or municipal securities dealer is entitled to no more than two automatic exemptions per 12-month period.

(iii) A broker, dealer or municipal securities dealer may not execute more than one automatic exemption relating to contributions by the same municipal finance professional regardless of the time period.

# FORM G-37/G-38

MSRB

Name of dealer: _____

Report period: _____

## I. CONTRIBUTIONS made to issuer officials (list by state)

| State | Complete name, title (including any city/county/state or other political subdivision) of issuer official | Contributions by each contributor category (*i.e.*, dealer, dealer controlled PAC, municipal finance professional controlled PAC, municipal finance professionals and executive officers). For each contribution, list contribution amount and contribution category (For example, $500 contribution by executive officer)<br><br>If any contribution is the subject of an automatic exemption pursuant to Rule G-37(j), list amount of contribution and date of such automatic exemption. |
|---|---|---|

## II. PAYMENTS made to political parties of states or political subdivisions (list by state)

| State | Complete name (including any city/county/state or other political subdivision) of political party | Payments by each contributor category (*i.e.*, dealer, dealer controlled PAC, municipal finance professional controlled PAC, municipal finance professionals and executive officers). For each payment, list payment amount and contributor category (For example, $500 payment by executive officer) |
|---|---|---|

# FORM G-37/G-38

**III. ISSUERS with which dealer has engaged in municipal securities business (list by state)**

| State | Complete name of issuer and city/county | Type of municipal securities business (negotiated underwriting, private placement, financial advisor, or remarketing agent) |
|---|---|---|

# FORM G-37/G-38

IV. CONSULTANTS
(specific information for each consultant must be attached)

NAME OF CONSULTANT (PURSUANT TO CONSULTANT AGREEMENT):

Signature: _____ Date: _____
(must be officer of dealer)

Name: _____

Address: _____

_____

Phone: _____

Submit two completed forms quarterly by due date (specified by the MSRB) to:

**Municipal Securities Rulemaking Board**
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412

# ATTACHMENT TO FORM G-37/G-38

(submit a separate attachment sheet for each consultant listed under IV)

Name of Consultant: _____

Consultant Company Name: _____

Consultant's Business Address: _____

Role to be Performed by Consultant: _____

Compensation Arrangement: _____

Municipal Securities Business Obtained or Retained by Consultant (list each such business separately **and**, if applicable, indicate dollar amounts paid to consultant connected with particular municipal securities business):

_____

_____

_____

Total Dollar Amount Paid to Consultant during Reporting Period: _____

Contributions Made to Issuer Officials by Consultant and Any Partner, Director, Officer or Employee of the Consultant Who Communicates With An Issuer Official to Obtain Municipal Securities Business for the Broker, Dealer, or Municipal Securities Dealer or Any PAC Controlled by Any of These Entities or Persons:

| State | Complete name and title (including any city/county/state or other political subdivision) of issuer official | For each contribution, list contribution amount and contributor category |
|---|---|---|

Payments Made to Political Parties of States and Political Subdivisions by Consultant and Any Partner, Director, Officer or Employee of the Consultant Who Communicates with An Issuer Official to Obtain Municipal Securities Business for the Broker, Dealer or Municipal Securities Dealer or Any PAC Controlled by Any of These Entities or Persons:

| State | Complete name and title (including any city/county/state or other political subdivision) of issuer official | For each payment, list payment amount and contributor category |
|---|---|---|

# FORM G-37x

MSRB

Name of dealer: _____

The undersigned, on behalf of the dealer identified above, does hereby certify that such dealer did not engage in "municipal securities business" (as defined in rule G-37) during the eight full consecutive calendar quarters ending immediately on or prior to the date of this Form G-37x.

The undersigned, on behalf of such dealer, does hereby acknowledge that, notwithstanding the submission of this Form G-37x to the MSRB, such dealer will be required to:

(1) submit Form G-37/G-38 for each calendar quarter unless it has met all of the requirements for an exemption set forth in rule G-37(e)(ii) for such calendar quarter;
(2) submit Form G-37/G-38 for each calendar quarter in which it has information relating to consultants that is required to be reported pursuant to rule G-37(e)(ii)(B), regardless of whether the dealer has qualified for the exemption set forth in rule G-37(e)(ii)(A)(2);
(3) undertake the recordkeeping obligations set forth in rule G-8(a)(xvi) at such time as it no longer qualifies for the exemption set forth in rule G-8(a)(xvi)(K);
(4) undertake the disclosure obligations set forth in rule G-37(e), including in particular the disclosure obligations under paragraph (e)(iii) thereof, at such time as it no longer qualifies for the exemption set forth in rule G-37(e)(ii)(A)(2); and
(5) submit a new Form G-37x in order to again meet the requirements for the exemption set forth in rule G-37(e)(ii)(A)(2) in the event that the dealer has engaged in municipal securities business subsequent to the date of this Form G-37x and thereafter wishes to qualify for said exemption.

Signature: _____ Date: _____
(must be officer of dealer)

Name: _____ Phone: _____

Address: _____

Submit to: **Municipal Securities Rulemaking Board**
1900 Duke Street
Suite 600
Alexandria, VA 22314-3412

## INSTRUCTIONS FOR FORM G-37/G-38 AND FORM G-37x

Instructions for completing Form G-37/G-38 and Form G-37x can be found on the MSRB's website (www.msrb.org). Click on the link entitled Political Contributions Information and then click on the link to the instructions.

## MSRB INTERPRETATIONS

QUESTIONS AND ANSWERS CONCERNING POLITICAL CONTRIBUTIONS AND PROHIBITIONS ON MUNICIPAL SECURITIES BUSINESS: RULE G-37

### I. PERSONS/ENTITIES SUBJECT TO THE RULE

I.1

**Q: To whom does Rule G-37 apply?**

A: In general, Rule G-37 applies to brokers, dealers and municipal securities dealers (collectively referred to as dealers), municipal finance professionals, and PACs controlled by the dealer or any municipal finance professional. In addition, the recordkeeping and disclosure provisions apply to non-MFP executive officers of the dealer.
(May 24, 1994)

### II. PROHIBITION ON ENGAGING IN MUNICPAL SECURITIES BUISNESS (RULE G-37(b))

II.1

**Q: What actions would cause a dealer to be prohibited from engaging in municipal securities business with an issuer?**

A: Rule G-37(b) prohibits a dealer from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer, (ii) any municipal finance professional associated with such dealer; or (iii) any PAC controlled by the dealer or any municipal finance professional.
(May 24, 1994)

II.2

**Q: Is there an exception to this prohibition on engaging in municipal securities business?**

A: There is one exception to Rule G-37(b). The prohibition does not apply if the only contributions to officials of issuers are made by municipal finance professionals entitled to vote for such officials, and provided such contributions, in total, are not in excess of $250 by each such municipal finance professional to each official of such issuer, per election.
(May 24, 1994)

II.3

**Q: What is the municipal securities business that a dealer would be banned from engaging in with an issuer if certain political contributions are made to officials of such issuers?**

A: The term "municipal securities business" is defined in Rule G-37(g)(vii) 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. The rule does not prohibit a dealer from engaging in competitive underwritings or competitive remarketing services for the issuer.
(May 24, 1994)

II.4

**Q: If a non-MFP executive officer makes a contribution to an official of an issuer, is the dealer prohibited from engaging in municipal securities business with that issuer?**

A: No. The prohibition section applies only to contributions made by the dealer, its municipal finance professionals, or any PAC controlled by the dealer or any of its municipal finance professionals. The definition of non-MFP executive officer does not include any municipal finance professional. However, contributions by non-MFP executive officers are subject to the reporting/disclosure provisions of the rule. In addition, pursuant to section (d), dealers are prohibited from using non-MFP executive officers (as well as any other person or entity) as a conduit for making contributions to officials of issuers.
(May 24, 1994)

II.5

**Q: Would a dealer be prohibited from engaging in municipal securities business with a state agency, whose board members are appointed by the governor, if the dealer makes contributions to the governor?**

A: Yes, the definition of "official of an issuer" in Rule G-37(g)(vi) includes any person who was, at the time of the contribution, an incumbent, candidate or successful candidate for any elective office of a state or of any political subdivision, which office has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by an issuer.
(May 24, 1994, revised October 30, 2003)

II.6

**Q: May a municipal finance professional who is entitled to vote for an issuer official make contributions to pay for such official's transition or inaugural expenses without causing a prohibition on municipal securities business with the issuer?**

A: Yes, under certain conditions. The *de minimis* exception allows a municipal finance professional to contribute up to $250 per candidate per election if the municipal finance professional is entitled to vote for that issuer official. The *de minimis* exception is keyed to an election cycle; therefore, if a municipal finance professional contributed $250 to the general election of an issuer official, the municipal finance professional would **not** be able to make any contributions to pay for transition or inaugural expenses without causing a prohibition on municipal securities business with the issuer. If a municipal finance professional made no contributions to an issuer official prior to the election, then the municipal finance professional **may**, if entitled to vote for the candidate, contribute up to $250 to pay for transition or inaugural expenses and payment of debt incurred in connection with the election without causing a prohibition on municipal securities business.
(September 9, 1997)

II.7

**Q: Are any payments made to issuer officials, other than political contributions, covered by the rule?**

A: No. However, any other payments may be subject to Rule G-20 on gifts and gratuities.
(May 24, 1994)

Primary, State Caucus or Convention

II.8

**Q: If an issuer official is involved in a primary election prior to the general election, may a municipal finance professional who is entitled to vote for such official contribute $250 to the issuer official's primary as well as general election?**

A: Yes, the municipal finance professional could contribute up to $500 to each such official (*i.e.*, $250 per election).
(May 24, 1994)

II.9
**Q: If the locality in which the incumbent or candidate is seeking election as an issuer official holds a convention or caucus (instead of a primary election) prior to the general election, may a municipal finance professional entitled to vote in that locality contribute $250 to the incumbent or candidate's convention or caucus election campaign, as well as $250 to the incumbent or candidate's general election, without causing a ban on municipal securities business with the issuer?**

A: Yes, if the issuer official has been qualified to be considered at the state caucus or convention.
(June 15, 1995)

MFP as Incumbent or Candidate

II.10
**Q: If a municipal finance professional also is an incumbent or candidate for political office in a municipality in which the municipal finance professional's employer (*i.e.*, the dealer) conducts municipal securities business, must the dealer terminate the municipal finance professional or are there any restrictions on the kind of business a dealer can engage in with that issuer?**

A: No. However, the dealer, any municipal finance professional and any PAC controlled by the dealer or municipal finance professional must ensure that the dealer does not engage in municipal securities business with the issuer if contributions (other than the *de minimis* contributions allowed under section (b)) are made to an official of the issuer. The municipal finance professional who is an incumbent or candidate for office is not limited to contributing the *de minimis* amount to his or her own campaign in such instances.
(May 24, 1994)

Attendance at Fund-Raising Dinner

II.11
**Q: May a dealer continue to engage in municipal securities business with an issuer if a municipal finance professional pays for and attends a fund-raising dinner for a candidate who is seeking election to a position as an official of such issuer?**

A: A municipal finance professional who contributes funds in this instance would subject the dealer to a prohibition on municipal securities business with the issuer unless the municipal finance professional is entitled to vote for such candidate and any contributions do not exceed $250 to such candidate per election. In addition, any municipal finance professional who attends the dinner for the purpose of soliciting contributions by others for the issuer official would violate Rule G-37's prohibition on soliciting contributions. *See also* Rule G-37(c).
(May 24, 1994)

Two-Year Look Back

II.12
**Q: A municipal finance professional (*i.e.*, a municipal investment banker subject to the two year look back) was associated with dealer X at the time he made a contribution which resulted in the dealer being prohibited from engaging in municipal securities business with the issuer. Then, less than two years after making the contribution, the municipal finance professional becomes associated with dealer Y. Is dealer Y also subject to the prohibition on business?**

A: Both dealers are subject to the prohibition for two years from the date the municipal finance professional made the contribution. Of course, dealer Y's prohibition on business only begins when the municipal finance professional becomes associated with that dealer.
(May 24, 1994, revised October 30, 2003)

II.13
**Q: Prior to becoming associated with any dealer, a person makes a contribution to an issuer official. Less than two years after making the contribution, that person becomes a municipal finance professional (*i.e.*, a municipal investment banker subject to the two year look back). Would the hiring dealer be prohibited from engaging in municipal securities business with that issuer?**

A: Yes. Rule G-37 attempts to sever any connection between the making of contributions and the awarding of municipal securities business by prohibiting the dealer from engaging in municipal securities business with the issuer for two years from the date the contribution was made. As noted above, the dealer's prohibition on business would begin when the municipal finance professional becomes associated with that dealer. Thus, if the individual was hired, for example, six months after making the contribution, then the dealer's prohibition on business would extend for one and one half years.
(May 24, 1994, revised October 30, 2003)

II.14
**Q: If a dealer hires an individual as a retail sales person, would the contributions made by that person prior to being hired subject the dealer to the two-year prohibition on municipal securities business?**

A: The rule's two-year prohibition is triggered by contributions by dealers, municipal finance professionals, and political action committees controlled by a dealer or a municipal finance professional. If a retail sales person is not a municipal finance professional and does not become a municipal finance professional within two years after making a contribution to an issuer official, then such contributions will not trigger the ban on business. However, if the retail sales person is, or within two years becomes, a municipal finance professional (*e.g.*, by solicitation of officials of an issuer), then contributions made by that person will subject the hiring dealer to the two-year ban on business. A retail sales person would not be considered to be a municipal finance professional solely because of his or her municipal securities retail sales activities. (*See* Rule G-37(g)(iv)).
(December 7, 1994, revised October 30, 2003)

II.15
**Q: A person is associated with a dealer in a non-municipal finance professional capacity, and makes a contribution to an issuer official. Less than two years after making the contribution, that person becomes a municipal finance professional (*i.e.*, a municipal investment banker subject to the two year look back). Would the dealer be prohibited from engaging in a negotiated underwriting with that issuer?**

A: Yes, the dealer is subject to the prohibition for two years from the date the contribution was made.
(May 24, 1994, revised October 30, 2003)

II.16
**Q: A person is associated with a dealer in a non-municipal finance professional capacity and makes a political contribution to an official of an issuer for whom such person is not entitled to vote. Less than two years after such person made the contribution, the dealer merges with another dealer and, solely as a result of the merger, that person becomes a municipal finance professional of the surviving dealer. Would the surviving dealer be prohibited from engaging in municipal securities business with that issuer?**

A: Yes. Rule G-37 would prohibit the surviving dealer from engaging in municipal securities business with the issuer for two years from the date the contribution was made. Of course, the surviving dealer's prohibition on business would only begin when the person who made the contribution becomes a municipal finance professional of the surviving dealer.
The Board notes, however, that Rule G-37 was not intended to prevent mergers in the municipal securities industry or, once a merger is consummated, to seriously hinder the surviving dealer's municipal securities business if the merger was not an attempt to circumvent the letter or spirit of

rule G-37. Thus, the dealer may wish to seek an exemption from the ban on business pursuant to Rule G-37(i) from its appropriate regulatory authority.
(June 29, 1998, revised October 30, 2003)

Refund of Inadvertent Contribution

II.17
**Q: A disgruntled municipal finance professional made a contribution purposely to subject the dealer to the two-year prohibition on business. When the contribution is discovered by the dealer, a refund of the contribution is requested and obtained. Is the dealer still banned from engaging in business with that issuer? In addition, does the contribution have to be disclosed on Form G-37?**

A: Rule G-37(b) prohibits a dealer from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer by any municipal finance professional associated with such dealer if the contribution does not meet the *de minimis* exemption. Section (i) of the rule provides a procedure whereby dealers may seek relief from the appropriate enforcement agency of the rule G-37 prohibition on business. In determining whether to grant such an exemption, one of the factors the enforcement agency will consider is whether the dealer has taken all available steps to obtain a return of the contribution. Even if a refund of the contribution has been obtained, dealers are required to seek an exemption from the ban on business. In addition, dealers also must disclose the contribution on Form G-37. Dealers may wish to indicate on the form (and in their own records) that a refund of the contribution was obtained. *See* Rule G-37(i).
(August 18, 1994)

Volunteer Work

II.18
**Q: Is a municipal finance professional prohibited from performing volunteer work on an issuer official's behalf?**

A: Rule G-37 is not intended to prohibit or restrict municipal finance professionals from engaging in personal volunteer work. However, soliciting and bundling of contributions would invoke application of the rule. In addition, if the municipal finance professional uses the dealer's resources (*e.g.*, a political position paper prepared by dealer personnel) or incurs expenses in the conduct of such volunteer work (*e.g.*, hosting a reception), then the value of such resources or expenses would constitute a contribution. Personal expenses incurred by the municipal finance professional in the conduct of such volunteer work, which expenses are purely incidental to such work and unreimbursed by the dealer (*e.g.*, cab fares and personal meals), would not constitute a contribution.
(May 24, 1994)

