MSRB REPORTS

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In This Issue

Board's Offices Move

The Board's Washington, D.C. offices are now located at 1150 18th Street N.W., Suite 400, Washington, D.C., 20036. The telephone number remains (202) 223-9347.

Also in This Issue

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Reminder

Effective July 1, 1994, the amendment to rule G-15(d)(ii) will require that all DVP/RVP customer transactions that are eligible for confirmation/acknowledgement in a system operated by a registered clearing agency be processed in such a system. A notice explaining the amendment was published in *MSRB Reports*, Vol. 14, No. 2 (March 1994) at 21-22.

Securities and Exchange Commission's Proposed Amendments to Rule 15c2-12

Comments to the SEC on proposed amendments to SEC Rule 15c2-12 must be received by the SEC on or before July 15, 1994. The proposed amendments would make it unlawful for a broker, dealer or municipal securities dealer to act as an underwriter of an issue of municipal securities unless the broker, dealer or municipal securities dealer has reasonably determined that the issuer or its designated agent has undertaken in a written agreement or contract for the benefit of the holders of such municipal securities to provide certain information to a nationally recognized municipal securities information repository; or to recommend the purchase or sale of a municipal security, without having reviewed the information the issuer of the municipal security has undertaken to provide. All comment letters should refer to File No. S7-5-94. A copy of the SEC release seeking comment on the proposed amendments was published in *MSRB Reports*, Vol. 14, No. 2 (March 1994) at 37-46.

Calendar

April 7	— Effective date of amendments to rules G-19, on suitability of recommendations, and G-8, on recordkeeping
April 25	— Effective date of rule G-37, on political contributions and prohibitions on municipal securities business
June 15	— Comments due to SEC on File No. S7-6-94
July 1	— Effective date of amendment to rule G-15(d)(ii)
July 15	— Comments due to SEC on File Nos. S7-4-94 and S7-5-94
July 31	— Due date for Form G-37 to be filed with the Board
Sept. 15	— Comments due on draft amendment to rule G-15(a), on customer confirmations
Pending	— Amendments to rules G-37, on political contributions and prohibitions on municipal securities business, and G-8, on recordkeeping
	— Amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, relating to gifts and gratuities

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Notice of Approval

Route to:

- [X] Manager, Muni Dept.
- [X] Underwriting
- [ ] Trading
- [ ] Sales
- [ ] Operations
- [X] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

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

Rule G-37 and Rule G-37 Filing Procedures Approved

The Securities and Exchange Commission approved rule G-37 on political contributions and prohibitions on municipal securities business, as well as amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively. In addition, rule G-37 filing procedures have been approved.

On April 7, 1994, the Securities and Exchange Commission (Commission) approved rule G-37 on political contributions and prohibitions on municipal securities business.[1] Rule G-37 prohibits dealers from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer; (ii) any municipal finance professional associated with such dealer; or (iii) any political action committee controlled by the dealer or any municipal finance professional. One exception to this prohibition is discussed below. Rule G-37 also includes a requirement for quarterly reporting by dealers of certain information regarding political contributions made and municipal securities business engaged in to the Board, which will make such information publicly available. In addition, amendments to rules G-8 and G-9, on recordkeeping and record retention, respectively, also were approved. The prohibition on engaging in municipal securities business will arise from contributions made on or after April 25, 1994. In addition, the recordkeeping and disclosure requirements apply only to contributions made or municipal securities business engaged in on or after April 25, 1994.

General Prohibition on Engaging in Municipal Securities Business

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 (PAC) controlled by the dealer or any municipal finance professional. One exception to this prohibition is discussed below.

Rule G-37 is not a ban on political contributions—it is a ban on engaging in municipal securities business with an issuer after certain contributions are made to officials of such issuer. The term "municipal securities business" is defined in the rule to encompass certain activities of dealers, such as acting as negotiated underwriters (as managing underwriter or as syndicate member), financial advisors and consultants, placement agents, and negotiated remarketing agents.[2] Thus, a dealer cannot provide any of these services to an issuer within two years after the dealer, any dealer-controlled PAC or any municipal finance professional made contributions to an official of such issuer. This prohibition on business also would result if a municipal finance professional associated with a dealer made such a contribution prior to becoming associated with the dealer (*i.e.*, the two-year ban on business applies to both the current and prior employer of the municipal finance professional). This is intended to prohibit the new employer from obtaining municipal securities business based on prior contributions by its municipal finance professionals. The prohibitions on business under the rule arise from contributions made on or after April 25, 1994.[3]

An "official of an issuer" is defined as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business. The definition includes any issuer official or candidate (or successful candidate) who has influence over the awarding of municipal securities business

Questions about rule G-37 may be directed to Diane G. Klinke, General Counsel, Jill C. Finder, Assistant General Counsel, or Ronald W. Smith, Legal Associate.

[1] SEC Release No. 34-33868. Pursuant to the Commission's order of approval, the effective date of rule G-37 is April 25, 1994.

[2] The proposed rule would not prohibit dealers from acting as competitive underwriters or competitive remarketing agents. *See* the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the discussion of the definition of "municipal securities business."

[3] *See* the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the discussion of a new section (i) to establish a procedure whereby the National Association of Securities Dealers and the three federal bank regulatory agencies, upon application, may exempt, conditionally or unconditionally, a dealer who is prohibited from engaging in municipal securities business from such prohibition.

so that contributions to certain state-wide executive or legislative officials (*e.g.*, governors) are included within the rule's prohibition on engaging in municipal securities business.[4]

"Contributions" which invoke application of the prohibition include any gift, subscription, loan, advance, or deposit of money or anything of value made: (i) for the purpose of influencing any election for federal, state[5] or local office; (ii) for payment or reduction of debt incurred in connection with any such election; or (iii) for transition or inaugural expenses incurred by the successful candidate for state or local office. The Board decided to include all such payments within the parameters of rule G-37 because of concern that such types of payments, in the past, have or may have been connected to the awarding of municipal securities business. The Board believes that the rule's definition of contribution will cover all circumstances in which political contributions are made to state and local issuer officials and candidates who can influence the awarding of municipal securities business, both before and after election to state and local office. The Board wishes to sever any connection between contributions and municipal securities business. Any other payments to issuer officials are addressed in other Board rules, such as rule G-20 on gifts and gratuities.