Dealer Resources

II.19
**Q: If an employee of a dealer is donating his or her time to an issuer official's campaign, does the dealer have to disclose this as a contribution to such official? In addition, would the fact that the employee is taking a leave of absence from the dealer cause a different result?**

A: An employee of a dealer generally can donate his or her time to an issuer official's campaign without this being viewed as a contribution by the dealer to the official, as long as the employee is volunteering his or her time during non-work hours, or is using previously accrued vacation time or the dealer is not otherwise paying the employee's salary (*e.g.*, an unpaid leave of absence).
(August 18, 1994)

Making Contributions to Issuer Officials on Behalf of Other Persons

II.20
**Q: A municipal finance professional signs a check drawn on a joint account, which is owned by the municipal finance professional and another person, and submits it to an issuer official as a contribution along with a writing which states that the contribution is being made solely by the other holder of the joint account. Would any portion of this contribution be attributable to the municipal finance professional under Rule G-37?**

A: If a municipal finance professional signs a check, whether the check was drawn on a joint account or not, and submits it as a contribution to an issuer official, then the municipal finance professional is deemed to have made the full contribution, regardless of any writing accompanying the check that provides or directs otherwise. Moreover, if this amount exceeds, or does not qualify for, the *de minimis* exception, then by making such a contribution the municipal finance professional will trigger the rule's ban on business thereby prohibiting his dealer/employer from engaging in municipal securities business with the particular issuer for two years.
(February 16, 1996)

II.21
**Q: If a municipal finance professional and another person (*e.g.*, her spouse) both sign a check drawn on their joint account and submit the check to an issuer official as a contribution, would the contribution amount be attributable equally between them (*i.e.*, 50% to each person) for purposes of Rule G-37?**

A: Yes. If a municipal finance professional and any other person both sign a check drawn on their joint account and submit it to an issuer official as a contribution, then each person is deemed to have made half of the contribution, regardless of any writing accompanying the check that provides or directs otherwise.
(February 16, 1996)

Making Contributions to a Candidate Who Later Loses the Election

II.22
**Q: If a municipal finance professional made a political contribution which was not subject to the *de minimis* exception to an issuer official candidate who subsequently did not win the election, is the dealer banned from engaging in municipal securities business with that issuer (*i.e.*, the governmental entity)?**

A: Yes. Rule G-37 defines the term "official of such issuer" or "official of an issuer" as "any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) for elective office of the issuer which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) for any elective office of a state or of any political subdivision, which office has authority to appoint any official(s) of an issuer, as defined in subparagraph (A), above." It is clear from the rule that, at the time the contribution is made, if the recipient of that contribution is an "official of an issuer," then the dealer is subject to the two-year ban on business with the issuer, regardless of whether the candidate wins or loses the election. Any other result would mean that municipal finance professionals could make contributions to issuer officials, but the ban on business would not be triggered (if at all) until election results were known.
(February 16, 1996)

## III. INDIRECT CONTRIBUTIONS (Rule G-37(d))

Contributions by Spouses and Household Members

III.1
**Q: Are contributions to issuer officials by municipal finance professionals' spouses and household members covered by the rule?**

A: No, unless these contributions are directed by the municipal finance professional, which is prohibited by section (d) of the rule.
(May 24, 1994)

III.2
**Q: If a municipal finance professional directs a retail sales person (who is not a municipal finance professional) to make a political contribution to an issuer official, would this trigger the rule's two-year prohibition on business with that issuer?**

A: Yes. Section (d) of the rule prohibits municipal finance professionals (and dealers) from using any person or means to do, directly or indirectly, any act which would violate the rule. In other words, a municipal finance professional is prohibited from using a sales person (or any other person not otherwise subject to the rule) as a conduit to circumvent the rule. Thus, contributions made, directly or indirectly, by a municipal finance professional (or a dealer) to an issuer official will subject the dealer to the rule's two-year prohibition on municipal securities business with that issuer. In addition to triggering the prohibition, the municipal finance professional in this case has violated section (d) of the rule.
(December 7, 1994)

Political Parties

III.3
**Q: Are contributions to national, state or local political parties covered by the rule?**

A: Any such contributions would not trigger the prohibition on business portion of the rule (section (b)) unless such entities are used as a conduit to indirectly contribute to an issuer official, which is prohibited by section (d) of the rule. However, contributions to state or local political parties must be recorded under Rule G-8(a)(xvi) and disclosed in summary form under Rule G-37(e), except for those contributions which meet the *de minimis* exemption. *See also* Rule G-37(e).
(May 24, 1994)

Contributions to a Non-Dealer Associated PAC and Payments to a State or Local Political Party

III.4
**Q: Could contributions to a non-dealer associated PAC or payments to a state or local political party lead to a ban on municipal securities business with an issuer under Rule G-37?**

A: Rule G-37(d) prohibits a dealer and any municipal finance professional from doing any act indirectly which would result in a violation of the rule if done directly by the dealer or municipal finance professional. A dealer would violate Rule G-37 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 non-dealer associated PAC or a local political party may be soliciting funds for the purpose of supporting a limited number of issuer officials. Depending upon the facts and circumstances, contributions to the PAC or payments to the political party might well result in the same prohibition on municipal securities business as would a contribution made directly to the issuer official.
(August 6, 1996)

III.5
**Q: If a dealer receives a fund raising solicitation from a non-dealer associated PAC or a political party with no indication of how the collected funds will be used, can the dealer make contributions to the non-dealer associated PAC or payments to the political party without causing a ban on municipal securities business?**

A: Dealers should inquire of the non-dealer associated PAC or political party how any funds received from the dealer would be used. For example, if the non-dealer associated PAC or political party is soliciting funds for the purpose of supporting a limited number of issuer officials, then, depending upon the facts and circumstances, contributions to the PAC or payments to the political party might well result in the same prohibition on municipal securities business as would a contribution made directly to the issuer official.
(August 6, 1996)

Making Payments to a National Political Party for its Non-Federal Account (Rule G-37(e))

III.6
**Q: If a national political party accepts payments in which contributors have designated that their payments be deposited into the account for a state or local political party, must the dealer record such payments and report them on Form G-37?**

A: Yes. Rule G-37 requires that dealers record and report payments made to state and local political parties and the ultimate recipient in the above scenario is a state or local political party so designated by the contributor.
(February 16, 1996)

## IV. DEFINITIONS (RULE G-37(g))

Contribution

IV.1
**Q: How is the term "contribution" defined in Rule G-37?**

A: The term "contribution" is defined in Rule G-37(g)(i) to mean 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 or local office; (ii) for payment 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.
(May 24, 1994)

IV.2
**Q: Is Rule G-37 applicable to contributions given to officials of issuers who are seeking election to federal office, such as the House of Representatives, the Senate or the Presidency?**

A: Yes. Rule G-37(g)(i) defines "contribution" as, among other things, any gift, subscription, loan, advance, or deposit of money or anything of value made for the purpose of influencing any election for federal, state or local office.
(June 15, 1995)

IV.3
**Q: Does Rule G-37 encompass all contributions to candidates for federal office?**

A: No. Rule G-37 encompasses, for federal offices, only those contributions to an official of an issuer who is seeking election to a federal office.
(May 24, 1994)

IV.4
**Q: Are contributions to bond election committees supporting ballot measures for bonds and tax levies subject to the requirements of Rule G-37?**

A: No.
(May 24, 1994)

Charitable Donations

IV.5
**Q: Would a charitable donation to an organization made by a dealer at the request of an issuer official meet the definition of "contribution" in Rule G-37?**

A: No. Charitable donations are not considered political contributions for purposes of Rule G-37 and therefore are not covered by the rule.
(May 24, 1994)

### Municipal Finance Professional

IV.6
**Q: Who is considered a municipal finance professional?**

A: To determine if a particular person is a municipal finance professional, first determine whether the person is an "associated person" of a dealer (other than a bank dealer) under Section 3(a)(18) of the Securities Exchange Act of 1934 (Act), or an associated person of a bank dealer under Section 3(a)(32) of the Act. Then determine whether the associated person fits within one of the four categories listed in the definition of municipal finance professional under Rule G-37.

Under Section 3(a)(18) of the Act, "associated person of a broker or dealer" is defined as:

- Any partner, officer, director, or branch manager (or any person occupying a similar status or performing similar functions);
- Any person directly or indirectly controlling, controlled by, or under common control with the dealer;
- Or any employee of such broker or dealer, except those whose functions are solely clerical or ministerial.

Under Section 3(a)(32) of the Act, "person associated with a municipal securities dealer" when used with respect to a municipal securities dealer which is a bank or a division or department of a bank means:

- Any person directly engaged in the management, direction, supervision, or performance of any of the municipal securities dealer's activities with respect to municipal securities; and
- Any person directly or indirectly controlling such activities or controlled by the municipal securities dealer in connection with such activities.

Under Rule G-37(g)(iv), a municipal finance professional is defined as:

1. Any associated person primarily engaged in municipal representative activities pursuant to Rule G-3(a)(i) (such activities include underwriting, trading, sales, financial advisory and consultant services, research or investment advice on municipal securities, or any other activities which involve communication, directly or indirectly, with public investors relating to the activities listed in this paragraph), provided, however, that sales activities with natural persons shall not be considered to be municipal securities representative activities for purposes of Rule G-37(g)(iv);

2. Any associated person who solicits "municipal securities business" as defined in Rule G-37 (which includes negotiated underwriting activities, private placement activities, negotiated remarketing services, financial advisory and consultant services);

3. Any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any persons described in paragraphs 1 or 2 above;

4. Any associated person who is a supervisor of the associated persons described in paragraph 3 above, up through and including: (i) for dealers that are not bank dealers, the CEO or similarly situated official; and (ii) for bank dealers, the officer or officers designated by the bank's board of directors as responsible for the day-to-day conduct of the bank's dealer activities.

5. For dealers other than bank dealers: any associated person who is a member of the executive or management committee, or similarly situated officials, if any. For bank dealers: any member of the executive or management committee of the separately identifiable department or division of the bank, as defined in Rule G-1, if any. However, if the only associated persons meeting the definition of municipal finance professional are those described in this paragraph 5, the broker, dealer or municipal securities dealer shall be deemed to have no municipal finance professionals.

Each person listed by the dealer as a municipal finance professional is deemed to be such for purposes of Rule G-37.
(May 24, 1994, revised October 30, 2003)

IV.7
**Q: Does the definition of municipal finance professional include all registered representatives?**

A: No. The definition of municipal finance professional includes, among others, any associated person primarily engaged in municipal representative activities pursuant to Rule G-3(a)(i), but excludes sales activities with natural persons.
(May 24, 1994, revised October 30, 2003)

IV.8
**Q: Does the definition of municipal finance professional include any associated person who solicits municipal securities business, even if this solicitation activity is a very small portion of the associated person's work?**

A: Yes. Even if an associated person is not "primarily engaged in municipal representative activities," that associated person can be considered a municipal finance professional if he or she solicits municipal securities business, as defined in Rule G-37 (such business includes negotiated underwriting activities, private placement activities, negotiated remarketing services, financial advisory and consultant services).
(May 24, 1994)

IV.9
**Q: Does the definition of municipal finance professional include anyone other than an associated person of the dealer, for example, consultants, lawyers or spouses of municipal finance professionals?**

A: No. Municipal finance professionals must be associated persons of the dealer. Of course, if a dealer or a municipal finance professional seeks indirectly to make contributions to issuer officials through consultants, lawyers or spouses, such contributions would result in the dealer being prohibited from engaging in municipal securities business with the issuer for two years from the date of such contributions.
(May 24, 1994)

### Solicitation

IV.10
**Q: What constitutes "solicitation" of municipal securities business?**

A: Solicitation activities may include, but are not limited to, responding to issuer Requests for Proposals, making presentations of public finance and/or municipal securities marketing capabilities to issuer officials, and engaging in other activities calculated to appeal to issuer officials for municipal securities business, or which effectively do so.
(December 7, 1994)

IV.11
**Q: Has a "solicitation" occurred if a retail sales person receives a "finder's fee" for bringing municipal securities business to the dealer?**

A: If a retail sales person receives a "finder's fee" for bringing municipal securities business to the dealer, then there should be a presumption that the sales person solicited municipal business from an issuer official. In such situations, the sales person becomes a municipal finance professional and any contributions made by that person to an issuer official may subject the dealer to the two-year prohibition on business with that issuer.
(December 7, 1994)

IV.12
**Q: Is a "finder's fee" solely cash compensation?**

A: No. Such compensation, for example, may take the form of: (i) an

unusually large allocation of bonds to a particular sales person; (ii) sales credits; or (iii) any other kind of remuneration.
(December 7, 1994)

IV.13

**Q: Any associated person who solicits municipal securities business is deemed a municipal finance professional under Rule G-37. The Board previously noted that "solicitation" may encompass a number of activities, including, for example, making presentations of public finance and/or municipal securities marketing capabilities to issuer officials, and engaging in other activities calculated to appeal to issuer officials for municipal securities business, or which effectively do so. If an associated person of a dealer attends a presentation by dealer personnel of public finance capabilities, would this also constitute "solicitation" under Rule G-37?**

A: Yes. If an associated person of a dealer attends such a presentation, then he or she is assumed to have solicited municipal securities business and therefore is deemed a municipal finance professional under Rule G-37. Accordingly, any contributions given to issuer officials by that person within the last two years could subject the dealer to the rule's two-year prohibition on business with such issuers.
(March 22, 1995)

Supervisors

IV.14

**Q: A sales representative at a branch office solicits municipal securities business for the dealer. Such activity results in that person becoming a "municipal finance professional" under Rule G-37(g)(iv)(B). Would that person's branch manager also be considered a municipal finance professional?**

A: Yes. Rule G-37(g)(iv)(C) provides that the definition of municipal finance professional includes, among others, any associated person who is both a (i) municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any associated person who solicits municipal securities business (or who is primarily engaged in municipal securities representative activities). If a sales person is soliciting municipal securities business, then the supervisor of that person (*i.e.*, the branch manager) also is included within the definition of municipal finance professional. Branch managers are included within the definition of municipal finance professional in the circumstances described above.
(March 22, 1995, revised October 30, 2003)

Designation Period for Municipal Finance Professionals

IV.15

**Q: Rule G-37(g)(iv) states that each person designated a municipal finance professional shall retain this designation for one year after the last activity or position which gave rise to the designation. If a dealer terminates a municipal finance professional's employment, and that person is no longer associated in any way with the dealer (including any affiliated entities of the dealer), must the dealer continue to designate that person a "municipal finance professional" for recordkeeping and reporting purposes under Rules G-37(g)(iv) and G-8(a)(xvi)?**

A: No. If a municipal finance professional is no longer employed by the dealer, and is not an "associated person" of the dealer, then the dealer is not required to designate that person a municipal finance professional and the dealer may cease its recordkeeping and reporting obligations with respect to that person.
(August 6, 1996, revised October 30, 2003)

IV.16

**Q: If a municipal finance professional is transferred from a firm's dealer department to another non-municipal department, such as the corporate department, must the dealer continue to designate this person a municipal finance professional for recordkeeping and reporting purposes?**

A: If a municipal finance professional is transferred to another department within the same firm (such as corporate, equities, etc.) and remains an "associated person" of the dealer, the dealer must continue to designate this person a municipal finance professional for one year from the date of the last activity or position which gave rise to this designation and must continue its recordkeeping and reporting obligations under Rules G-37 and G-8. It is incumbent upon each dealer to determine whether the person is an associated person pursuant to Section 3(a)(18) of the Securities Exchange Act of 1934. If so, then in addition to recordkeeping and reporting obligations, dealers should be mindful that any contributions made by this associated person during the one-year designation period (other than contributions that qualify for the rule's $250 *de minimis* exception) will subject the dealer to the rule's ban on municipal securities business for two years from the date of such contribution. Of course, the ban can only be triggered if the person previously was a municipal finance professional.
(August 6, 1996, revised October 30, 2003)

IV.17

**Q: A municipal finance professional resigns from a dealer, but still remains an associated person of the dealer (*e.g.*, by retaining a position in the dealer's holding company). May the dealer cease designating this person a municipal finance professional for purposes of the recordkeeping and reporting requirements under Rules G-37 and G-8? In addition, may this person make contributions to issuer officials without causing the dealer to be banned from municipal securities business with such issuers?**

A: If a person is no longer a municipal finance professional because he or she has left the dealer's employ, but nevertheless remains an associated person of the dealer, then the dealer must continue to designate this person a municipal finance professional for one year from the last activity or position which gave rise to such designation. Moreover, any contributions by this associated person (other than those that qualify for the *de minimis* exception under Rule G-37(b)) will subject the dealer to the rule's ban on municipal securities business for two years from the date of the contribution.
(August 6, 1996, revised October 30, 2003)

IV.18

**Q: In making the determination of which associated persons of a dealer meet the definitions of municipal finance professional and non-MFP executive officer, is it correct to designate all the executives of the dealer (*e.g.*, President, Executive Vice Presidents) under the category of non-MFP executive officers?**

A: No. In making the determination of whether someone is a municipal finance professional or non-MFP executive officer, one must review the activities of the individual and not his or her title. Rule G-37(g)(iv) defines the term "municipal finance professional" as:

> (A) any associated person primarily engaged in municipal securities representative activities, as defined in Rule G-3(a)(i), provided, however, that sales activities with natural persons shall not be considered to be municipal securities representative activities for purposes of this subparagraph (A);
>
> (B) any associated person who solicits municipal securities business, as defined in paragraph (vii);
>
> (C) any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any persons described in subparagraphs (A) or (B);
>
> (D) any associated person who is a supervisor of any person described in subparagraph (C) up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the

Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to Rule G-1(a); or

(E) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in Rule G-1) executive or management committee or similarly situated officials, if any; provided, however, that, if the only associated persons meeting the definition of municipal finance professional are those described in this subparagraph (E), the broker, dealer or municipal securities dealer shall be deemed to have no municipal finance professionals.

Rule G-37(g)(v) defines the term "non-MFP executive officer" as:

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); provided, however, that, if no associated person of the broker, dealer or municipal securities dealer meets the definition of municipal finance professional, the broker, dealer or municipal securities dealer shall be deemed to have no non-MFP executive officers. [emphasis added]

Dealers should first review the activities of their associated persons to determine whether they are municipal finance professionals, and then, once that list of individuals has been established, conduct a review of the remaining associated persons to determine whether they are non-MFP executive officers. Dealers should pay close attention to those associated persons who are soliciting municipal securities business and, thus, will be considered municipal finance professionals. The Board has previously stated that solicitation activities may include, but are not limited to, responding to issuer Requests for Proposals, making presentations of public finance and/or municipal marketing capabilities to issuer officials, and engaging in other activities calculated to appeal to issuer officials for municipal securities business, or which effectively do so.
(September 9, 1997, revised October 30, 2003)

### Non-MFP Executive Officer

IV.19
**Q: Who is a non-MFP "executive officer?"**

**A:** Pursuant to Rule G-37(g)(v), a non-MFP executive officer is defined 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 (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.
(May 24, 1994)

IV.20
**Q: In a bank with a separately identifiable dealer department, who would be considered a non-MFP executive officer?**

**A:** For most bank dealer departments which deal only in municipal securities, there are no individuals who meet the definition of non-MFP executive officer within Rule G-37.
(August 18, 1994)

### Official of an Issuer

IV.21
**Q: How is the term "official of an issuer" defined in Rule G-37?**

**A:** Rule G-37(g)(vi) defines the term "official of an issuer" to mean "any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) for elective office of the issuer which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) for any elective office of a state or of any political subdivision, which office has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by an issuer. Thus, contributions to certain state-wide executive or legislative officials would be included within the prohibition on engaging in municipal securities business.
(May 24, 1994, revised October 30, 2003)

IV.22
**Q: How can a dealer determine whether an incumbent or candidate for a particular elective office will be able to award or influence the awarding of municipal securities business? For example, in many states, such influence is found in executive branch elected officials, not legislative branch officials.**

**A:** The dealer must review the scope of authority of the particular office at issue, whether executive or legislative branch, not the individual, to determine whether influence over the awarding of municipal securities business is present.
(May 24, 1994)

IV.23
**Q: An incumbent was seeking re-election as an issuer official but she lost the election. She is now soliciting money to pay for the debt incurred in connection with this election. Would there be a prohibition on engaging in municipal securities business with the issuer if a dealer or a municipal finance professional provides money for the payment of this debt?**

**A:** No, under certain conditions. If the incumbent is out of office at the time she is soliciting money to pay for the election debt, then she is no longer considered to be within the definition of "official of an issuer" and any monies given for the payment of debt incurred in connection with the election in this instance is not subject to Rule G-37. If the incumbent still holds her issuer official position at the time she is soliciting money to pay for the election debt, then, if a municipal finance professional contributed $250 to her during the general election, the municipal finance professional would **not** be able to make any contributions for the payment of debt without causing a prohibition on municipal securities business with the issuer. If a municipal finance professional made no contributions to the incumbent prior to the election, then the municipal finance professional **may,** if entitled to vote for the candidate, contribute up to $250 for the payment of debt incurred in connection with the election while the incumbent is still in office without causing a prohibition on municipal securities business. A dealer may **not** contribute any monies towards the payment of debt while the incumbent is still in office without causing a prohibition on municipal securities business with the issuer.
(September 9, 1997)

### Dealer-Controlled PAC

IV.24
**Q: What is a "dealer-controlled" PAC?**

**A:** Each dealer must determine whether a PAC is dealer controlled. For dealers, other than bank dealers, one may assume that any PAC of the dealer would be considered a dealer-controlled PAC for purposes of Rule G-37. For bank dealers, it will depend upon whether the dealer or anyone from the dealer department has the ability to direct or cause the direction of the management or the policies of the PAC.
(May 24, 1994)

## V. SCOPE OF WAIVER PROVISION IN RULE G-37(i)

V.1

**Q: If an enforcement agency grants an exemption from a ban on municipal securities business pursuant to Rule G-37(i), may this exemption be applied retroactively so that any municipal securities business engaged in after the ban had gone into effect but prior to the date on which the exemption was granted would not be viewed as a Rule G-37 violation?**

**A:** Rule G-37(i) allows the enforcement agencies to exempt a dealer from a ban on municipal securities business. It is the Board's view that such an exemption is only effective as of the date of the exemption. Rule G-37(i) does not contain a provision allowing for the retroactive application of the exemption. Thus, a dealer would violate Rule G-37 if, prior to the date of the exemption, the dealer engaged in municipal securities business with an issuer while subject to a ban with this issuer because of a political contribution. As with any violation of a Board rule, the enforcement agencies have discretion in determining the type and extent of enforcement action appropriate for such violation, in light of the specific facts and circumstances. If an enforcement agency has granted an exemption to a dealer from the ban on municipal securities business, the facts and circumstances considered by such agency in granting the exemption could appropriately also be considered (together with any other relevant facts and circumstances) in determining what, if any, enforcement action should be taken against such dealer if it had engaged in municipal securities business after the ban on such business became effective but prior to the date on which the exemption was granted.
(March 1, 2000)

## VI. RECORDKEEPING AND REPORTING (RULES G-37(e), G-8 AND G-9)

VI.1

**Q: If a dealer has instituted an internal voluntary ban on political contributions, is the dealer still subject to the recordkeeping requirements?**

**A:** Yes. The Board amended Rules G-8 and G-9, on recordkeeping and record retention, respectively, to require each dealer to maintain records of certain information. This recordkeeping is designed to assist dealers in determining whether or not they may engage in business with a particular issuer, as well as to facilitate compliance with, and enforcement of, Rule G-37.
(May 24, 1994)

VI.2

**Q: Rule G-8 requires dealers to record all issuers with which the dealer has engaged in municipal securities business. The term "issuer" includes the issuer of a separate security as defined in SEC Rule 3b-5(a) under the Act. In the context of industrial revenue bond issues, for example, the issuer of a separate security is a private corporation, not a government entity. Must we record these "issuers"?**

**A:** No. Such private corporations, which are not an agency or instrumentality of a state or any political subdivision, need not be recorded. Of course, dealers are required to record the governmental issuer in these situations, for both taxable and tax-exempt municipal securities.
(December 7, 1994)

VI.3

**Q: What are the reporting requirements under rule G-37?**

**A:** Dealers are required to submit Form G-37/G-38 to the MSRB by the last day of the month following the end of each calendar quarter. These submission dates correspond to January 31, April 30, July 31 and October 31 of each year. There is no fixed time frame for submission of Form G-37x. However, if a dealer wishes to rely on the Form G-37x exemption from the Form G-37/G-38 submission requirement for a particular calendar quarter, Form G-37x must be submitted by no later than the submission deadline for such quarter.
(May 24, 1994, revised October 30, 2003)

VI.4

**Q: Under what circumstances must Form G-37/G-38 be filed with the Board?**

**A:** Form G-37/G-38 must be submitted to the Board for a calendar quarter if ANY one of the following occurred: (i) reportable political contributions or payments to political parties were made during the reporting period, unless the dealer has previously submitted Form G-37x and the submission remains effective; (ii) the dealer engaged in municipal securities business during the reporting period; or (iii) the dealer used consultants during the reporting period (*i.e.*, new or continuing relationship with consultants).
(May 24, 1994, revised October 30, 2003)

VI.5

**Q: Does a dealer have to complete the section of Form G-37/G-38 concerning issuers with whom the dealer has engaged in municipal securities business if the only municipal securities related business engaged in during the reporting period was as a selling group member?**

**A:** No. Rule G-37 does not define "municipal securities business" to include selling group member activities.
(May 24, 1994)

VI.6

**Q: Which contributions to officials of issuers and political parties of states and political subdivisions must be disclosed to the Board on Form G-37/G-38?**

**A:** Those contributions which are required to be recorded pursuant to rule G-8(a)(xvi). These include (i) the contributions, direct or indirect, to officials of an issuer and to political parties of states and political subdivisions made by the dealer and each PAC controlled by the dealer (or controlled by any municipal finance professional of such dealer); (ii) the contributions, direct or indirect, to officials of an issuer made by each municipal finance professional and non-MFP executive officer, however, such records need not reflect any contribution made by a municipal finance professional or non-MFP executive officer to officials of an issuer for whom such person is entitled to vote if the contributions by each such person, in total, are not in excess of $250 to any official of an issuer, per election; and (iii) the contributions, direct or indirect, to political parties of states and political subdivisions made by all municipal finance professionals and non-MFP executive officers, however, such records need not reflect those contributions made by any municipal finance professional or non-MFP executive officer to a political party of a state or political subdivision in which such persons are entitled to vote if the contributions by each such person, in total, are not in excess of $250 per political party, per year.
(May 24, 1994)

VI.7

**Q: May non-dealers (*e.g.*, attorneys, independent financial advisors) voluntarily submit information on political contributions and other activities to the Board?**

**A:** Yes, as long as the filing procedures are followed.
(May 24, 1994)

VI.8

**Q: Will the Forms G-37 submitted to the Board be available for public review?**

**A:** Yes. The Forms G-37/G-38 and Forms G-37x submitted to the Board are posted on the Board's website for viewing (www.msrb.org). In addition, one copy of each Form G-37 will be maintained at the Board's Public Access Facility in Alexandria, Virginia. These forms will be available to

the public for review and photocopying. The Board will charge 20 cents per page plus sales tax, if applicable, for photocopying.
(May 24, 1994)

VI.9

**Q: May a holding company submit to the Board one Form G-37/G-38 reflecting information for various dealers within the control of the holding company?**

A: No. A separate Form G-37/G-38 must be submitted for each dealer.
(February 16, 1996)

VI.10

**Q: Rule G-37(e) requires, among other things, that dealers submit information to the Board on Form G-37/G-38 about the municipal securities business in which they engaged. Is information about the municipal securities business engaged in required to be submitted by all syndicate and selling group members, or is it only the responsibility of the manager(s) to submit such information on behalf of the syndicate?**

A: All manager(s) and syndicate members (excluding selling group members) must separately report the municipal securities business in which they engaged.
(September 9, 1997)

## Interpretation of Prohibition on Municipal Securities Business Pursuant to Rule G-37

February 21, 1997

Recently, dealers have raised questions regarding how the prohibition on municipal securities business in rule G-37, on political contributions and prohibitions on municipal securities business, applies to certain situations. Rule G-37 prohibits 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 controlled by the dealer or any municipal finance professional.[1] If a municipal finance professional makes a political contribution to an issuer official for whom he is not entitled to vote, the dealer is prohibited from engaging in municipal securities business with that issuer for two years. The Board has been asked whether the prohibition on municipal securities business extends to certain services provided under contractual agreements with an issuer that pre-date the contribution. The Board is issuing the following interpretation of the prohibition on municipal securities business pursuant to rule G-37.

*"New" Municipal Securities Business*

A dealer subject to a prohibition on municipal securities business with an issuer may not enter into any new contractual obligations with that issuer for municipal securities business.[2] The Board adopted rule G-37 in an effort to sever any connection between the making of political contributions and the awarding of municipal securities business. The Board believes that the problems associated with political contributions—including the practice known as "pay-to-play"—undermine investor confidence in the municipal securities market, which confidence is crucial to the long-term health of the market, both in terms of liquidity and capital-raising ability.

*Pre-Existing Issue-Specific Contractual Undertakings*

The Board believes that it is consistent with the intent of rule G-37 that a dealer subject to a prohibition on municipal securities business with an issuer be allowed to continue to execute certain issue-specific contractual obligations in effect prior to the date of the contribution that caused the prohibition. For example, if a bond purchase agreement was signed prior to the date of the contribution, a dealer may continue to perform its services as an underwriter on the issue. Also, if an issue-specific agreement for financial advisory services was in effect prior to the date of the contribution, the dealer may continue in its role as financial advisor for that issue. In the same manner, a dealer may act as remarketing agent or placement agent for an issue and also may continue to underwrite a commercial paper program as long as the contract to perform these services was in effect prior to the date of the contribution. Subject to the limitations noted below, these activities are not considered new municipal securities business and thus can be performed by dealers under a prohibition on municipal securities business with the issuer.

Dealers also have asked questions regarding certain terms in contracts to provide on-going municipal securities business that allow for additional services or compensation. For example, a dealer may have an agreement to provide remarketing services for a municipal securities issue, the terms of which allow the issuer to change the "mode" of the outstanding bonds from variable to a fixed rate of interest or from Rule 2a-7 eligible to non-Rule 2a-7 eligible.[3] Generally, the per bond fee increases if the dealer sells fixed rate municipal securities or non-money market fund securities. Also, an agreement to underwrite a commercial paper program may include terms for increasing the size of the program. While the per bond fee probably does not increase if more commercial paper is underwritten, the amount of money paid to the dealer does increase. The Board views the provisions in existing contracts that allow for changes in the services provided by the dealer or compensation paid by the issuer as new municipal securities business and, therefore, rule G-37 precludes a dealer subject to a prohibition on municipal securities business from performing such additional functions or receiving additional compensation.

*Non-Issue Specific Contractual Undertakings*

Dealers also at times enter into long-term contracts with issuers for municipal securities business, *e.g.*, a five-year financial advisory agreement. If a contribution is given after such a non-issue-specific contract is entered into that results in a prohibition on municipal securities business, the Board believes the dealer should not be allowed to continue with the municipal securities business, subject to an orderly transition to another entity to perform such business. This transition should be as short a period of time as possible and is intended to give the issuer the opportunity to receive the benefit of the work already provided by the dealer and to find a replacement to complete the work, as needed.

* * *

The Board recognizes that there is a great variety in the terms of agreements regarding municipal securities business and that the interpretation noted above may not adequately deal with all such agreements. Thus, the Board is seeking comment on how a prohibition on municipal securities business pursuant to rule G-37 affects contracts for municipal securities business entered into with issuers prior to the date of the contribution triggering the prohibition on business. In particular, the Board is seeking comment on other examples whereby a dealer may be contractually obligated to perform certain activities after the date of the triggering contribution. If other examples are provided, the Board would like comments on how these situations should be addressed pursuant to rule G-37.

Based upon the comments received on this notice, the Board may issue additional interpretations or amend the language of rule G-37.

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[1] The only exception to rule G-37's absolute prohibition on municipal securities business is for certain contributions made to issuer officials by municipal finance professionals. Contributions by such persons to officials of issuers do not invoke application of the prohibition on business if (i) the municipal finance professional is entitled to vote for such official and (ii) contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election.

[2] The term "municipal securities business" is defined in the rule to encompass certain activities of dealers, such as acting as negotiated underwriters (as managing underwriter or as syndicate member), financial advisors, placement agents and negotiated remarketing agents. The rule does not prohibit dealers from engaging in business awarded on a competitive bid basis.

[3] SEC Rule 2a-7 under the Investment Company Act of 1940 defines eligible securities for inclusion in money market funds

## APPLICATION OF RULE G-37 TO PRESIDENTIAL CAMPAIGNS OF ISSUER OFFICIALS

March 23, 1999

In response to numerous calls on this subject, the Board wishes to reiterate its position on the application of rule G-37, on political contributions and prohibitions on municipal securities business, to Presidential campaigns of issuer officials. The Board directs persons interested in contributing to an issuer official's Presidential campaign to the *MSRB Interpretation of May 31, 1995* ("the 1995 Interpretive Letter").[1]

Rule G-37, among other things, prohibits a broker, dealer or municipal securities dealer ("dealer") from engaging in municipal securities business with an issuer within two years after any contribution to an official of an issuer made by the dealer; any municipal finance professional associated with the dealer; or any political action committee controlled by the dealer or any municipal finance professional. In the 1995 Interpretive Letter, the Board noted that rule G-37 is applicable to contributions given to officials of issuers who seek election to federal office, such as the Presidency. The Board also explained that the only exception to rule G-37's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals.[2] Specifically, contributions by such persons to officials of issuers would not invoke application of the prohibition if the municipal finance professional is entitled to vote for such official, and provided that any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election. In the example of an issuer official running for President, any municipal finance professional in the country can contribute the *de minimis* amount to the official's Presidential campaign without causing a ban on municipal securities business with that issuer.