Finally, the Board does not seek, through its definition of contribution, to restrict the personal volunteer work of municipal finance professionals in political campaigns other than soliciting or coordinating contributions.[6] However, if resources of the dealer are used (*e.g.*, a political position paper is prepared by dealer personnel) or expenses are incurred by the municipal finance professional in such personal volunteer work, the value of such resources or expenses are included within the definition of contribution.

Exception for Certain Contributions

The only exception to rule G-37's absolute prohibition on business is for certain contributions made to issuer officials by municipal finance professionals. Contributions by such persons to officials of issuers would not invoke application of the prohibition on business, but only if the municipal finance professional is entitled to vote for such official and provided any contributions by such municipal finance professional do not exceed, in total, $250 to each official, per election.[7] The Board believes that this exception is appropriate because contributions of this nature present less opportunity for a conflict of interest or the appearance of a conflict of interest on the part of an issuer official in the awarding of municipal securities business.

The term "municipal finance professional" means: (i) any associated person primarily engaged in municipal securities representative activities, as defined in rule G-3(a)(i),[8] (ii) any associated person who solicits municipal securities business; (iii) any direct supervisor of such persons up through and including, in the case of a dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G-1(a); or (iv) any member of the dealer executive or management committee or similarly situated officials, if any (or, in the case of a bank dealer, similarly situated officials in the separately identifiable department or division of the bank, as defined in rule G-1).[9]

Included within the definition of municipal finance professional is any associated person of the dealer involved in the solicitation of municipal securities business or bringing to market new issue municipal securities. The definition also includes those individuals who have an economic interest in seeing that the dealer is awarded municipal securities business and who thus may be in a position to make political contributions for the purpose of influencing the awarding of such business by issuer officials. Such persons would include those in the public finance department, as well as underwriters, traders and institutional and retail sales persons primarily engaged in municipal securities activities. The Board is not including within the definition of municipal finance professional retail sales persons who primarily sell other products or associated persons employed in departments other than the municipal securities department.

Direct and Indirect Contributions

In addition to the prohibition on business described above, rule G-37 also 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. This proscription was modeled after Section 20(b) of the Securities Exchange Act[10] and

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[4] *See* the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the discussion of the definition of "official of an issuer."

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

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

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

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

[9] See the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the discussion of the definition of "municipal finance professional."

[10] Section 20(b) provides that:

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

is intended to prohibit those parties subject to the rule from using other persons or entities as conduits in order to circumvent the rule. A dealer would violate rule G-37 by engaging in municipal securities business with an issuer after directing a person to make a contribution to an official of such issuer. For example, a violation would result if a dealer does business with an issuer after directing contributions by associated persons, family members of associated persons, consultants, lobbyists, attorneys, other dealer affiliates, their employees or PACs, or other persons or entities as a means to circumvent the rule. Finally, the dealer would violate the rule by doing business with an issuer after providing money to any person or entity when the dealer knows that such money will be given to an official of an issuer who could not receive such a contribution directly from the dealer without triggering the rule's prohibition on business. For example, in certain instances, a local political party may be soliciting contributions for the purpose of supporting one issuer official. If this is the case, contributions made to the political party would result in the same prohibition on municipal securities business as would a contribution made directly to the issuer official.

Solicitation and Bundling Prohibition

Rule G-37 also would prohibit a dealer and any municipal finance professional from soliciting the parties described above, as well as any other person or entity, to make contributions to an official of an issuer with which the dealer engages or is seeking to engage in municipal securities business or to coordinate (*i.e.*, bundle) contributions.[11] Dealers may not engage in municipal securities business with issuers if they or their municipal finance professionals engage in any kind of fund-raising activities for officials of such issuers. As noted previously, municipal finance professionals may volunteer their personal services in other ways to political campaigns.

Recordkeeping Requirements

To facilitate compliance with, and enforcement of, rule G-37, the Board also amended rules G-8 and G-9, concerning recordkeeping and record retention, respectively. The amendment to rule G-8 is designed to assist dealers in determining whether or not they may engage in business with a particular issuer. These amendments require a dealer to maintain a list of: (i) names, titles, city/county and state of residence of every municipal finance professional; (ii) names, titles, city/county and state of residence of all executive officers;[12] (iii) the states in which the dealer is engaging or is seeking to engage in municipal securities business; (iv) every issuer with which municipal securities business has been conducted during the current year, as well as the previous two years and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with such issuer; and (v) all contributions, direct or indirect, to officials of issuers and to political parties of states and political subdivisions made by the dealer, any dealer-controlled PAC, any municipal finance professional or executive officer. The dealer is not, however, required to maintain a list of contributions by its municipal finance professionals or executive officers that are made: (i) to officials for whom the person is entitled to vote, provided such contributions do not exceed $250 to each issuer official, per election; and (ii) to political parties for the state and political subdivision in which the person is entitled to vote, provided such contributions do not exceed $250 per party, per year. In addition, dealers would not be required to maintain a list of contributions by any other employees, affiliate companies and their employees, spouses of covered employees, or any other person or entity unless the contributions were directed by persons or entities subject to the proposed rule.