The Board previously has stated that, if an issuer official is involved in a primary election prior to the general election, a municipal finance professional who is entitled to vote for such official may contribute up to $250 for the primary election and $250 for the general election to each such official.[3] In the context of a Presidential campaign, the Board notes that the $250 *de minimis* amount applies to the entire primary process, up through and including the national party convention. While rule G-37 allows a municipal finance professional to then contribute another $250 to the party candidate's general election campaign fund, the Board understands that a Presidential candidate who has accepted public funding for the general election is prohibited under federal law from accepting any contributions to further his or her general election campaign.

Finally, the Board also notes that rule G-37(c) provides that no dealer or municipal finance professional shall solicit any person or political action committee to make any contributions, or shall coordinate any contributions, to an official of an issuer with which the dealer is engaging or is seeking to engage in municipal securities business.

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[1] The 1995 Interpretive Letter is reprinted in MSRB *Rule Book* (January 1, 1999) at 201-203. It also is available from the MSRB *Rules/Interpretive Letters* section of the Board's Web site at www.msrb.org.

[2] The term "municipal finance professional" is a defined term in rule G-37 (g)(iv). The Board wishes to remind dealers that the term is broader than persons directly involved in municipal securities activities and may include certain supervisors, including in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer, 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. It also may include members of the dealer's executive or management committee or similarly situated officials. *See* Question and Answer number 2 dated May 24, 1994, reprinted in MSRB *Rule Book* (January 1, 1999) at 192; *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 13; Question and Answer number 3 dated September 9, 1997, reprinted in MSRB *Rule Book* (January 1, 1999) at 199. The Questions and Answers also are available from the MSRB *Rules/Interpretive Notice* section of the Board's Web site at www.msrb.org.

[3] *See* Question and Answer number 10 dated May 24, 1994, reprinted in MSRB *Rule Book* (January 1, 1999) at 192; *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 13. The Question and Answer also is available from the MSRB *Rules/Interpretive Notice* section of the Board's Web site at www.msrb.org.

## ACTIVITIES BY DEALERS AND MUNICIPAL FINANCE PROFESSIONALS DURING TRANSITION PERIODS FOR ELECTED ISSUER OFFICIALS

November 29, 2001

The MSRB has received inquiries on the applicability of rule G-37 to certain activities by dealers and municipal finance professionals relating to the transition period during which an issuer official has won an election but has not yet taken office. The definition of "contribution" in rule G-37(g)(i) includes any gift, subscription, loan, advance, or deposit of money or anything of value made for transition or inaugural expenses incurred by the successful candidate.

The MSRB stated in a Question and Answer Notice dated May 24, 1994 (Q&A number 24) that rule G-37 is not intended to prohibit or restrict municipal finance professionals from engaging in personal volunteer work; however, if the municipal finance professional uses the dealer's resources (*e.g.*, a political position paper prepared by dealer personnel) or incurs expenses in the conduct of such volunteer work (*e.g.*, hosting a reception), then the value of such resources or expenses would constitute a contribution. In addition, personal expenses incurred by the municipal finance professional in the conduct of such volunteer work, which expenses are purely incidental to such work and unreimbursed by the dealer (*e.g.*, cab fares and personal meals), would not constitute a contribution. In a Question and Answer Notice dated August 18, 1994 (Q&A number 3), the MSRB stated that an employee of a dealer generally can donate his or her time to an issuer official's campaign without this being viewed as a contribution by the dealer to the official, as long as the employee is volunteering his or her time during non-work hours, or is using previously accrued vacation time or the dealer is not otherwise paying the employee's salary (*e.g.*, an unpaid leave of absence). Thus, rule G-37 does not prohibit a municipal finance professional from serving on an issuer official's transition team or performing other transition-related activities; however, as noted above, the use of dealer resources in connection with such activity would be considered a contribution by the dealer to the issuer official thereby resulting in the dealer being prohibited from engaging in municipal securities business with the issuer for two years.

The MSRB also recognizes that dealers and their municipal finance professionals may solicit issuer officials for municipal securities business during the transition period prior to these officials taking office. In the course of making such solicitations, dealers may sometimes prepare and present materials such as financing plans and economic development studies. The provision of these types of materials to an issuer official during the transition period would not constitute contributions under rule G-37 if performed as part of a solicitation for municipal securities business.

Finally, in a Question and Answer Notice dated September 9, 1997 (Q&A number 1), the MSRB addressed whether a municipal finance professional who is entitled to vote for an issuer official may make contributions to pay for such official's transition or inaugural expenses without causing a prohibition on municipal securities business with the issuer. If a municipal finance professional contributed $250 to the general election of an issuer official, the municipal finance professional would not be able to make any contributions to pay for transition or inaugural expenses without causing a prohibition on municipal securities business with the issuer. If a municipal finance professional made no contributions to an issuer official prior to the election, then the municipal finance professional may, if entitled to vote for the candidate, contribute up to $250 to pay for transition or inaugural expenses and payment of debt incurred in connection

with the election without causing a prohibition on municipal securities business.

### Interpretation on the Effect of a Ban on Municipal Securities Business under Rule G-37 Arising During a Pre-Existing Engagement Relating to Municipal Fund Securities

April 2, 2002

Rule G-37, on political contributions and prohibitions on municipal securities business, prohibits any broker, dealer or municipal securities dealer (a "dealer") from engaging in municipal securities business with an issuer within two years after any contribution (other than certain de minimis contributions) 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 Municipal Securities Rulemaking Board ("MSRB") has received inquiries regarding the effect of a ban on municipal securities business with an issuer arising from a contribution made after a dealer has entered into a long-term contract to serve as the primary distributor of the issuer's municipal fund securities.

In an interpretive notice published in 1997 (the "1997 Interpretation"), the MSRB stated that a dealer subject to a prohibition on municipal securities business with an issuer is allowed to continue to execute certain issue-specific contractual obligations in effect prior to the date of the contribution that caused the prohibition.[1] For example, dealers that had already executed a contract with the issuer to serve as underwriter or financial advisor for a new issue of debt securities prior to the contribution could continue in these capacities.

The 1997 Interpretation also addressed certain types of on-going, non-issue-specific municipal securities business that a dealer may have contracted with an issuer to perform prior to the making of a contribution that causes a prohibition on municipal securities business with the issuer. For example, the MSRB noted that a dealer may act as remarketing agent for an outstanding issue of municipal securities or may continue to underwrite a specific commercial paper program so long as the contract for such services was in effect prior to the contribution. The MSRB stated that these activities are not considered new municipal securities business and may be performed by dealers that are banned from municipal securities business with an issuer. The MSRB further stated, however, that provisions in existing contracts that allow for changes in the services provided by the dealer or compensation paid by the issuer would be viewed by the MSRB as new municipal securities business and, therefore, rule G-37 would preclude a dealer subject to a ban on municipal securities business from performing such additional functions or receiving additional compensation. The MSRB cited two examples of these types of provisions. The first involved a contract to serve as remarketing agent for a variable rate issue that might permit a fixed rate conversion, with a concomitant increase in the per bond compensation. The second example involved an agreement to underwrite a commercial paper program that might include terms for increasing the size of the program, with no increase in per bond fees but an increase in overall compensation resulting from the larger outstanding balance of commercial paper. In both cases, the MSRB viewed the exercise of these provisions as new municipal securities business that would be banned under the rule.

In the 1997 Interpretation, the MSRB recognized that there is great variety in the terms of agreements regarding municipal securities business and that its guidance in the 1997 Interpretation may not adequately deal with all such agreements. The MSRB sought input on other situations where contracts obligate dealers to perform various types of activities after the date of a contribution that triggers a ban on municipal securities business and stated that additional interpretations might be issued based upon such input.

The MSRB understands that dealers typically are selected by issuers to serve as primary distributors of municipal fund securities on terms that differ significantly from those of a dealer selected to underwrite an issue of debt securities. Issuers generally enter into long-term agreements (in many cases with terms of ten years or longer) with the primary distributor of municipal fund securities for services that include the sale in a continuous primary offering of one or more categories or classes of the securities issued within the framework of a single program of investments.[2] In addition, an issuer may often engage a particular dealer to serve as the primary distributor of its municipal fund securities as part of a team of professionals that includes the dealer's affiliated investment management firm, which is charged with managing the investment of the underlying portfolios.

The MSRB believes that the guidance provided in the 1997 Interpretation, although appropriate for the circumstances discussed therein, may not be adequate to address the unique features of municipal fund securities programs. For example, so long as a program realizes net in-flows of investor cash, the size of an offering of municipal fund securities will necessarily increase over time. Under most compensation arrangements in the market, any net in-flow of cash generally would result in an increase in total compensation, causing any new sales of municipal fund securities that exceed redemptions to be considered new municipal securities business under the 1997 Interpretation. Also, the addition by the issuer of a new category of investments (*e.g.*, a new portfolio in an aged-based Section 529 college savings plan created for children born in the most recent year) could be considered a new offering from which such dealer might be banned, even where such new category may have been clearly contemplated at the outset of the dealer's engagement. Further, the MSRB understands that the repercussions to an issuer of municipal fund securities or investors in such securities of a sudden change in the primary distributor (and possible concurrent change in the investment manager) resulting from a ban on municipal securities business arising during the term of an existing arrangement often will be significantly greater than in the case of an underwriting or other primary market activity relating to the typical debt offering. Issuers could be faced with redesigning existing programs and investors may need to establish new relationships with different dealers in order to maintain their investments.

As a result, the MSRB believes that further interpretive guidance is necessary in this area. The MSRB is of the view that, where a dealer has become subject to a ban on municipal securities business with an issuer of municipal fund securities with which it is currently serving as primary distributor, any continued sales of existing categories of municipal fund securities for such issuer during the duration of the ban would not be considered new municipal securities business if the basis for determining compensation does not change during that period, even if total compensation increases as a result of net in-flows of cash. Further, the MSRB believes that any changes in the services to be provided by the dealer to the issuer throughout the duration of the ban that are contemplated under the pre-existing contractual arrangement (*e.g.*, the addition of new categories of securities within the framework of the existing program) would not be considered new municipal securities business so long as such changes do not result in: (1) an increase in total compensation received by the dealer for services performed for the duration of the ban (whether paid during the ban or as a deferred payment after the ban); or (2) in an extension of the term of the dealer in its current role.

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[1] *See* Rule G-37 Interpretation – Interpretation on Prohibition on Municipal Securities Business Pursuant to Rule G-37, February 21, 1997, MSRB *Rule Book* (January 2002) at 232.

[2] The various categories generally reflect interests in funds having different allocations of underlying investments. For example, a so-called Section 529 college savings plan may offer one category that represents investments primarily in equity securities and another in debt securities, or may have categories where the allocation shifts from primarily equity securities to primarily debt or money market securities as the number of years remain-

ing until the beginning of college decreases. In the case of state and local government pools, the types of securities in the underlying portfolios may be allocated so as to create one category of short-term "money market" like investments (*i.e.*, with net asset value maintained at approximately $1 per share) and another with a longer timeframe and fluctuating net asset value.

## NOTICE CONCERNING INDIRECT RULE VIOLATIONS: RULES G-37 AND G-38

August 6, 2003

The Municipal Securities Rulemaking Board's ("MSRB" or Board") statutory mandate is to protect investors and the public interest in connection with dealers' activities in the municipal securities market. The municipal securities market is one of the world's leading securities markets. Investors hold approximately $1.6 trillion worth of municipal securities—either through direct ownership or through investment in institutional portfolios. These investors provide much needed capital to more than 50,000 state and local governments. Maintaining municipal market integrity is an exceptionally high priority for the Board as it seeks to foster a fair and efficient municipal securities market through dealer regulation.

In 1994, the MSRB adopted Rule G-37 in an effort to remove the real or perceived conflict of interest of issuers who receive political contributions from dealers and award municipal securities business to such dealers. As noted by the Court reviewing Rule G-37, "[u]nderwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity."[1] Pay-to play harms the integrity of the underwriter selection process.

In general, Rule G-37 prohibits brokers, dealers and municipal securities dealers ("dealers") from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers; prohibits dealers and municipal finance professionals ("MFP") from soliciting or bundling contributions to an official of an issuer with which the dealer is engaging or seeking to engage in municipal securities business; and requires dealers to record and disclose certain political contributions, as well as other information, to allow public scrutiny of political contributions and the municipal securities business of a dealer. The rule also seeks to ensure that payments made to political parties by dealers, MFPs, and political action committees ("PAC") not controlled by the dealer or MFP do not represent attempts to make indirect contributions to issuer officials in contravention of Rule G-37 by requiring dealers to record and disclose all payments made to state and local political parties.[2] The party payment disclosure requirements were intended to assist in severing any connection between payments to political parties (even if earmarked for expenses other than political contributions) and the awarding of municipal securities business.[3]

Although Rule G-37 initially included certain limited disclosure requirements for consultants used by dealers to obtain municipal securities business, in 1996, the MSRB adopted a separate Rule G-38, on consultants, to prevent persons from circumventing Rule G-37 through the use of consultants. Rule G-38 currently requires dealers who use consultants[4] to evidence the consulting arrangement in writing, to disclose, in writing, to an issuer with which it is engaging or seeking to engage in municipal securities business information on consulting arrangements relating to such issuer, and to submit to the Board, on a quarterly basis, reports of all consultants used by the dealer, amounts paid to such consultants, and certain political contribution and payment information from the consultant.

The impact of Rules G-37 and G-38 has been very positive. The rules have altered the political contribution practices of municipal securities dealers and opened discussion about the political contribution practices of the entire municipal industry.

While the Board is pleased with the success of these rules, it also is concerned with increasing signs that individuals and firms subject to the rules may be seeking ways around Rule G-37 through payments to political parties or non-dealer controlled PACs that find their way to issuer officials, significant political contributions by dealer affiliates (*e.g.*, bank holding companies and affiliated derivative counterparty subsidiaries) to both issuer officials and political parties, contributions by associated persons of the dealer who are not MFPs and by the spouses and family members of MFPs to issuer officials, and the use of consultants who make or bundle political contributions. In addition to dealer and dealer-related giving, the Board is also concerned about media and other reports regarding significant giving by other market participants, including independent financial advisors, swap advisors, swap counterparties, investment contract providers and public finance lawyers.

The MSRB is mindful that Rule G-37's prohibitions involve sensitive constitutional issues and is reluctant to significantly broaden the scope of the rule. The rule was constructed and will continue to be reviewed with full regard for and consideration of an individual's right to participate fully in our political processes. The Board, however, wishes to remind dealers that Rule G-37, as currently in effect, covers indirect as well as direct contributions to issuer officials, and to alert dealers that it has expressed its concern to the entities that enforce the Board's rules that some of the increased political giving may indicate a rise in indirect Rule G-37 violations. While Rule G-37 was adopted to deal specifically with contributions made to officials of issuers by dealers and MFPs, and PACS controlled by dealers or MFPs, the rule also prohibits MFPs and dealers from using conduits—be they parties, PACS, consultants, lawyers, spouses or affiliates—to contribute indirectly to an issuer official if such MFP or dealer can not give directly to the issuer without triggering the ban on business. The MSRB will continue to work with the enforcement agencies to identify and halt abusive practices. If, at a later date, the Board learns of specific problematic dealer practices that it believes must be addressed more directly, the Board may proceed with additional rulemaking relating to Rules G-37 and G-38.

The Board strongly believes that pay-to-play undermines the integrity of the municipal securities industry. Such practices are regulated not only by the specific parameters of Rule G-37, but also by the fair practice principles embodied in the MSRB's Rule G-17, on fair dealing. Similarly, the MSRB reminds issuers and dealers that the SEC has previously advised that, with respect to primary offering disclosure, increased attention needs to be directed at disclosure of potential conflicts of interest and material financial relationships among issuers, advisors and underwriters, including those arising from political contributions.[5] These issuer conflicts of interest can and do arise not only from contributions made by municipal securities dealers, but also from payments by unregulated municipal securities market participants.

The costs of political campaigns are skyrocketing across the country. The MSRB is aware of reports that elected officials, or persons acting on behalf of elected officials, are putting pressure on dealers and MFPs to find ways to contribute to the costs associated with political campaigns. The Board also recognizes that there is significant political giving that is not by, or directed by, municipal securities dealers. Thus, the MSRB wishes to encourage state and local governments to take a fresh look at these issues and see whether their policies and procedures should be revised to help maintain the integrity of the underwriting process. The Board believes that it is critical that the municipal market engender the highest degree of public confidence so that investors will continue to provide much needed capital to state and local governments.

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[1] *Blount v. SEC*, 61 F. 3d 938 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 1351 (1996).

[2] If a dealer or MFP is considering contributing funds to a non-dealer associated PAC or political party, Rule G-37 requires that the dealer or MFP "should inquire of the non-

dealer associated PAC or political party how any funds received from the dealer [or MFP] would be used." *See Questions and Answers Notice: Rule G-37*, No. 2 (August 6, 1996), reprinted in *MSRB Rule Book*.

3 *See* Securities and Exchange Act Release No. 35446 (SEC Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Rule G-37 on Political Contributions and Prohibitions on Municipal Securities Business, and Rule G-8, on Recordkeeping) (March 6, 1995).

4 Rule G-38 (a)(i) defines the term "consultant" as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the dealer or any other person

5 *See* SEC Release No. 33-7049; 34-33741 (Statement of the Commission Regarding Disclosure Obligations of Municipal Issuers and Others) (March 17, 1994).

**See also:**

**Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market,** January 18, 2001.

## *Interpretive Letters*

**Solicitation of contributions.** This is in response to your letter dated September 29, 1994 regarding rule G-37, on political contributions and prohibitions on municipal securities business. You review a situation regarding a municipal finance professional's participation in a fundraising event for a certain state official. You seek guidance on two matters. First, you inquire whether the activities of the municipal finance professional in connection with this fundraiser constitute a violation of the solicitation prohibition in rule G-37(c). Second, you inquire that, if a violation of rule G-37(c) occurred, would such violation subject your firm to a two-year ban on municipal securities business with the state. The Board has reviewed your letter and authorized this response.

Rule G-37(b) 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 municipal finance professional.[1] Rule G-37(c) provides that no dealer or any municipal finance professional 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 dealer is engaging or is seeking to engage in municipal securities business.

With regard to your first inquiry, the Board is not the appropriate authority to determine whether in this instance the municipal finance professional's activities amounted to a solicitation of contributions in violation of rule G-37(c). While the Board has authority to adopt rules concerning transactions in municipal securities effected by brokers, dealers and municipal securities dealers, it has no enforcement authority over dealers; that authority is vested with the National Association of Securities Dealers, Inc. (NASD) for securities firms. Whether a particular activity should be characterized as a solicitation of a contribution and a violation of the rule is fact specific, and further inquiry and investigation may be appropriate prior to a determination of violation. The Board believes that it is more appropriate for the NASD to make such inquiries and determinations. Your letter has been forwarded to the NASD for its review.

The Board believes, however, that if a dealer's or a municipal finance professional's name appears on fundraising literature for an issuer official for which the dealer is engaging or seeking to engage in municipal securities business, there is a presumption that such activity is a solicitation by the named party.

With regard to your second inquiry, a violation of rule G-37(c) does not trigger a two-year ban on engaging in municipal securities business with an issuer. If the NASD finds a violation of rule G-37(c) has occurred, the NASD will determine the appropriate sanction.

Finally, rule G-27, on supervision, requires each dealer to adopt, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Board rules, including rule G-37. In view of the significant penalties associated with rule G-37, including a two-year ban on municipal securities business with an issuer in certain cases, effective compliance procedures are essential. We recognize that some dealers may focus their compliance procedures on the areas in the rule concerning certain political contributions. Rule G-37 has other important provisions, however, such as the prohibition against certain solicitations and the recordkeeping and reporting requirements. Given the situation presented in your letter, your firm may wish to review its procedures to determine whether they are sufficient to ensure compliance with all provisions of rule G-37. *MSRB Interpretation of November 7, 1994.*

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1 The prohibition does not apply if the only contributions to officials of issuers are made by municipal finance professionals entitled to vote for such officials, and provided, such contributions, in total, are not in excess of $250 by each such municipal finance professional to each official of such issuer, per election.

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**Solicitation of contributions.** This is in response to your letter in which you summarize your understanding of our telephone conversation relating to section (c) of rule G-37, on political contributions and prohibitions on municipal securities business. As I noted during our conversation, the Board's rules, including rule G-37, apply solely to brokers, dealers and municipal securities dealers ("dealers"). The Board's rulemaking authority, granted under Section 15B of the Securities Exchange Act of 1934, does not extend to issuers of municipal securities. Thus, rule G-37 does not impose any obligations upon issuers or officials of issuers. Although the Board appreciates your interest in not placing dealers and their associated persons in a position to violate their obligations under the rule, it is ultimately the responsibility of such dealers and associated persons, in consultation with appropriate compliance personnel, to ensure compliance with Board rules.

As you know, rule G-37(c) provides that no dealer or municipal finance professional 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 dealer is engaging or is seeking to engage in municipal securities business. The Board has previously stated that this provision would:

> prohibit a dealer and any municipal finance professional from soliciting . . . 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. . . .[*] [M]unicipal finance professionals may volunteer their personal services in other ways to political campaigns.[1]

You had sought guidance regarding what activities would be covered by this provision of the rule. As you noted in your letter, I had indicated that the term "solicit" is not explicitly defined for purposes of section (c) of the rule. I had stated that whether a particular activity can be characterized as a solicitation of a contribution for purposes of section (c) is dependent upon the facts and circumstances surrounding such activity. I had noted, however, that the rule does not prohibit or restrict municipal finance professionals from engaging in personal volunteer work, unless such work constituted solicitation or bundling of contributions for an official of an issuer with which the municipal finance professional's dealer is engaging or seeking to engage in municipal securities business.[2] Municipal finance professionals are therefore free to,

among other things, solicit votes or other assistance for such an issuer official so long as the solicitation does not constitute a solicitation or coordination of contributions for the official.[3]

Whether a municipal finance professional is permitted by section (c) of the rule to indicate to third parties that someone is a "great candidate" or to provide a list of third parties for the candidate to call would be dependent upon all the facts and circumstances surrounding such action. The facts and circumstances that may be relevant for this purpose may include, among any number of other factors, whether the municipal finance professional has made an explicit or implicit reference to campaign contributions in his or her conversations with third parties whom the candidate may contact and whether the candidate contacts such third parties seeking campaign contributions. However, the totality of the facts and circumstances surrounding any particular activity must be considered in determining whether such activity may constitute a solicitation of contributions for purposes of section (c) of the rule. Therefore, the Board cannot prescribe an exhaustive list of precautions that would assure that no violation of this section would occur as a result of such activity. *MSRB interpretation of May 21, 1999.*

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**Campaign for federal office.** This is in response to your letter dated May 5, 1995, concerning the application of the Board's rule G-37 to a campaign for President of the United States. You ask specifically about the application of rule G-37 to contributions to Governor [name deleted] presidential campaign. The Board reviewed your letter at its May 18-19, 1995 meeting and has authorized this response.

As you know, rule G-37, among other things, prohibits any broker, dealer or municipal securities dealer (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 controlled by the dealer or any municipal finance professional. The only exception to rule G-37's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals. Specifically, contributions by such persons to officials of issuers would not invoke application of the prohibition if the municipal finance professional is entitled to vote for such official, and provided that any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election. Rule G-37(g)(i) defines the term "contribution" as any "gift, subscription, loan, advance, or deposit of money or anything of value made: (A) for the purpose of influencing any election for federal, state or local office..."

The Board previously has clarified that rule G-37 does not encompass all contributions to candidates for federal office. Rather, for federal office, the rule encompasses only those contributions to a current issuer official who is seeking election to federal office.[1]

You ask whether the Governor of [a state] is an "official of an issuer" for purposes of rule G-37. Rule G-37(g)(vi) defines the term "official of an issuer" as "any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) for elective office of the issuer which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) for any elective office of a state or of any political subdivision, which office has authority to appoint any official(s) of an issuer..." as defined above. The Board has not provided any exemptions from, or exception to, the definition "official of an issuer" as set forth in rule G-37.

The Board does not make determinations concerning whether a particular individual meets the definition of "official of an issuer." The Board believes that because such determinations may involve particular issues of fact, such decisions must generally be the dealer's responsibility. The Board has, however, provided guidance in this area by recommending that dealers review the scope of authority conferred upon the particular office (and not the individual) to determine whether the office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business.[2] For example, a state may have certain issuing authorities whose boards of directors are appointed by the governor. In such circumstances, the Board previously has stated that it intended to include the governor as an official of the issuer.[3]

You ask whether rule G-37 applies to candidates for President of the United States. As noted above, the term "contribution" as defined in rule G-37(g)(i) includes payments "for the purpose of influencing any election for **federal,** state or local office." [Emphasis added]. Thus, rule G-37 is applicable to contributions given to officials of issuers who seek election to federal office, such as the House of Representatives, the Senate or the Presidency.

You ask whether rule G-37 unfairly impinges upon Governor [name deleted] equal protection and freedom of speech and association rights in the context of the Presidential election since he is, at this time, the only candidate with respect to whom those covered by the rule face "disqualification" from municipal securities business for making contributions. You also state that rule G-37 violates the First Amendment rights of association or speech by limiting the ability of municipal finance professionals to contribute to Governor [name deleted] presidential campaign. In its order approving rule G-37, the Securities and Exchange Commission stated that:

> any resulting hardship to candidates for federal office who are currently local officials is not a reason for eliminating these requirements. The MSRB cannot overlook potential conflicts of interest solely because there are candidates for the same federal office who do not face the same conflicts. In any event, the resulting burden to current local officials does not appear to be significant.[4]

The Board believes that rule G-37 is not the product of governmental action and is not subject to Constitutional review. However, as you may be aware, these issues currently are pending before the D.C. Court of Appeals.

You ask whether the creation of the District of Columbia Financial Responsibility and Management Assistance Authority means that the President of the United States is an "official of an issuer" and that all candidates for President now fall under rule G-37. Rule G-37(g)(vi) defines "official of an issuer" as "any person ...

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[1] *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 5. *See* Securities Exchange Act Release No. 33868 (April 7, 1994), 59 FR 17621 (April 13, 1994). *See also Questions and Answers Concerning Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37*, May 24, 1994, reprinted in *MSRB Rule Book*; *MSRB Interpretation of November 7, 1994*, reprinted in *MSRB Rule Book*; *MSRB Interpretation of May 31, 1995*, reprinted in *MSRB Rule Book*. Furthermore, the Board stated in its filing of the rule with the Securities and Exchange Commission that the rule's "anti-solicitation and anti-bundling proscriptions are intended to prohibit covered parties from: (i) soliciting others, including spouses and family members, to make contributions to issuer officials; and (ii) coordinating, or soliciting others to coordinate, contributions to issuer officials in order to influence the awarding of municipal securities business." SEC File No. SR-MSRB-94-2.

[2] *See Question and Answer No. 24*, May 24, 1994, reprinted in *MSRB Rule Book*; *Question and Answer No. 3*, August 18, 1994, reprinted in *MSRB Rule Book*. In addition, if the municipal finance professional used dealer resources or incurred expenses that could be considered contributions in the course of undertaking such volunteer work, the ban on municipal securities business under section (b) of the rule could be triggered.

[3] In upholding the constitutionality of rule G-37, the United States Court of Appeals for the District of Columbia Circuit observed that "municipal finance professionals are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events." *Blount v. SEC*, 61 F.3d 938, 948 (D.C. Cir. 1995), *cert. denied*, 116 S. Ct. 1351 (1996). However, the Board has stated that hosting or paying to attend a fundraising event may constitute a contribution subject to section (b) of the rule. *See Questions and Answers Nos. 24 and 29*, May 24, 1994, reprinted in *MSRB Rule Book*.

[4] [Sentence deleted to reflect current rule provisions.]

who was, at the time of the contribution, an incumbent, candidate or successful candidate: (A) **for elective office of the issuer** which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer; or (B) **for any elective office of a state or political subdivision,** which office has authority to appoint any official(s) of an issuer." [Emphasis added]. The President does not hold an elective office of an "issuer" of municipal securities. In addition, the President is not, and would not become, an issuer official by virtue of his authority to appoint members to the D.C. Financial Responsibility and Management Assistance Authority because the Presidency is not an elective office of a state or political subdivision.

You ask a number of questions concerning what activities are permissible by those individuals covered by the rule. You ask whether the $250 *de minimis* contribution exception in rule G-37 applies to Presidential candidates. As noted previously, the only exception to rule G-37's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals. Specifically, contributions by such persons to officials of issuers would not invoke application of the prohibition if the municipal finance professional is entitled to vote for such official, and provided that any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election. The Board previously has stated that, if an issuer official is involved in a primary election prior to the general election, the municipal finance professional who is entitled to vote for such official may contribute up to $250 for the primary election and $250 for the general election to each such official.[5]

[Two paragraphs deleted.][6]

You ask whether an individual covered by rule G-37 may raise money from others on behalf of Governor [name deleted]. Rule G-37(c) provides that no dealer or any municipal finance professional 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 dealer is engaging or is seeking to engage in municipal securities business. A violation of rule G-37(c) does not trigger a two-year ban on engaging in municipal securities business with an issuer; however, if the appropriate enforcement agency finds that a violation of rule G-37(c) has occurred, the enforcement agency will determine the appropriate sanction.[7] You ask whether the *de minimis* exception applies to solicited and bundled contributions of $250 and less. Solicitations of contributions are prohibited by the rule (for those covered); therefore, there is no *de minimis* exception.

You ask whether a covered individual may hold a party in his home for a Presidential candidate if contributions are raised at the party. The Board has stated that rule G-37 is not intended to restrict municipal finance professionals from engaging in personal volunteer work.[8] Personal expenses incurred by the municipal finance professional in the conduct of such volunteer work, which expenses are purely incidental to such work and unreimbursed by the dealer (*e.g.*, cab fares and personal meals), would not constitute a contribution. However, the expenses incurred for hosting a party to solicit contributions would be viewed as a contribution.[9] The Board also has stated that if a dealer's or a municipal finance professional's name appears on fundraising literature for an issuer official for which the dealer is engaging or seeking to engage in municipal securities business then there is a presumption that such activity is a solicitation by the dealer or municipal finance professional in violation of section (c) of the rule.[10]

Finally, you ask whether spouses and eligible children of covered personnel may contribute to a Presidential candidate. The Board has stated that contributions to issuer officials by municipal finance professionals' spouses and household members are not covered by rule G-37 unless these contributions are directed by the municipal finance professional, which is prohibited by section (d) of the rule.[11] *MSRB interpretation of May 31, 1995.*

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1 *See* MSRB *Reports*, Vol. 14, No. 3 (June 1994) at 14.

2 Id.

3 *See* MSRB *Reports*, Vol. 14, No. 4 (August 1994) at 24.

4 *See* Securities Exchange Act Release No. 33868 (April 7, 1994) at 41-42; 59 FR 17621.

5 *See* MSRB *Reports*, Vol. 14, No. 3 (June 1994) at 13.

6 An interpretation on determining whether a municipal finance professional is "entitled to vote" for an issuer official was withdrawn by the Board in January 1996. The Board has issued a revised interpretation of "entitled to vote" which states that a municipal finance professional is "entitled to vote" for an issuer official if the municipal finance professional's principal residence is in the locality in which the issuer official seeks election. In such instances, a municipal finance professional is able to make a *de minimis* contribution without resulting in a ban on municipal securities business. For example, if an issuer official is a governor running for re-election, anyone residing in that state may make a *de minimis* contribution to the official without causing a ban on municipal securities business with that issuer. In the example of an issuer official running for President, anyone in the country can contribute the *de minimis* amount to the official's Presidential campaign. The Securities and Exchange Commission approved this revision on February 16, 1996. See MSRB *Reports*, Vol. 16. No. 1 (January 1996) at 31-34.

7 The enforcement agencies are: for securities firms, the National Association of Securities Dealers; and for bank dealers, the Federal Deposit Insurance Corporation, the Federal Reserve Board, or the Office of the Comptroller of the Currency.

8 *See* MSRB *Reports*, Vol. 14, No. 3 (June 1994) at 15.

9 Id.

10 *See* MSRB *Reports*, Vol. 14, No. 5 (December 1994) at 17.

11 *See* MSRB *Reports*, Vol. 14, No. 3 (June 1994) at 15.

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**Municipal finance professional: supervisor.** This is in response to your inquiry seeking guidance regarding the possible classification as a municipal finance professional under rule G-37 of a Taxable Department Head at your firm. You stated that the Taxable Department Head is the direct supervisor of a Branch Manager and this Branch Manager manages a sales representative who has solicited municipal securities business from an issuer. You state that it is clear that the Branch Manager and the sales representative are both municipal finance professionals. However, you further state that the Taxable Department Head has delegated all Public Finance/Municipal oversight responsibilities to the Public Finance Department Head for the Taxable Department Head's personnel. You ask whether, under these circumstances, the Taxable Department Head would be considered a municipal finance professional under rule G-37 as a result of his or her supervisory position.