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

Rule G-8 also requires dealers to record every issuer with which municipal securities business has been conducted, the type of business, and, where applicable, the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with the issuers listed.

The records do not have to be maintained for contributions made or business engaged in prior to April 25, 1994. The amendment to rule G-9 requires dealers to maintain these records, required pursuant to the amendments to rule G-8, for a six-year period.[13]

Disclosure Requirements

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

The information on Form G-37 must include, by state: (i) the name, title (including any city/county/state or other political subdivision) of each official of an issuer and political party receiving contributions; (ii) total number and dollar amount of contributions made by the persons and entities described above; and (iii) such other identifying information as required by Form G-37. The names of individual municipal finance

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

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

[13] *See* the notice on pages 17-20 of this issue concerning recent amendments to rules G-37 and G-8, in particular the discussion of the amendment to rule G-8(f) to clarify that dealers complying with SEC Rule 17a-3 are still required to maintain the information and records required by Board rule G-37.

professionals and executive officer contributors would not be disclosed. Such reports also would include a list of issuers with which the dealer has engaged in municipal securities business during the reporting period, along with the type of municipal securities business and the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business with such issuers.[14]

The Board believes that it is important to provide certain summary information on contributions to the public to help assure investors in the municipal securities market that dealers are not engaging in municipal securities business with issuers to whom contributions have been made by the dealer, dealer-controlled PACs and municipal finance principals. In addition, the Board is concerned that, with the prohibition on business in effect, dealers may seek to continue making contributions to obtain business through contributions by executive officers or to political parties. Thus, rule G-37 requires disclosure of such contributions. Finally, to reduce the opportunity for dealers to circumvent the rule's requirements through the use of consultants and other persons, disclosure of the dealer's municipal securities business activities and information about persons hired to obtain or retain such business is required.

Filing Procedures

Rule G-37 filing procedures[15] require dealers to file two copies of Form G-37, and to submit such forms within thirty (30) calendar days after the end of each calendar quarter.[16] These dates correspond to January 31, April 30, July 31, and October 31. The Board will maintain one copy of each Form G-37 off-site for back-up purposes, and will maintain the second copy of each Form G-37 at its Public Access Facility in Virginia, where it will be available to the public for review and photocopying.[17] The Board also will maintain a database of reports filed by each dealer (as well as any other party voluntarily submitting information on political contributions), so that any member of the public may telephone the Board's offices to inquire whether a particular dealer (or other party) has submitted a report pursuant to rule G-37.[18] In order to further enhance public access to this information, the Board will provide a list of companies that offer document retrieval and mailing services. As the Board gains experience with rule G-37 submission procedures, and as the informational needs of the municipal market change with regard to political contributions, the Board will seek to expand the access and services available to the public.

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

Finally, the Board understands that a number of dealers have offered voluntarily to submit additional information on contributions to a repository for public access and dissemination. So too, certain non-dealer municipal market participants also may wish voluntarily to provide a central repository with contribution information. Rule G-37 notes that the Board will accept additional information related to contributions voluntarily submitted by dealers or others as long as such information is submitted in accordance with Board filing procedures. The Board is considering whether it may have to charge a filing fee to cover expenses associated with certain of this voluntarily submitted information. It is also reviewing what kinds of access fees to the forms filed, if any, would be appropriate.

Dealer Compliance Procedures

Pursuant to rule G-27, on supervision, each dealer must adopt, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Board rules. In regard to rule G-37, effective compliance procedures are essential because the rule requires dealers to have information regarding each contribution made by the dealer, dealer-controlled PACs and municipal finance professionals so that it can determine where and with whom it may or may not engage in municipal securities business. In addition, it must have information on executive officer and political party contributions and consultant hiring practices for disclosure purposes. Moreover, because of the "directly and indirectly" provision in section (d) of rule G-37, as well as the no solicitation and no bundling provisions in section (c), dealers would have to take measures to ensure that those persons and entities subject to the rule are not causing the dealer to be in violation. Furthermore, the dealer must ensure that other people and entities hired to assist in municipal securities activities (*e.g.*, consultants) are not being directed to make contributions that might result in a violation of the rule.

In addition, the Board wishes to note that rule G-37 sets forth a minimum standard of conduct for dealers involved in municipal securities business. The Board has sought to target the rule's requirements to the areas of abuse to which it has been alerted, while reducing potentially burdensome requirements where appropriate. Dealers are urged, where possible, to do even more to sever any possible connection between political contributions and the awarding of municipal securities business.

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The Board adopted rule G-37 as a first step toward eliminating the problems associated with political contributions in connection with the awarding of municipal securities business.

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[14] *See* the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the clarification that dealers are not required to disclose the name of any municipal finance professional hired by the dealer to obtain or retain municipal securities business.

[15] The SEC approved the filing procedures on May 9, 1994. SEC Release No. 34-34027.

[16] *See* the notice on pages 17-20 of this issue concerning recent amendments to rule G-37, in particular the requirement that dealers send Forms G-37 to the Board by certified or registered mail or by some other means that provides a record of sending.

[17] The Board will charge 20 cents per page plus sales tax, if applicable, for photocopying.

[18] In addition to the dealer's name, the information available through the database also will include, among other things, the quarterly period covered by the report and summary information on political contributions. Although rule G-37 requires dealers to report certain summary information concerning contributions, it does not require disclosure of the names of individual municipal finance professionals or executive officer contributors.

It believes the rule is targeted to the reported major problem areas and should be an effective deterrent to activities which have called into question the integrity of the market. The Board will closely monitor rule G-37's effectiveness. If it determines that compliance problems exist, or if dealers seek to circumvent the rule's requirements, the Board will not hesitate to amend the rule to make its prohibitions applicable to a broader range of entities and individuals or to include other prohibitions or disclosure requirements.

April 25, 1994

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

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

(a) *Purpose*. The purpose and intent of this rule are to ensure that the high standards and integrity of the municipal securities industry are maintained, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to perfect a free and open market and to protect investors and the public interest by: (i) prohibiting brokers, dealers and municipal securities dealers from engaging in municipal securities business with issuers if certain political contributions have been made to officials of such issuers; and (ii) requiring brokers, dealers and municipal securities dealers to disclose certain political contributions, as well as other information, to allow public scrutiny of political contributions and the municipal securities business of a broker, dealer or municipal securities dealer.

(b) No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the broker, dealer or municipal securities dealer; (ii) any municipal finance professional associated with such broker, dealer or municipal securities dealer; or (iii) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional; provided, however, that this section shall not prohibit the broker, dealer or municipal securities dealer from engaging in municipal securities business with an issuer if the only contributions made by the persons and entities noted above to officials of such issuer within the previous two years were made by municipal finance professionals to officials of such issuer for whom the municipal finance professionals were entitled to vote and which contributions, in total, were not in excess of $250 by any municipal finance professional to each official of such issuer, per election.

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

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

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

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

(f) The Board will accept additional information related to contributions voluntarily submitted by brokers, dealers or municipal securities dealers or others provided that such information is submitted in accordance with Board rule G-37 filing procedures.

(g) *Definitions*. (i) The term "contribution" means any gift, subscription, loan, advance, or deposit of money or anything of value made: (A) for the purpose of influencing any election for federal, state or local office; (B) for payment of debt incurred in connection with any such election; or (C) for transition or inaugural expenses incurred by the successful candidate for state or local office.

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

* Underlining indicates new language; strikethrough denotes deletions.

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

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

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

(v) The term "executive officer" means an associated person in charge of a principal business unit, division or function or any other person who performs similar policy making functions for the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G-1), but does not include any municipal finance professional, as defined in paragraph (iv) of this section (g).

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

(vi) The term "official of such issuer" or "official of an issuer" means any person who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of the issuer (including any election committee for such person) which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business.

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

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

(B) the offer or sale of a primary offering of municipal securities on behalf of any issuer (*i.e.*, private placement); or

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

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

(h) The prohibition on engaging in municipal securities business, as described in section (b) of this rule, arises only from contributions made on or after April 25, 1994.

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

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

(i) through (xv) No change.

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

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

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

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

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

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

(F) the contributions, direct or indirect, to officials of an issuer made by each municipal finance professional and executive officer for the current and previous two calendar years, which records shall include: (i) the names, titles, city/county and state of residence of contributors, (ii) the names, titles (including any city/county/state or other political subdivision) of

the recipients of such contributions, and (iii) the amounts and dates of such contributions; provided, however, that such records need not reflect any contribution made by a municipal finance professional or executive officer to officials of an issuer for whom such person is entitled to vote if the contributions by such person, in total, are not in excess of $250 to any official of an issuer, per election; and

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

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

(I) No record is required by this paragraph (a)(xvi) of any municipal securities business done or contribution made prior to April 25, 1994.

(b) through (f) No change.

Rule G-9. Preservation of Records

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

(i) through (vii) No change.

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

(b) through (g) No change.

Form G-37 is contained on the next page

FORM G-37

NAME OF DEALER: _____

REPORT PERIOD: _____

CONTRIBUTIONS MADE: (LIST BY STATE)

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

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

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

SIGNATURE: _____ DATE: _____

(MUST BE OFFICER OF DEALER)

NAME: _____

ADDRESS: _____

PHONE: _____

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

Volume 14, Number 3

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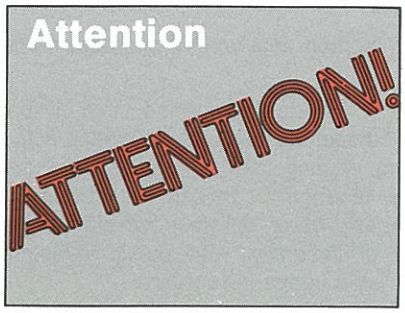

Route to:

- [X] Manager, Muni Dept.
- [X] Underwriting
- [ ] Trading
- [ ] Sales
- [ ] Operations
- [X] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

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

Questions and Answers

Answers to frequently asked questions concerning rule G-37, on political contributions and prohibitions on municipal securities business.

This notice outlines the provisions of rule G-37 concerning political contributions and prohibitions on municipal securities business. It also responds to a number of questions that have been raised by market participants regarding the rule's provisions. The Board is providing this information to assist dealers in complying with the rule. Rule G-37 applies to contributions made and municipal securities business engaged in on and after April 25, 1994.[1]

I. Overview of Rule G-37

In general, rule G-37 (i) 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; and (ii) 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 is divided into eight sections, which are lettered (a) - (h).

Section (a) sets forth the general purpose and intent of the rule.

Section (b) is the business prohibition section which 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 the dealer, any municipal finance professional and any political action committee (PAC) controlled by the dealer or any municipal finance professional. This paragraph also sets forth a *de minimis* exemption such that a dealer would not be subject to the prohibition on business if the only contributions made were by municipal finance professionals who were entitled to vote for the officials to whom they contributed, provided that such contributions by each municipal finance professional did not exceed $250 per official per election.

Section (c) is the anti-solicitation provision which prohibits dealers and municipal finance professionals from soliciting any person or PAC to make contributions, or to coordinate (or bundle) contributions to an official of an issuer with which the dealer is engaging or seeking to engage in municipal securities business.

Section (d) prohibits dealers and municipal finance professionals from doing indirectly any act which the dealer or municipal finance professional is prohibited from doing directly, pursuant to sections (b) and (c) of the rule.