The term "municipal finance professional" is defined in rule G-37(g)(iv). Clauses (C) and (D) of the definition set forth the basis for considering an associated person of a dealer to be a municipal finance professional as a result of his or her supervisory position. Clause (C) includes any associated person who is <u>both</u> (i) either a municipal securities principal or municipal securities sales principal and (ii) a supervisor of any associated person either primarily engaged in municipal securities representative activities or who solicits municipal securities business (referred to herein as a "primary municipal securities supervisor"). Clause (D) includes any associated person who is a supervisor of a primary municipal securities supervisor up through and including (in the case of a non-bank dealer) the Chief Executive Officer or similarly situation official (referred to herein as a "secondary municipal securities supervisor").

Unlike in the case of a primary municipal securities supervisor, a secondary municipal securities supervisor is <u>not</u> required to be a municipal securities principal or municipal securities sales principal. The status of a secondary municipal securities supervisor as a municipal finance professional is not conditioned on the areas in which such supervisor has responsibility over a primary municipal securities supervisor, so long as such secondary municipal securities supervisor retains some degree of supervisory responsibility (whether or not relating to municipal securities activities) over the primary municipal securities supervisor. *MSRB interpretation of November 23, 1999.*

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**Financial advisor to conduit borrower.** This is in response to your letter concerning rule

G-37, on political contributions and prohibitions on municipal securities business. You state that your firm served as financial advisor to the underlying borrower, not the governmental issuer, for a certain issue of municipal securities. You ask whether you are required to report this financial advisory activity on Form G-37/G-38.

Rule G-37(g)(vii) defines the term "municipal securities business" to include "the provision of financial advisory or consultant services to or on behalf of an issuer with respect to a primary offering of municipal securities in which the dealer was chosen to provide such services on other than a competitive bid basis." If the financial advisory services your firm provided were to the underlying borrower and not "to or on behalf of an issuer,"[1] then your firm was not engaging in "municipal securities business" and these financial advisory services are not required to be reported on Form G-37/G-38. *MSRB interpretation of January 23, 1997.*

[1] Rule G-37(g)(ii) defines "issuer" as the governmental issuer specified in section 3(a)(29) of the Securities Exchange Act.

See also:

**Rule G-23 Interpretive Letters – Fairness Opinions,** *MSRB interpretation of January 10, 1997.*

**– Financial advisory relationship: private placements,** *MSRB interpretation of October 5, 1999.*

## Rule G-38: Consultants

(a) *Definitions*

(i) The term "consultant" means any person used by a broker, dealer or municipal securities dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on behalf of such broker, dealer or municipal securities dealer where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the broker, dealer or municipal securities dealer or any other person; provided, however, that the following persons shall not be considered consultants for purposes of this rule: (A) a municipal finance professional of the broker, dealer or municipal securities dealer; and (B) any person whose sole basis of compensation from the broker, dealer or municipal securities dealer is the actual provision of legal, accounting or engineering advice, services or assistance in connection with the municipal securities business that the broker, dealer or municipal securities dealer is seeking to obtain or retain.

(ii) The term "issuer" shall have the same meaning as in rule G-37(g)(ii).

(iii) The term "municipal finance professional" shall have the same meaning as in rule G-37(g)(iv).

(iv) The term "municipal securities business" shall have the same meaning as in rule G-37(g)(vii).

(v) The term "payment" shall have the same meaning as in rule G-37(g)(viii).

(vi) The term "reportable political contribution" means:

(A) if the consultant has had direct or indirect communication with an issuer on behalf of the broker, dealer or municipal securities dealer to obtain or retain municipal securities business for such broker, dealer or municipal securities dealer, a political contribution to an official(s) of such issuer made by any contributor referred to in paragraph (b)(i) during the period beginning six months prior to such communication and ending six months after such communication;

(B) the term does not include those political contributions to official(s) of an issuer made by any individual referred to in subparagraph (b)(i)(A) or (B) of this rule who is entitled to vote for such official if the contributions made by such individual, in total, are not in excess of $250 to any official of such issuer, per election.

(vii) The term "reportable political party payment" means:

(A) if a political party of a state or political subdivision operates within the geographic area of an issuer with which the consultant has had direct or indirect communication to obtain or retain municipal securities business on behalf of the broker, dealer or municipal securities dealer, a payment to such party made by any contributor referred to in paragraph (b)(i) during the period beginning six months prior to such communication and ending six months after such communication;

(B) the term does not include those payments to political parties of a state or political subdivision made by any individual referred to in subparagraph (b)(i)(A) or (B) of this rule who is entitled to vote in such state or political subdivision if the payments made by such individual, in total, are not in excess of $250 per political party, per year.

(viii) The term "official of such issuer" or "official of an issuer" shall have the same meaning as in rule G-37(g)(vi).

(b) *Written Agreement.*

(i) Each broker, dealer or municipal securities dealer that uses a consultant shall evidence the consulting arrangement by a writing setting forth, at a minimum, the name, business address, role (including the state or geographic area in which the consultant is working on behalf of the broker, dealer or municipal securities dealer) and compensation arrangement of each such consultant ("Consultant Agreement"). In addition, the Consultant Agreement shall include a statement that the consultant agrees to provide the broker, dealer or municipal securities dealer with a list by contributor category, in writing, of any reportable political contributions and any reportable political party payments during each calendar quarter made by:

(A) the consultant;

(B) if the consultant is not an individual, any partner, director, officer or employee of the consultant who communicates with an issuer to obtain municipal securities business on behalf of the broker, dealer or municipal securities dealer; and

(C) any political action committee controlled by the consultant or any partner, director, officer or employee of the consultant who communicates with an issuer to obtain municipal securities business on behalf of the broker, dealer or municipal securities dealer.

(ii) The Consultant Agreement shall require that, if applicable, the consultant shall provide to the broker, dealer or municipal securities dealer a report that no reportable political contributions or reportable political party payments

were made during a calendar quarter.

(iii) The Consultant Agreement shall require that the consultant provide the reportable political contributions and political party payments for each calendar quarter, or report that no reportable political contributions or political party payments were made for a particular calendar quarter, to the broker, dealer or municipal securities dealer in sufficient time for the broker, dealer or municipal securities dealer to meet its reporting obligations under paragraph (e) of this rule.

(iv) The Consultant Agreement must be entered into before the consultant engages in any direct or indirect communication with an issuer on behalf of the broker, dealer or municipal securities dealer.

(c) *Information Concerning Political Contributions to Official(s) of an Issuer and Payments to State and Local Political Parties made by Consultants.*

(i) A broker, dealer or municipal securities dealer is required to obtain information on its consultant's reportable political contributions and reportable political party payments beginning with a consultant's first direct or indirect communication with an issuer on behalf of the broker, dealer or municipal securities dealer to obtain or retain municipal securities business for such broker, dealer or municipal securities dealer. The broker, dealer or municipal securities dealer shall obtain from the consultant the information concerning each reportable political contribution required to be recorded pursuant to rule G-8(a)(xviii)(F) and each reportable political party payment required to be recorded pursuant to rule G-8(a)(xviii)(G) or, if applicable, a report indicating that the consultant made no reportable political contributions and no reportable political party payments required to be recorded pursuant to rule G-8(a)(xviii)(H).

(ii) The requirement to obtain the information referred to in paragraph (c)(i) of this rule shall end upon the termination of the Consultant Agreement.

(iii) A broker, dealer or municipal securities dealer will not violate this section if it fails to receive from its consultant all required information on reportable political contributions and reportable political party payments and thus fails to report such information to the Board if the broker, dealer or municipal securities dealer can demonstrate that it used reasonable efforts in attempting to obtain the necessary information. Reasonable efforts shall include:

(A) a statement in the Consultant Agreement that Board rules require disclosure of consultant contributions to issuer officials and payments to state and local political parties;

(B) the broker, dealer or municipal securities dealer sending quarterly reminders to its consultants of the deadline for their submissions to the broker, dealer or municipal securities dealer of the information concerning their reportable political contributions and reportable political party payments;

(C) the broker, dealer or municipal securities dealer including in the Consultant Agreement provisions to the effect that:

(1) the Consultant Agreement will be terminated by the broker, dealer or municipal securities dealer if, for any calendar quarter, the consultant fails to provide the broker, dealer or municipal securities dealer with information about its reportable political contributions or reportable political party payments, or a report noting that the consultant made no reportable political contributions or no reportable political party payments, and such failure continues up to the date to be determined by the dealer, but no later than the date by which the broker, dealer or municipal securities dealer is required to send Form G-37/G-38 to the Board with respect to the next succeeding calendar quarter, such termination to be effective upon the date the broker, dealer or municipal securities dealer must send its Form G-37/G-38 to the Board (i.e., January 31, April 30, July 31 or October 31); and

(2) no further payments, including payments owed for services performed prior to the date of termination, shall be made to the consultant by or on behalf of the broker, dealer or municipal securities dealer as of the date of such termination; and

(D) the broker, dealer or municipal securities dealer enforcing the Consultant Agreement provisions described in paragraph (c)(iii)(C) of this rule in a full and timely manner and indicating the reason for and date of the termination on its Form G-37/G-38 for the applicable quarter.

(d) *Disclosure to Issuers.* Each broker, dealer or municipal securities dealer shall submit in writing to each issuer with which the broker, dealer or municipal securities dealer is engaging or is seeking to engage in municipal securities business, information on consulting arrangements relating to such issuer, which information shall include the name of the consultant pursuant to the Consultant Agreement, business address, role (including the state or geographic area in which the consultant is working on behalf of the broker, dealer or municipal securities dealer) and compensation arrangement of any consultant used, directly or indirectly, by the broker, dealer or municipal securities dealer to attempt to obtain or retain municipal securities business with each such issuer. Such information shall be submitted to the issuer either:

(i) prior to the selection of any broker, dealer or municipal securities dealer in connection with the particular munic-

ipal securities business being sought; or

(ii) at or prior to the consultant's first direct or indirect communication with the issuer for any municipal securities business. Each broker, dealer or municipal securities dealer shall promptly advise the issuer, in writing, of any change in the information disclosed, pursuant to this subsection (ii), on each consulting arrangement relating to such issuer. In addition, each broker, dealer or municipal securities dealer disclosing information pursuant to this subsection (ii) shall update such information by notifying each issuer in writing within one year of the previous disclosure made to such issuer concerning each consultant's name, company, role and compensation arrangement, even where the information has not changed; provided, however, that this annual requirement shall not apply where the broker, dealer or municipal securities dealer has ceased to use the consultant, directly or indirectly, to attempt to obtain or retain municipal securities business with the particular issuer.

(e) *Disclosure to Board.* Each broker, dealer and municipal securities dealer shall send to the Board, and the Board shall make public, reports of all consultants used by the broker, dealer or municipal securities dealer during each calendar quarter. Such reports must be sent to the Board on Form G-37/G-38 by the last day of the month following the end of each calendar quarter (these dates correspond to January 31, April 30, July 31, and October 31) in the manner provided under Rule G-37. Such reports shall include, for each consultant, in the prescribed format, the consultant's name pursuant to the Consultant Agreement, business address, role (including the state or geographic area in which the consultant is working on behalf of the broker, dealer or municipal securities dealer), compensation arrangement, any municipal securities business obtained or retained by the consultant with each such business listed separately, and, if applicable, dollar amounts paid to the consultant connected with particular municipal securities business. Such reports shall indicate the total dollar amount of payments made to each consultant during the report period. In addition, such reports shall include the following information to the extent required to be obtained during such calendar quarter pursuant to paragraph (c)(i) of this rule:

(i)(A) the name and title (including any city/county/state or political subdivision) of each official of an issuer and political party receiving reportable political contributions or reportable political party payments, listed by state; and

(B) contribution or payment amounts made and the contributor category of the persons and entities described in paragraphs (b)(i) of this rule; or

(ii) if applicable, a statement that the consultant reported that no reportable political contributions or reportable political party payments were made; or

(iii) if applicable, a statement that the consultant failed to provide any report of information to the broker, dealer or municipal securities dealer concerning reportable political contributions or reportable political party payments.

Once a contribution or payment has been disclosed on a report, the broker, dealer or municipal securities dealer should not continue to disclose that particular contribution or payment on subsequent reports.

## MSRB INTERPRETATIONS

### RULE G-38 QUESTIONS AND ANSWERS

February 28, 1996

#### Consultants

***1. Q: Who is considered a "consultant" pursuant to rule G-38?***

A: Rule G-38(a)(i) defines "consultant" as any person used by a dealer to obtain or retain municipal securities business[1] through direct or indirect communication by such person with an issuer on behalf of such dealer where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the dealer or any other person. The definition specifically excludes "municipal finance professionals" of the dealer, as that term is defined in rule G-37(g)(iv), because such individuals are covered by the requirements of rule G-37. The definition also excludes any person whose sole basis of compensation from the dealer is the actual provision of legal, accounting or engineering advice, services or assistance in connection with the municipal securities business that the dealer is seeking to obtain or retain.

***2. Q: What are examples of persons who would be excluded from the definition of consultant for providing legal, accounting or engineering advice, services or assistance to a dealer in connection with municipal securities business?***

A: The exclusion would apply, for example, to a lawyer retained to conduct a legal analysis on a particular transaction contemplated by the dealer, or to review local regulations; an accountant retained to conduct a tax analysis or to scrutinize financial reports; or an engineer retained to perform a technical review or feasibility study. The exemption is intended to ensure that professionals who are engaged by the dealer solely to perform substantive work in connection with municipal securities business are not brought within the definition of consultant as long as their compensation is in consideration of only those professional services actually provided in connection with such municipal securities business.

***3. Q: Would an attorney hired by a dealer to conduct a legal analysis on a transaction being contemplated by the dealer and then subsequently paid a finder's fee by the dealer for bringing that municipal securities business to the dealer be considered a consultant?***

A: Yes, any attorney or other professional used by the dealer as a "finder" for municipal securities business is considered a consultant pursuant to rule G-38.

***4. Q: Does the definition of consultant also encompass third parties who initiate contact with dealers to offer their services in obtaining or retaining municipal securities business through direct or indirect communication by such person with an issuer official?***

A: Yes. The definition of consultant in rule G-38 does not distinguish between instances in which the dealer initiates contact with a third party to act as a consultant and instances in which the third party initiates contact.

*5. Q: Does the definition of consultant encompass a lobbyist hired by the dealer if the only activity the lobbyist engages in on behalf of the dealer is to lobby state legislators for legislation which grants issuers authority to issue certain types of municipal securities?*

A: No, however, if the lobbyist is also used by the dealer to obtain or retain municipal securities business through direct or indirect communication with an issuer on the dealer's behalf where the communication is undertaken for payment from the dealer or any other person, then the lobbyist would meet the definition of consultant.

*6. Q: If an affiliated company of a bank introduces one of its customers (a municipal issuer) to the bank's dealer department for purposes of engaging in municipal securities business, and the dealer pays the affiliated company for this activity, would the affiliated company be a "consultant" under rule G-38?*

A: Any person used by a dealer as a "finder" for municipal securities business would be considered a consultant under rule G-38. In this example, if the affiliated company is used by the bank dealer to obtain or retain municipal securities business through direct or indirect communication by the affiliated company with the issuer on the dealer's behalf, and the affiliated company does so with the understanding of receiving payment from the dealer, then the affiliated company would be a consultant.

*7. Q: Does the definition of consultant encompass a person retained by an affiliate or parent of a dealer if any portion of that person's activity relates to efforts to obtain municipal securities business for the dealer?*

A: Yes, because the definition of consultant includes those who receive payment from the dealer or "any other person" for use in obtaining or retaining municipal securities business through communication with an issuer on behalf of the dealer. In such instances, the dealer would need to be in compliance with the provisions of rule G-38, as discussed below.

### Consultant Agreement

*8. Q: Rule G-38 requires dealers to evidence their consulting arrangements in writing. What must be included in this Consultant Agreement?*

A: The Consultant Agreement must include, at a minimum, the name, company, role and compensation arrangement of each consultant used by the dealer.

*9. Q: When must the dealer enter into the Consultant Agreement?*

A: The Consultant Agreement must be entered into before the consultant engages in any direct or indirect communication with an issuer on the dealer's behalf.

### Disclosure to Issuers

*10. Q: Does rule G-38 require a dealer to disclose its consulting arrangements to an issuer with which it is engaging or seeking to engage in municipal securities business:*

A: Yes; such disclosures must be in writing.

*11. Q: What must be included in these written disclosures to issuers?*

A: The written disclosures must include, at a minimum, the name, company, role and compensation arrangement with the consultant or consultants.

*12. Q: When are dealers required to make their written disclosures concerning consultants to issuers?*

A: The written disclosures must be made prior to the issuer's selection of any dealer in connection with the municipal securities business being sought, regardless of whether the dealer making the disclosure ultimately is the one to obtain or retain that business.

### Disclosure to the Board

*13. Q: Are dealers required to submit any reports concerning their consultants to the Board?*

A: Yes. Dealers must submit to the Board, on a quarterly basis, reports of all consultants used by the dealers. These reports must be submitted on Form G-37/G-38.