Section (e) is the reporting provision which requires dealers to submit to the Board certain summary information on their municipal securities business and contributions to issuer officials and political parties, by the dealer, municipal finance professionals, PACs controlled by dealers and municipal finance professionals, and executive officers. Section (e) also provides that the reports must be submitted in accordance with rule G-37 filing procedures. These procedures require dealers to file two copies of Form G-37 within thirty (30) calendar days after the end of each calendar quarter (which filing dates correspond to January 31, April 30, July 31, and October 31).

Section (f) states that the Board will accept additional information that is voluntarily provided by dealers or others, so long as such information is submitted pursuant to the rule G-37 filing procedures.

Section (g) is the definitional section which defines the following terms: (i) contribution; (ii) issuer; (iii) broker, dealer and municipal securities dealer; (iv) municipal finance professional; (v) executive officer; (vi) official of an issuer; and (vii) municipal securities business.

Section (h) provides that a prohibition on municipal securities business under section (b) arises only from contributions made on or after April 25, 1994.

In addition, Board rule G-8(a)(xvi) sets forth the specific recordkeeping requirements for rule G-37 which begin with contributions made and municipal securities business engaged in as of April 25, 1994. These requirements are designed to assist dealers in determining whether or not they may engage in business with a particular issuer. In addition to recording contributions to officials of issuers made by dealers, municipal finance professionals and PACs controlled by

[1] The Securities and Exchange Commission (SEC) approved rule G-37 on April 7, 1994. *See* Securities Exchange Act Release No. 33868 (April 7, 1994); 59 FR 17621 (April 13, 1994).

dealers and municipal finance professionals, rule G-8 requires dealers to record contributions made by executive officers and contributions made to political parties of states and political subdivisions. Dealers also are required to record the name, company, role and compensation arrangement of any person employed by the dealer to obtain or retain municipal business. Rule G-9(a)(viii), on record retention, requires dealers to retain the records made pursuant to rule G-8(a)(xvi) for at least six years.

Finally, the Board recently filed with the SEC amendments to rule G-37, which are described in the rule filing.[2]

II. Questions and Answers[3]

Persons/Entities Subject to the Rule

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 executive officers of the dealer.

2.

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);

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. Direct supervisors of the associated persons described above, including: (1) for dealers that are not bank dealers, the CEO or similarly situated official; and (2) 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.

4. For dealers other than bank dealers: any 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.

Each person listed by the dealer as a municipal finance professional is deemed to be such for purposes of rule G-37. Remember that the prohibition on business applies to contributions made within the previous two years, beginning with contributions made on April 25, 1994.

3.

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). These 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.

4.

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).

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[2]SR-MSRB-94-5.

[3]These questions and answers are divided into the following four general categories: Persons/Entities Subject to the Rule; Prohibition on Engaging in Municipal Securities Business; Recordkeeping; and Reporting.

5.

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.

6.

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.

7.

Q: Who is an "executive officer?"

A: Pursuant to rule G-37(g)(v), an 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.

Prohibition on Engaging in Municipal Securities Business

8.

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.

9.

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.

10.

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).

11.

Q: What is the municipal securities business that a dealer would be banned from engaging in with an issuer if certain political contribution 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.

12.

Q: A dealer may discover that a "disgruntled" municipal finance professional made a contribution to an issuer official deliberately to prohibit the dealer from engaging in municipal securities business with the issuer. Is there a procedure in place whereby the dealer can seek an exemption from the prohibition on municipal securities business in such circumstances?

A: The Board recognizes that there may be limited circumstances in which a dealer should be able to request an exemption from the prohibition on business. Thus, the Board has filed with the SEC an amendment to rule G-37 that allows the National Association of Securities Dealers and the federal bank regulatory authorities (the Office of the Comptroller of the Currency, Federal Reserve Board and Federal Deposit Insurance Corporation), upon application by a dealer, to grant such exemption, conditionally or unconditionally, in certain circumstances. See the rule filing, SR-MSRB-94-5, for more information about this procedure.

13.

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.

14.

Q: A municipal finance professional 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.

15.

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. 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.

16.

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. 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.

17.

Q: If an 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 executive officer does not include any municipal finance professional. However, contributions by executive officers are subject to the reporting/disclosure provisions of the rule. In addition, pursuant to section (d), dealers are prohibited from using executive officers (as well as any other person or entity) as a conduit for making contributions to officials of issuers.

18.

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" as any incumbent, candidate or successful candidate for elective office of the issuer, which office is directly or indirectly responsible for, or can influence the outcome of, the hiring of a dealer for municipal securities business. The definition includes any issuer official or candidate (or successful candidate) in a position which has influence over the awarding of municipal securities business. Thus, contributions to certain state-wide executive or legislative officials would be included within the prohibition on engaging in municipal securities business.

19.

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: The Board intended to prohibit a dealer from engaging in municipal securities business with this state agency in these circumstances. The Board recently filed with the SEC an amendment to rule G-37 to clarify the definition of "official of an issuer." See the rule filing, SR-MSRB-94-5, for more information about this amendment.

20.

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.

21.

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.

22.

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.

23.

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.

24.

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.

25.

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.

26.

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.

27.

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.

28.

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.

29.

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.

Recordkeeping

30.

Q: Does a dealer have to collect information on political contributions for the two years prior to April 25, 1994?

A: No. Records do not have to be maintained for contributions made or municipal securities business engaged in prior to April 25, 1994.

31.

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.

32.

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.

Reporting

33.

Q: What are the reporting requirements under rule G-37?

A: Each dealer is required to file two copies of Form G-37 within 30 calendar days after the end of each calendar quarter (*i.e.*, by January 31, April 30, July 31 and October 31). The Board recently filed an amendment to rule G-37 with the SEC to require that the forms be submitted by certified or registered mail or some other equally prompt means that provides a record of sending. See the rule filing, SR-MSRB-94-5, for more information about this amendment.

34.

Q: Under what circumstances must Form G-37 be filed with the Board?

A: Form G-37 must be filed with the Board if, during the reporting period, (i) political contributions were made by those entities and/or persons subject to rule G-37, and/or (ii) the dealer engaged in municipal securities business with an issuer, as defined in rule G-37(g)(vii). Rule G-37 attempts to sever any connection between the making of contributions

and the awarding of municipal securities business. However, the making of contributions and the resulting awarding of municipal securities business may not come within a single reporting period. Thus, it is important that information on political contributions be disclosed even if no municipal securities business was engaged in during the reporting period. So too, it is important to disclose municipal securities business even if no political contributions were made during the reporting period. However, a dealer is not required to file Form G-37 if no political contributions were made **and** the dealer did not engage in municipal securities business during the reporting period.

35.

Q: Does a dealer have to complete the section of Form G-37 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.

36.

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?

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 executive officer, however, such records need not reflect any contribution made by a municipal finance professional or executive officer to officials of an issuer for whom such person is entitled to vote if the contributions by 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 executive officers, however, such records need not reflect those contributions made by any municipal finance professional or executive officer to a political party of a state or political subdivision in which such persons are entitled to vote if the contributions by each such person, in total, are not in excess of $250 per political party, per year.

37.

Q: The disclosure of the compensation arrangement of any person employed by the dealer to obtain or retain municipal securities business must be included on Form G-37. Does this include disclosure of the compensation arrangements of municipal finance professionals?

A: No. The Board recently filed with the SEC an amendment to the rule to clarify this point. See the rule filing, SR-MSRB-94-5, for more information about this provision.

38.

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.

39.

Q: Will the Forms G-37 submitted to the Board be available for public review?

A: Yes. 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.

40.

Q: Will the Board answer telephone inquiries as to whether a report has been filed?

A: Yes. The Board will maintain a database of reports filed by each dealer (as well as any other party voluntarily submitting information on political contributions), so that any member of the public may telephone the Board's offices to inquire whether a certain dealer (or other party) has submitted a report pursuant to rule G-37. In order to further enhance public access to this information, the Board will provide a list of companies that offer document retrieval and mailing services.

May 24, 1994

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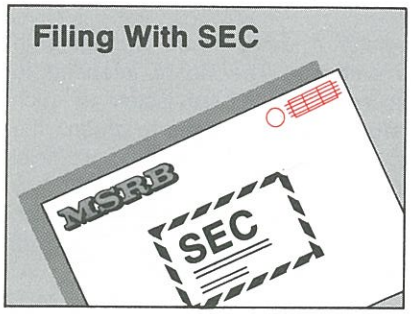

Route to:

- [X] Manager, Muni Dept.
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- [ ] Trading
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- [ ] Operations
- [X] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

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

Amendments Filed

The Board has proposed amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping.

On May 24, 1994, the Board filed with the Securities and Exchange Commission (Commission) proposed amendments to rule G-37 on political contributions and prohibitions on municipal securities business, and rule G-8 on recordkeeping: (i) to establish a procedure whereby dealers may seek relief from the rule G-37 prohibition on business, in limited circumstances; and (ii) to clarify certain definitions in rule G-37.[1] The Board has requested accelerated approval by the Commission of the proposed amendments to assist dealers in complying with rule G-37.

Background

Since rule G-37 on political contributions and prohibitions on municipal securities business was first proposed by the Board and submitted to the SEC for approval,[2] the Board has received a number of comments regarding whether the Board might consider providing, in limited instances, a "good faith exception" to the rule's prohibition on municipal securities business.[3] In light of these comments, as well as others received by the Board, the Board determined to adopt the proposed amendments.[4]

Summary of Filing

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

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

The Board recognizes that in certain circumstances, such as those discussed above, the rule's prohibition on business may be too harsh a consequence for truly inadvertent contributions or the contributions of disgruntled employees. Thus, the Board has determined to add new paragraph (i) to rule G-37 to establish a procedure whereby the National Association of Securities Dealers (NASD) and the federal bank regulatory agencies (*i.e.*, the Office of Comptroller of the Currency, Federal Reserve Board, and Federal Deposit Insurance Corporation), upon application by a dealer subject to such association's or agency's inspection and enforcement authority, may exempt, conditionally or unconditionally, a dealer who is prohibited from engaging in municipal securities business from such prohibition.[5] In determining whether to grant such an exemption, the proposed amendments would require that the NASD and bank regulatory agencies consider, among other factors, whether:

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

(ii) such dealer (A) prior to the time the contribution(s)

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

[1] File No. SR-MSRB-94-5. Comments submitted to the Commission should refer to this file number.

[2] The Commission approved rule G-37 in Securities Exchange Act Release No. 33868 (April 7, 1994); 59 FR 17621 (April 13, 1994). Pursuant to the Commission's order of approval, the rule became effective on April 25, 1994.

[3] The Board previously considered and rejected the inclusion of a good-faith exception to the rule. *See* File No. SR-MSRB-94-2 at 34.

[4] For more information regarding rule G-37, see the notice on pages 3-10 of this issue.

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

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

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

Definition of "official of an issuer"

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

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

The definition of "municipal securities business" in rule G-37(g)(vii) includes certain dealer activities, such as acting as negotiated underwriters, financial advisors and consultants, placement agents, and negotiated remarketing agents. In its rule G-37 filing with the Commission, the Board noted that the rule would not prohibit dealers from acting as competitive underwriters or competitive remarketing agents.[6] The Board is amending this definition to clarify that the rule also would not prohibit dealers from engaging in competitive financial advisory activities.