*14. Q: What information concerning consultants must be included on Form G-37/G-38?*

A: For each consultant, dealers must report, in the prescribed format (refer to Form G-37/G-38), the consultant's name, company, role and compensation arrangement, as well as the dollar amount of any payment made to the consultant during the quarterly reporting period. If any payment made during the reporting period is related to the consultant's efforts on behalf of the dealer which resulted in particular municipal securities business, whether the municipal securities business was completed during that or a prior reporting period, then the dealer must separately identify that business and the dollar amount of the payment.

*15. Q: If a dealer includes information concerning a particular consultant on a Form G-37/G-38 submission, must the dealer continue to submit information concerning this consultant on subsequent Form G-37/G-38 submissions?*

A: As long as the dealer continues to use the consultant to obtain or retain municipal securities business (*i.e.*, has a continuing arrangement with the consultant), the dealer must report information concerning such consultant every quarter, whether or not compensation is paid to the consultant during the reporting period.

*16. Q: What are the due dates for the submission of Form G- 37/G-38?*

A: The quarterly due dates are within 30 calendar days after the end of each calendar quarter (i.e., January 31, April 30, July 31 and October 31).

*17. Q: Will the Board accept fax transmissions of Form G-37/G-38?*

A: No. Dealers are required to submit Forms G-37/G-38 to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending.

*18. Q: Are Forms G-37/G-38 submitted by dealers available to the public for review?*

A: Yes. These forms are available to the public for inspection and photocopying at the Board's Public Access Facility in Alexandria, Virginia, and for review by the agencies charged with enforcement of Board rules.

*19. Q: If a dealer has adopted a voluntary ban on political contributions and/or does not use consultants, is the dealer still required to submit a Form G-37/G-38?*

A: Dealers are required to submit a Form G-37/G-38 to the Board if ANY one of the following occurred: (i) reportable political contributions or payment to political parties were made during the reporting period; (ii) the dealer engaged in municipal securities business (as defined in rule G-37(g)(vii) during the reporting period; or (iii) the dealer used consultant during the reporting period (i.e., new or continuing relationships with consultants). Dealers are not required to submit a Form G-37/G-38 for a reporting period if all three of the following conditions are met for that particular reporting period: (i) there were not reportable political contributions or payments made to political parties; (ii) the dealer did not engage in municipal securities business; and (iii) the dealer did not use consultants.

### Recordkeeping Requirements

***20. Q: What records concerning consultants must dealers maintain?***

A: Rule G-8, on books and records, requires dealers to maintain: (i) a listing of the name, company, role and compensation arrangement of each consultant: (ii) a copy of each Consultant Agreement referred to in rule G-38(b); (iii) a listing of the compensation paid in connection with each such Consultant Agreement; (iv) where applicable, a listing of the municipal securities business obtained or retained through the activities of each consultant; (v) a listing of issuers and a record of disclosures made to such issuers, pursuant to rule G-38(c), concerning each consultant used by the dealer to obtain or retain municipal securities business with each such issuer; and (vi) the date of termination of any consultant arrangement.

***21. Q: How long must dealers maintain their records concerning consultants?***

A: Rule G-9, on preservation of records, requires dealers to maintain their records concerning consultants for a six-year period.

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[1] "Municipal securities business" as used in rule G-38 has the same meaning as in rule G-37(g)(vii): (i) negotiated underwriting (if the dealer is a manager or syndicate member); (ii) private placement; (iii) the provision of financial advisory or consultant services to or on behalf of an issuer (on a negotiated bid basis); or (iv) the provision of remarketing agent services (on a negotiated bid basis).

## ADDITIONAL QUESTIONS AND ANSWERS

November 18, 1996

### Role to be Performed by Consultant

***1. Q: Is there specific information concerning the role to be performed by a consultant that a dealer must disclose on Form G-37/G-38?***

A: The role to be performed by a consultant may be described in general terms on Form G-37/G-38; however, dealers must include the state or geographic area in which the consultant is working on behalf of the dealer.

### Compensation Arrangement, Total Dollar Amount Paid to Consultant During Reporting Period and Dollar Amount Paid to Consultant Connected with Particular Municipal Securities Business

***2. Q: When providing the information required to be disclosed on Form G-37/G-38, how should dealers describe the consultant's compensation arrangement?***

A: Dealers must ensure that the compensation arrangement is clearly described and that it correlates with the information being disclosed concerning the total dollar amount paid to the consultant during the reporting period and the dollar amounts paid in connection with particular municipal securities business.

- For example, if a consultant is paid a monthly retainer, the amount of the monthly retainer must be disclosed and the total dollar amount paid during the reporting period must be reported.
- If a consultant is reimbursed for expenses, the amount of the reimbursed expenses must be disclosed either separately or within the total dollar amount paid for the quarter.
- If a consultant is to be paid a success fee, dealers must disclose how the success fee will be arrived at (e.g., a certain percentage of profits). The sum total of the dollar amounts paid to the consultant in connection with particular municipal securities business should equal the total dollar amount paid to the consultant during the reporting period.
- In addition, if any discretionary bonus or similar payment is made, this amount must be included within the total amount paid for the quarter in which it is paid.

***3. Q: What information must a dealer disclose on Form G-37/G-38 for the dollar amounts paid to a consultant connected with particular municipal securities business?***

A: If any payment made during the reporting period is related to a consultant's efforts on behalf of the dealer which resulted in particular municipal securities business, whether the municipal securities business was completed during that or a prior reporting period, then the dealer must separately identify that business and the dollar amount of the payment.

### Disclosure to Issuers of the Compensation Arrangement with Consultants

***4. Q: Rule G-38 requires a dealer to disclose in writing its consulting arrangements to an issuer with which it is engaging or seeking to engage in municipal securities business and this written disclosure must include, among other things, the compensation arrangement. What is the level of disclosure required to issuers of the compensation arrangement with consultants?***

A: The written disclosure to issuers of the compensation arrangement must explain the arrangement.

- For example, if a consultant is paid a monthly retainer, the amount of the monthly retainer must be disclosed.
- If a consultant also is reimbursed for expenses, this fact must be noted.
- If a consultant is to be paid a success fee, the dealer must disclose to the issuer how that fee will be arrived at (e.g., a certain percentage of profits).

## QUESTION AND ANSWER NOTICE: RULE G-38

May 20, 1998

### Bank Affiliates and Definition of Payment

***Q: A bank and its employees communicate with an issuer on behalf of an affiliated dealer to obtain municipal securities business for that dealer. In return, the bank and its employees receive certain "credits" from the dealer. These credits, which do not involve any direct or indirect cash payments from the dealer to the bank or its employees, are used for internal purposes to identify the source of business referrals. Are the credits considered a "payment" under rule G-38 thereby requiring the dealer to designate the bank or its employees as consultants and comply with the requirements of rule G-38?***

A: Rule G-38 defines a consultant as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on behalf of the dealer where the communication is undertaken by the person in exchange for, or with the understanding of receiving, payment from the dealer or any other person.[1] The term payment, as used in rule G-38, means any gift, subscription, loan, advance, or deposit of money or anything of value. The absence of an immediate transfer of funds or anything of value to an affiliate or individual employed by the affiliate would not exclude the credits from the definition of payment if such credits eventually (e.g., at the end of the fiscal year) result in compensation to the affiliate or individual employed by the affiliate for referring municipal securities business to the dealer. In this regard, the compensation may be in the form of cash (e.g., a bonus) or non-cash. In either case, if the dealer or any other person[2] eventually gives anything of value (e.g., makes a "payment") to the affiliate or individual based, even in part, on the referral, then the affiliate or individual is a consultant for purposes of rule G-38. In this regard, each dealer (bank or securities firm) should determine whether the affiliate or individual employee(s) of the affiliate is its consultant(s), and must then ensure compliance with rule G-38, including the contractual arrangements

and disclosures required by the rule. For additional guidance in this area, you may wish to review Q&A numbers 6 and 7 in the MSRB Manual following rule G-38, as well as Q&A number 4 (dated December 7, 1994) in the MSRB Manual following rule G-37.

[1] Municipal finance professionals and any person whose sole basis of compensation is the actual provision of legal, accounting or engineering advice, services or assistance are excepted from the definition of consultant.

[2] The Securities Exchange Act of 1934 (the "Act") defines the term "person" as a "natural person, company, government, or political subdivision, agency, or instrumentality of a government." Board rule D-1 provides that unless the context otherwise specifically requires, the terms used in Board rules shall have the same meanings as set forth in the Act.

## RULE G-38 QUESTION AND ANSWER

March 4, 1999

### Agreement to Jointly Seek Underwriting Assignments

***Q: Dealer Firm A and Dealer Firm B have entered into an agreement to jointly seek underwriting assignments. As part of this agreement, the two dealers have jointly submitted proposals to issuers. Dealer Firm A ultimately is selected to underwrite a negotiated sale of a primary offering of municipal securities (i.e., "municipal securities business" as defined in rule G-37). Dealer Firm B will not act as an underwriter on this offering but will assist Dealer Firm A in structuring the transaction. Dealer Firm A will compensate Dealer Firm B for the work it provides on the transaction. Is Dealer Firm B a consultant to Dealer Firm A pursuant to rule G-38, on consultants?***

A: Yes. Dealer Firm B is a consultant to Dealer Firm A because, pursuant to the definition of consultant in rule G-38(a)(i), Dealer Firm B is: (1) used by Dealer Firm A to obtain municipal securities business, (2) through direct or indirect communication with an issuer on behalf of Dealer Firm A, and (3) the communication is undertaken by Dealer Firm B in exchange for, or with the understanding of receiving, payment from Dealer Firm A. Moreover, Dealer Firm B is not exempt from the definition of consultant since it is not a municipal finance professional, and its sole basis of compensation is not the actual provision of legal, accounting or engineering advice, services or assistance. In addition, the Board believes that, even though Dealer Firm B is providing substantive work on the transaction, any dealer used by another dealer (other than a member of the syndicate) to assist in obtaining or retaining municipal securities business is acting as a consultant pursuant to rule G-38.

## QUESTIONS AND ANSWERS CONCERNING INFORMATION ABOUT CONSULTANTS' POLITICAL CONTRIBUTIONS AND PAYMENTS TO STATE AND LOCAL POLITICAL PARTIES

March 1, 2000

### GENERAL REQUIREMENTS OF NEW AMENDMENTS

***1. Q: What are the new amendments to rule G-38 about?***

A: The amendments will require dealers to collect from their consultants, and to disclose to the Board on revised Form G-37/G-38, information regarding certain contributions to issuer officials and certain payments to state and local political parties made by such consultants.

***2. Q: What political contributions and political party payments are subject to the new reporting requirement?***

A: This depends upon whether the consultant is an individual or a company. If the consultant is an individual, then the contributions and payments that are covered (to the extent reportable under the rule) are those of (1) that individual and (2) any political action committee controlled by such individual. If the consultant is a company, then the contributions and payments that are covered (to the extent reportable under the rule) are those of (1) that company, (2) any partner, director, officer or employee of such company who communicates with an issuer to obtain municipal securities business on behalf of the dealer, and (3) any political action committee controlled by such company or any of the individuals identified in the immediately preceding clause (2).

***3. Q: May the dealer enter into a Consultant Agreement with either an individual or a company?***

A: Yes, provided that the dealer must enter into a Consultant Agreement with the actual party that is serving as the consultant. For example, if the consultant is in effect a company with several employees making actual contact with issuers on the dealer's behalf, a Consultant Agreement entered into only with one of these employees may not, depending upon all the relevant facts and circumstances, satisfy the requirement that the dealer enter into a Consultant Agreement with the consultant.

***4. Q: Must a Consultant Agreement include any provisions regarding a consultant's reportable political contributions and reportable political party payments?***

A: Yes. A dealer is required to include within its Consultant Agreement a provision to the effect that the consultant agrees to provide the dealer each calendar quarter with either (1) a listing of reportable political contributions to official(s) of an issuer and reportable payments to political parties of states and political subdivisions during such quarter, or (2) a report that no reportable political contributions or reportable political party payments were made during such quarter, as appropriate.

***5. Q: Which contributions to issuer officials made by consultants are reportable under the rule?***

A: Rule G-38(a)(vi) defines the term "reportable political contribution" to mean, if the consultant has had direct or indirect communication with an issuer on behalf of the dealer to obtain or retain municipal securities business for such dealer, a political contribution to an official(s) of such issuer made by any contributor referred to in rule G-38(b)(i) (see Question and Answer number 2) during the period beginning six months prior to such communication and ending six months after such communication.

***6. Q: Which payments to state and local political parties made by consultants are reportable under the rule?***

A: Rule G-38(a)(vii) defines the term "reportable political party payment" to mean, if a political party of a state or political subdivision operates within the geographic area (e.g., city, county and state parties) of an issuer with which the consultant has had direct or indirect communication to obtain or retain municipal securities business on behalf of the dealer, a payment to such party made by any contributor referred to in rule G-38(b)(i) (see Question and Answer number 2) during the period beginning six months prior to such communication and ending six months after such communication.

***7. Q: Is there a de minimis exception for the reporting of political contributions and political party payments?***

A: Yes. The *de minimis* exception for contributions to official(s) of an issuer provides that a consultant need not provide to a dealer information about contributions of the consultant (but only if the consultant is an individual) or by any partner, director, officer or employee of the consultant (if the consultant is a company) who communicates with issuers to obtain municipal securities business on behalf of the dealer made to any official of an issuer for whom such individual is entitled to vote if such individual's contributions, in total, are not in excess of $250 to each official of such issuer, per election.

Similarly, the *de minimis* exception for political party payments provides that a consultant need not provide to a dealer information about payments of the consultant to political parties of a state or political subdi-

vision (but only if the consultant is an individual) or by any partner, director, officer or employee of the consultant (if the consultant is a company) who communicates with issuers to obtain municipal securities business on behalf of the dealer and who is entitled to vote in such state or political subdivision if the payments made by the individual, in total, are not in excess of $250 per political party, per year.

Again, the *de minimis* exception applies only to contributions or payments by individuals. There is no *de minimis* exception for contributions by the consultant if it is a company or for any PAC controlled by the company or individuals covered by the rule.

***8. Q: If a consultant makes political contributions during a particular quarter but these contributions do not meet the definition of "reportable political contribution" as defined in rule G-38, is the consultant required to report any information about its political contributions to the dealer?***

A: The consultant is required to report to the dealer that it made no reportable political contributions during the quarter.

***9. Q: With respect to a particular issuer, if a consultant is communicating with one individual but has made a contribution to a different individual, would the consultant report this contribution to the dealer? For example, if the dealer is seeking municipal securities business from City A and its consultant communicates with the Mayor of the City, would a non-de minimis political contribution to the City's Comptroller (an official of the issuer) have to be reported?***

A: Yes. A consultant must report and a dealer must disclose contributions with respect to those "issuers" from which a consultant is seeking municipal securities business on behalf of the dealer, regardless of whether contributions are going to and communications are occurring with the same or different personnel within that particular issuer.

***10. Q: What is the date that establishes the obligation for the collection of reportable political contributions and reportable political party payments?***

A: The date of the consultant's communication with the issuer to obtain or retain municipal securities business on behalf of the dealer is the key date with respect to determining whether a contribution or payment is reportable. For the quarter in which a consultant first communicates with the issuer, the dealer is required to collect from the consultant its reportable political contributions and reportable political party payments for such quarter and, pursuant to the six-month look-back, for the six-month period preceding such first communication.

***11. Q: How do the "look-back" and "look-forward" provisions operate?***

A: Pursuant to the look-back provision, a consultant must disclose to the dealer the reportable political contributions and reportable political party payments made by the consultant during the six months prior to the date of the consultant's communication with the issuer. These contributions and payments become reportable in the calendar quarter in which the consultant first communicates with the issuer. Of course, any reportable political contributions and reportable political party payments made during the period that the consultant continues to communicate with the issuer are required to be disclosed. Once communication with an issuer ceases, the consultant still must disclose information with respect to reportable political contributions and reportable political party payments made during the ensuing six months pursuant to the look-forward provision. Contributions and payments made simultaneously with or after the consultant's first communication with the issuer are reportable in the calendar quarter in which they are made.

***12. Q: When does the requirement cease for a dealer to collect contribution and payment information from its consultants?***

A: The requirement ceases when a consultant agreement has been terminated. Of course, dealers should not attempt to avoid the requirements of rule G-38 by terminating a consultant relationship after directing or soliciting the consultant to make a political contribution to an issuer official after such termination. Rule G-37(d) prohibits a dealer from doing any act indirectly which would result in a violation of rule G-37 if done directly by the dealer. Thus, a dealer may violate rule G-37 by engaging in municipal securities business with an issuer after directing or soliciting any person to make a contribution to an official of such issuer.