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

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

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

Rule G-37(e)(i) currently requires dealers to submit quarterly reports to the Board on Form G-37 concerning political contributions and municipal securities business. The Board is concerned, however, that some confusion could arise over whether particular reports were actually sent and/or lost in the mail. To obviate any such problem, the Board is amending this paragraph to require that dealers send such reports to the Board "by certified or registered mail, or some other equally prompt means that provides a record of sending." This will ensure that dealers have a record of all reports submitted to the Board.[7]

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

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

Paragraph (e)(ii) of rule G-37 requires that the reports re-

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

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

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

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

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

May 24, 1994

Text of Proposed Amendments*

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

(a) - (d) No change.

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

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

(f) No change.

(g) Definitions.

(i) - (iii) No change.

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

(v) No change.

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

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

* Underlining indicates additions; strikethrough denotes deletions.

any official(s) of an issuer, as defined in subparagraph (A), above.

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

(A) - (B) No change.

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

(D) No change.

(h) No change.

(i) A registered securities association with respect to a broker, dealer or municipal securities dealer who is a member of such association, or the appropriate regulatory agency as defined in Section 3(a)(34) of the Act with respect to any other broker, dealer or municipal securities dealer, upon application, may exempt, conditionally or unconditionally, a broker, dealer or municipal securities dealer who is prohibited from engaging in municipal securities business with an issuer pursuant to paragraph (b) of this rule from such prohibition. In determining whether to grant such exemption, the registered securities association or appropriate regulatory agency shall consider, among other factors, whether:

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

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

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

(a) - (e) No change.

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

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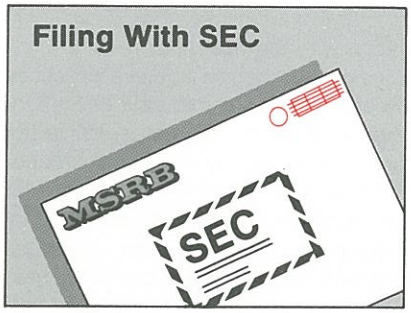

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [X] Sales
- [ ] Operations
- [X] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

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

Amendments Filed

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

On May 26, 1994, the Board filed with the Securities and Exchange Commission (Commission) amendments to rules G-8 and G-9, on recordkeeping and record retention, that relate to rule G-20, on gifts and gratuities. The amendments require dealers to keep and retain specific records on gifts and gratuities given to others in relation to municipal securities activities. The amendments will become effective 30 days after approval by the Commission. Persons wishing to comment on the amendments should comment directly to the Commission.[1]

Background

In 1993, the municipal securities market came under increased scrutiny because of concerns that municipal securities dealers were influencing municipal securities issuers to hire such dealers for municipal securities business through the payment of political contributions and other monies to persons with influence over the dealer selection process. While the Board addressed the issue of political contributions through rule G-37, the Board was concerned that other activities, such as excessive gifts, also might be viewed as influencing the dealer selection process. In January, the Board proposed for comment draft amendments to rules G-8 and G-9, on recordkeeping and record retention, that relate to rule G-20, on gifts and gratuities, which would require dealers to keep records of gifts and gratuities given to others, including issuer officials and employees, in relation to municipal securities activities. These amendments have been filed with the Commission for approval.

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

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

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

The amendments require dealers to keep and retain specific records of all gifts and gratuities subject to paragraph (a) of the rule.[3] The amendments also require dealers to keep and retain records of all contracts of employment or agreements

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

[1] Comments sent to the Commission should refer to SEC File No. SR-MSRB-94-7.

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

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

for compensation for services and all compensation paid as a result of those agreements.[4] These amendments are consistent with the rules of other self-regulatory organizations (SROs).

Dealings with Issuer Officials and Employees

In January 1994, when the Board published the draft amendments for comment, the Board also indicated that it was considering additional rulemaking regarding dealings with issuer officials, but prior to acting in this area, requested additional information and comments.[5]

The Board indicated two areas of specific concern. First, the Board noted that, unlike other SRO rules on gift and gratuities, rule G-20 must take into consideration that municipal securities dealers interact with public officials who occupy a special position of public trust. Although many aspects of the dealer/issuer relationship are addressed in other rules, the Board sought comments as to whether it is necessary or appropriate to place additional requirements in rule G-20 designed to deal with situations in which there may be an appearance of improper influence of issuer officials. Second, the Board indicated that it had received information that some issuer officials solicit charitable and other contributions from dealers. Although recognizing the benefits of charitable contributions, the Board noted that certain contributions made as a result of a solicitation by a public official may be viewed as influencing the selection of the dealer in connection with municipal securities business. To assist the Board's review of these issues, the Board requested information and comment on a number of specific questions.

Summary of Comments and Discussion

The Board received one comment letter in response to its notice requesting comment.[6] The commentator supported the proposed amendments to rules G-8 and G-9 to strengthen the Board's recordkeeping and record retention requirements relating to gifts and gratuities. With regard to the other issues raised by the Board, the commentator acknowledged that business entertainment practices present opportunities for abuse, but believed that "existing law and regulation, properly enforced, provides sufficient protection against abuse in the area of business entertainment and gift-giving in the municipal securities industry." Because of the importance of gifts and gratuity issues to the integrity of the municipal securities market, the Board is disappointed that more comments were not received from dealers.

The Board is firmly committed to taking appropriate measures to ensure that municipal securities business is awarded on the basis of merit and not awarded based on inappropriate factors, such as the payment of political contributions and other monies to persons with influence over the dealer selection process. The Board believes that the amendments to the recordkeeping and record retention requirements related to gifts and gratuities will facilitate dealer compliance with rule G-20, and assist enforcement agencies in monitoring for compliance with the rule.