## "REASONABLE EFFORTS" PROVISION

***13. Q: What is the reasonable efforts provision contained in rule G-38?***

A: This provision provides that a dealer will not be found to have violated rule G-38 if the dealer fails to receive from its consultants all required information about reportable political contributions and reportable political party payments and thus fails to report such information to the Board if the dealer can demonstrate that it used reasonable efforts in attempting to obtain the necessary information.

***14. Q: What must a dealer do to avail itself of the reasonable efforts provision?***

A: A dealer must: (1) state in the Consultant Agreement that Board rules require disclosure of consultant contributions to issuer officials and payments to state and local political parties; (2) send quarterly reminders to its consultants of the deadline for their submissions to the dealer of contribution and payment information; (3) include language in the Consultant Agreement to the effect that: (a) the Consultant Agreement will be terminated if, for any calendar quarter, the consultant fails to provide the dealer with information about its reportable contributions or payments, or a report noting that the consultant made no reportable contributions or payments, and such failure continues up to the date to be determined by the dealer but no later than the date by which the dealer is required to send Form G-37/G-38 to the Board with respect to the next succeeding calendar quarter, such termination to be effective upon the date the dealer must send its Form G-37/G-38 to the Board, and (b) the dealer may not make any further payments to the consultant, including payments owed for services performed prior to the date of termination, as of the date of such termination; and (4) enforce the Consultant Agreement provisions described above in a full and timely manner and indicate the reason for and date of the termination on its Form G-37/G-38 for the applicable quarter.

***15. Q: If a dealer does not include the termination and non-payment provisions in a Consultant Agreement or enforce any such provision that may be contained in the Consultant Agreement, would this constitute a violation of rule G-38?***

A: No. Failure to follow the requirements of the reasonable efforts provision would not result in a violation of rule G-38; however, the dealer would be precluded from invoking the reasonable efforts provision as a defense against a possible violation for failing to disclose consultant contribution information, which the consultant may have withheld from the dealer. Of course, whether or not a dealer would be charged with a violation of rule G-38 for failure to disclose consultant contribution information would depend upon a review of the facts and circumstances of the individual case by the appropriate regulatory agency.

## DISCLOSURE ON FORM G-37/G-38

***16. Q: What information concerning consultants' political contributions and payments to political parties is required to be reported to the Board on Form G-37/G-38?***

A: Forms G-37/G-38 shall include the following information to the extent required to be obtained for a calendar quarter: (1) the name and title (including any city/county/state or political subdivision) of each official of an issuer and political party receiving reportable political contributions or reportable political party payments, listed by state, and

contribution or payment amounts made and the contributor category; or (2) if applicable, a statement that the consultant reported that no reportable political contributions or reportable political party payments were made; or (3) if applicable, a statement that the consultant failed to provide any report of information to the dealer concerning reportable political contributions or reportable political party payments.

*17. Q: Does a dealer have a reporting obligation if a consultant fails to provide a report for a particular quarter?*

A: Yes. The dealer must disclose on Form G-37/G-38 if the consultant has failed to provide it with a report of its reportable political contributions and reportable political party payments.

*18. Q: In listing consultants' reportable political contributions and reportable political party payments on Form G-37/G-38, how are the contributors to be identified?*

A: By contributor category (i.e., company, individual, company controlled PAC or individual controlled PAC).

*19. Q: How should look-back contributions and payments be disclosed on Form G-37/G-38?*

A: Dealers must disclose, in addition to the other required information, the calendar quarter and year of any reportable political contributions and reportable political party payments that were made prior to the calendar quarter for which the form is being completed. Look-back contributions and payments should be disclosed on the Form G-37/G-38 for the quarter in which the consultant has first communicated with an issuer to obtain municipal securities business on behalf of the dealer.

## RECORDKEEPING

*20. Q: What records concerning consultants' political contributions and payments to political parties are required to be maintained?*

A: Rule G-8(a)(xviii) requires a dealer to maintain: (1) records of each reportable political contribution, (2) records of each reportable political party payment, (3) records indicating, if applicable, that a consultant made no reportable political contributions or no reportable political party payments, and (4) a statement, if applicable, that a consultant failed to provide any report of information to the dealer concerning reportable political contributions or reportable political party payments.

## EFFECTIVE DATE OF REQUIREMENTS CONCERNING CONSULTANTS' POLITICAL CONTRIBUTIONS AND PAYMENTS TO STATE AND LOCAL POLITICAL PARTIES

*21. Q: What is the effective date of the amendments to rule G-38 concerning the disclosure of consultants' reportable political contributions and reportable political party payments?*

A: The amendments will become effective on April 1, 2000. On the Forms G-37/G-38 for the second quarter of 2000 (required to be sent to the Board by July 31, 2000) dealers are required to disclose their consultants' reportable political contributions and reportable political party payments for the second quarter of 2000 and include, if applicable, reportable political contributions and reportable political party payments made since October 1, 1999 pursuant to the six-month look-back provision.

### BANK AFFILIATES: INDIVIDUALS AS MUNICIPAL FINANCE PROFESSIONALS OR CONSULTANTS

June 6, 2001

*Q: In a Question and Answer Notice relating to rule G-38 dated May 20, 1998, the MSRB discussed a scenario in which a bank and its employees communicate with an issuer on behalf of an affiliated broker, dealer or municipal securities dealer (a "dealer") to obtain municipal securities business for that dealer in return for certain "credits." These credits, which do not involve any direct or indirect cash payments from the dealer to the bank or its employees, are used for internal purposes to identify the source of business referrals. The MSRB observed that, even if there is no immediate transfer of funds or anything of value to an affiliate or individual employed by the affiliate, the referral credits would still be considered payment for purposes of rule G-38 if such credits eventually (e.g., at the end of the fiscal year) result in compensation to the affiliate or individual employed by the affiliate for referring municipal securities business to the dealer. The MSRB concluded that if the dealer or any other person eventually gives anything of value (e.g., makes a "payment") to the affiliate or individual based, even in part, on the referral, then the affiliate or individual is a consultant for purposes of rule G-38. Does this mean that in all cases where a bank's employee refers municipal securities business to an affiliated dealer, such bank employee is necessarily a consultant under rule G-38 rather than a municipal finance professional of the dealer under rule G-37?*

A: No. The purpose of the Question and Answer Notice was to illustrate that the term "payment" as used in rule G-38 is not limited to cash payments but also includes anything of value, such as referral credits, that ultimately results in cash or non-cash compensation to the bank employee. The MSRB was not providing guidance as to whether such bank employee should be considered a consultant rather than a municipal finance professional of the dealer. As the MSRB noted in footnote 1 to the Question and Answer Notice, municipal finance professionals are excluded from the definition of consultant. If a dealer has an arrangement whereby referral credits are given to an employee of a bank affiliate in exchange for a referral of municipal securities business, the dealer should first determine whether the bank employee is a municipal finance professional of the dealer. As a threshold question, the dealer must determine whether such bank employee is a person associated with the dealer within the meaning of the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1] If the bank employee is an associated person of the dealer and has solicited municipal securities business on behalf of the dealer, the employee would be a municipal finance professional of the dealer subject to the provisions of rule G-37, regardless of whether such employee has received a referral credit or any other payment.[2] Such employee, as a municipal finance professional of the dealer, is excluded from being a consultant of the dealer under rule G-38. If the bank employee is not an associated person of the dealer and has received such referral credits as a result of a solicitation of municipal securities business for the dealer, the employee would be a consultant of the dealer subject to the provisions of rule G-38.

[1] Questions regarding the scope of the term "person associated with a broker or dealer" under Section 3(a)(18) of the Exchange Act or "person associated with a municipal securities dealer" under Section 3(a)(32) of the Exchange Act should be addressed to staff of the Securities and Exchange Commission.

[2] The definition of municipal finance professional in rule G-37 is not dependent upon whether the associated person has received payment in exchange for the solicitation of municipal securities business.

See also:

**Rule D-12 Interpretation – Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market,** January 18, 2001.

**Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers,** November 20, 1998.

*Interpretive Letter*

**Referrals of municipal securities business and payments.** This is in response to your November 12, 1999 letter in which you request interpretive guidance concerning rule G-38, on consultants. You state that several years ago [name deleted] ("Dealer") purchased the public finance area of a national bank located in the southeastern region. You also state that personnel employed by the bank often will refer a customer of theirs to Dealer where that customer has indicated a need for public finance services. You state that Dealer has given no remuneration for any such referrals.

You also report that in order to conduct appropriate due diligence as part of the underwriting process, Dealer wishes to engage this bank to conduct a credit analysis of municipal issuer customers and to then provide the analysis or letter of credit to Dealer, a service for which the bank would be compensated. You ask whether such compensation would fall within the exception set forth in subsection (a)(i)(B) of rule G-38 such that the bank would not be considered a consultant for purposes of that rule.

In general, rule G-38 defines a "consultant" as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communications by such person with an issuer on behalf of such dealer where the communication is undertaken by such person in exchange for, or with the understanding of receiving, payment from the dealer or any other person. The definition specifically excludes "municipal finance professionals" of the dealer, as that term is defined in rule G-37. As you are aware, the definition also excludes any person whose sole basis of compensation from the dealer is the actual provision of legal, accounting or engineering advice, services or assistance in connection with the municipal securities business that the dealer is seeking to obtain or retain.[1]

The exemption to the term "consultant" provided by rule G-38(a)(i)(B) is expressly limited to the actual provision of legal, accounting or engineering advice, services or assistance. Neither the bank employee referrals, nor the proposed credit analysis by the bank, is the provision of legal, accounting or engineering services that would qualify for the exemption.

The dealer must make the determination whether the activities described would make the bank a consultant pursuant to rule G-38. I would like to refer you to certain previously published Questions and Answers to assist you in making that determination. While you state in your letter that no remuneration has been given by Dealer for any business referrals, it is important to note that the definition of consultant includes those who receive payment from the dealer or **"any other person"** for use in obtaining or retaining municipal securities business.[2] Moreover, the term payment, as used in rule G-38, means any gift, subscription, loan advance, or deposit of money or **anything of value.** The absence of an immediate transfer of funds or anything of value to an individual employed by the bank would not exclude, for example, credits paid by the bank to its employees from the definition of payment if such credits eventually (*e.g.*, at the end of the fiscal year) result in compensation to the bank or individual employed by the bank for referring municipal securities business to the dealer.[3]

Similarly, the bank's provision of a credit analysis of issuer clients to Dealer must be analyzed pursuant to the definitions contained in rule G-38. For example, if Dealer has retained the bank to do the credit analyses in return for the bank's referral of issuer customers, then the bank's activities might fall within the definition of consultant contained in rule G-38, depending upon all the relevant facts and circumstances. Again, it is the dealer who must make the determination based on the specific facts and circumstances whether the bank's activities are consultant activities. *MSRB interpretation of December 9, 1999.*

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[1] *See* MSRB rule G-38(a); Questions and Answers numbers 1-7 (dated February 28, 1996) in the *MSRB Rule Book*. The text of the rule as well as Interpretive Letters and Notices concerning the rule interpretation are also available at the MSRB's web site, www.msrb.org.

[2] *See* MSRB rule G-38(a); Question and Answer number 7 (dated February 28, 1996) in the *MSRB Rule Book*.

[3] *See* MSRB rule G-38(a); Question and Answer Notice (dated May 20, 1998) in the *MSRB Rule Book*.

## Rule G-39: Telemarketing

(a) No broker, dealer or municipal securities dealer or person associated with a broker, dealer or municipal securities dealer shall:

(i) make outbound telephone calls to the residence of any person for the purpose of soliciting the purchase of municipal securities or related services at any time other than between 8 a.m. and 9 p.m. local time at the called person's location, without the prior consent of the person; or

(ii) make an outbound telephone call to any person for the purpose of soliciting the purchase of municipal securities or related services without disclosing promptly and in a clear and conspicuous manner to the called person the following information:

(A) the identity of the caller and the firm;

(B) the telephone number or address at which the caller may be contacted; and

(C) that the purpose of the call is to solicit the purchase of municipal securities or related services.

(b) The prohibitions of section (a) shall not apply to telephone calls by any person associated with a broker, dealer, or municipal securities dealer, or another associated person acting at the direction of such person for the purpose of maintaining and servicing the accounts of existing customers of the broker, dealer or municipal securities dealer under the control of or assigned to such associated person:

(i) to an existing customer who, within the preceding twelve months, has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or the deposit, was under the common control of or assigned to, such associated person;

(ii) to an existing customer who previously has effected a securities transaction in, or made a deposit of funds or securities into, an account that, at the time of the transaction or deposit, was under the control of or assigned to, such associated person, provided that such customer's account has earned interest or dividend income during the preceding twelve months; or

(iii) to a broker, dealer or municipal securities dealer.

For the purposes of section (b), the term "existing customer" means a customer for whom the broker, dealer or municipal securities dealer, or a clearing broker or dealer on behalf of such broker, dealer or municipal securities dealer, carries an account. The scope of this rule is limited to the telemarketing calls described herein; the terms of this rule shall not otherwise expressly or by implication impose on brokers, dealers or municipal securities dealers any additional requirements with respect to the relationship between a broker, dealer or municipal securities dealer and a customer or between a person associated with a broker, dealer or municipal securities dealer and a customer.

### *MSRB INTERPRETATION*

See:

Rule G-32 Interpretation – Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998.

## Rule G-40: Electronic Mail Contacts

(a)(i) Each broker, dealer or municipal securities dealer shall appoint a Primary Electronic Mail Contact to serve as the official contact person for purposes of electronic mail communication between the broker, dealer or municipal securities dealer and the MSRB. Each Primary Electronic Mail Contact shall be a registered municipal securities principal of the broker, dealer or municipal securities dealer.

(ii) Each broker, dealer or municipal securities dealer may appoint an Optional Electronic Mail Contact for purposes of electronic mail communication between the broker, dealer or municipal securities dealer and the MSRB.

(b)(i) Upon completion of its Rule A-12 submissions and assignment of an MSRB Registration Number, each broker, dealer or municipal securities dealer shall submit to the MSRB by mail a completed Form G-40 setting forth, in the prescribed format, the following information:

(A) The name of the broker, dealer or municipal securities dealer, and the date.

(B) The MSRB Registration Number of the broker, dealer or municipal securities dealer.

(C) The name of the Primary Electronic Mail Contact, and his/her electronic mail address, telephone number and Individual Central Registration Depository (CRD) Number.

(D) The name of the Optional Electronic Mail Contact, if any, and his/her electronic mail address and telephone number.

(E) The name, title, signature and telephone number of the person who prepared the form.

(ii) A broker, dealer or municipal securities dealer may change the name of its Electronic Mail Contacts or other information previously provided by electronically submitting to the MSRB an amended Form G-40.

(c) Each broker, dealer or municipal securities dealer shall update information on its Electronic Mail Contacts periodically as requested and prescribed by the MSRB and shall submit such information electronically to the MSRB.

MSRB

# FORM G-40
# Electronic Mail Contacts

Check One: ____ Original Form
____ Amended Form

MSRB Registration Number
_____

Name of Dealer:_____

Date: _____

The dealer name above designates (name) _____
as its Primary Electronic Mail Contact for purposes of electronic communications with the MSRB.
This Primary Contact person is a Series 53-registered municipal securities principal or a Series 51-registered municipal fund securities limited principal with the dealer.

E-Mail Address of Primary Contact: _____
Phone Number of Primary Contact: _____
Individual CRD Number of Primary Contact (NASD member firms only): _____

(Optional): The dealer named above designates (name): _____
as its Optional Electronic Mail Contact.
E-Mail Address of Optional Contact: _____
Phone Number of Optional Contact: _____

Name and title of person preparing this form: _____
Signature: _____
Telephone number: _____

NEW FORMS MUST BE MAILED TO:

MSRB
1900 Duke Street, Suite 600
Alexandria, Virginia 22314

FORMS MAY BE AMENDED ELECTRONICALLY BY LOGGING ON TO THE MSRB'S WEB SITE (www.msrb.org) AND USING THE PRIMARY CONTACT'S USER ID AND PASSWORD TO CHANGE INFORMATION RELATING TO THAT PERSON, OR USING THE OPTIONAL CONTACT'S USER ID AND PASSWORD TO CHANGE INFORMATION RELATING TO THAT PERSON.

## Rule G-41: Anti-Money Laundering Compliance Program

No broker, dealer or municipal securities dealer shall be qualified for purposes of Rule G-2 unless such broker, dealer or municipal securities dealer has met the anti-money laundering compliance program rules set forth by either the registered securities association of which the dealer is a member (*e.g.*, NASD Rule 3011), or the rules set forth by the appropriate regulatory agency as defined in Section 3(a)(34) of the Act with respect to any other broker, dealer or municipal securities dealer (*e.g.*, 12 C.F.R. 21.21 (OCC); 12 C.F.R. 208.63 (FRB); 12 C.F.R. 326.8 (FDIC); and 12 C.F.R. 563.177 (OTS)), to the same extent as if such rules were applicable to such broker, dealer or municipal securities dealer.