The absence of data indicating specific abusive practices coupled with the absence of dealer views makes it difficult for the Board to pursue further rulemaking at this time. While the Board has determined not to propose any additional amendments to rule G-20 at this time, it will continue to monitor relationships between dealers and municipal officials that may inappropriately impact the awarding of municipal securities business. The Board urges dealers to review their policies regarding gifts and gratuities to ensure strict adherence to the limitation in rule G-20(a). Finally, the Board will continue to accept comments on these issues and is prepared to propose additional amendments, if warranted.

May 26, 1994

Text of Proposed Amendments*

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

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

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

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

(b) through (e) No change.

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

Rule G-9. Preservation of Records

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

(i) through (viii) (proposed) No change

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

(b) through (g) No change

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

[5] *MSRB Reports*, Vol. 14, No. 1 (January 1994) at 11-12.

[6] The comment letter is available for inspection at the Board's offices.

* Underlining indicates new language; strikethrough denotes deletions.

Notice of Approval

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [X] Sales
- [ ] Operations
- [ ] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

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

Amendments Approved

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

On April 7, 1994, the Securities and Exchange Commission (SEC) approved amendments to rules G-19 and G-8 relating to the suitability of recommendations to customers.[1] The amendments: (1) clarify and strengthen the existing language of rule G-19 that requires suitability determinations to be made when recommending transactions to customers; (2) clarify the obligation of dealers to make reasonable efforts to obtain specific types of customer suitability information for all accounts that are not "institutional accounts" (*i.e.*, retail accounts); and (3) clarify the definition of "institutional account." The amendments became effective upon approval by the Commission.

Summary of Amendments

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

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

While re-examining the standard for customer suitability determinations, the Board also decided to review and clarify the customer data inquiries that are necessary for non-institutional and institutional accounts. For non-institutional (retail) accounts, the amendments clarify that dealers must make reasonable efforts to obtain the following information: the customer's financial status, tax status, investment objectives and such other information used or considered to be reasonable and necessary by the dealer in making recommendations to the customer. For some institutional customers, however, these specific information requests may not be appropriate. For example, the "tax status" of a tax-exempt bond fund generally is not relevant to a suitability determination. Therefore, the amendment to rule G-19 does not provide a specific list of items that must be obtained from institutional accounts, but rather states that dealers must

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

[1] Securities Exchange Act Release No. 33869 (April 7, 1994).

obtain appropriate and sufficient data from each institutional customer to make a suitability determination for each transaction that is recommended.

Finally, the amendments revise the definition of "institutional account" contained in rule G-8. This definition is used in rule G-19, by cross-reference. This amendment makes the Board's definition of institutional account the same as the NASD's definition for purposes of suitability determinations.[2] Accounts that do not qualify as "institutional accounts" (*i.e.*, retail accounts) would be subject to the specific information inquiries described above.

April 7, 1994

Text of Amendments*

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

(a) No change.

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

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

(i) the customer's financial status;

(ii) the customer's tax status;

(iii) the customer's investment objectives; and

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

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

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

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

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

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

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

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

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

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

for believing that the recommendation is suitable.

(d) through (e) No change.

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

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

(i) through (x) No change

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

(A) through (E) No change

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

(G) through (K) No change

For purposes of this subparagraph, the terms "general securities representative" and "general securities principal" shall mean such persons as so defined by the rules of a national securities exchange or registered securities association. For purposes of this subparagraph, the term "institutional account" shall mean ~~the account of an investment company as defined in section 3(a) of the Investment Company Act of 1940, a bank, an insurance company, or any other institutional type account.~~ the account of: (i) a bank, savings and loan association, insurance company, or registered investment company;

[2] *See NASD Manual*, Rules of Fair Practice, Article III, Secs. 2 and 21. In the order approving the amendments, the SEC noted that the NASD and the MSRB should reconsider specifying information collection requirements for dealers when recommending securities to "institutional accounts."

* Underlining indicates new language; strikethrough denotes deletions.

(ii) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940; or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million. Anything in this subparagraph to the contrary notwithstanding, every municipal securities broker and municipal securities dealer shall maintain a record of the information required by items (A), (C), (F), (H), (I) and (K) of this subparagraph with respect to each customer which is an institutional account.

(xii) through (xv) No change

(b) through (f) No change

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [X] Sales
- [ ] Operations
- [ ] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

Customer Confirmations: Rule G-15(a)

Comments Requested

The Board is requesting comment on a draft amendment to rule G-15(a), on customer confirmations. The draft amendment would clarify the current customer confirmation requirements by reorganizing the rule and incorporating previous Board interpretations into the language of the rule. The draft amendment also would revise certain requirements in areas where the Board believes more disclosure is necessary. In addition, minor modifications to the current confirmation disclosure requirements are being proposed. Finally, the Board is seeking comment on broader issues associated with disclosure and the role of the customer confirmation.

As part of the Board's ongoing customer protection review, the Board has reviewed rule G-15(a), regarding customer confirmations. In response to market developments and regulatory concerns, the rule has been subject to numerous amendments and Board interpretive notices since it was adopted in 1977. The draft amendment to rule G-15(a) would clarify the current customer confirmation requirements by reorganizing the rule and incorporating previous Board interpretations into the language of the rule. The draft amendment also would revise certain requirements in areas where the Board believes that more disclosure is necessary. In addition, minor modifications to the rule's requirements are being proposed. The Board requests comment on this draft amendment.

Additionally, the Board believes that this is an opportune time for the industry to review confirmation and disclosure issues for securities transactions in general. The Securities and Exchange Commission (SEC) recently initiated a review of Rule 10b-10, the confirmation rule applicable to transactions in securities other than municipal securities, and also has proposed Rule 15c2-13 that would require certain disclosures to be made on confirmations for transactions in municipal securities. As a result, in addition to proposing the draft amendment, the Board is requesting comment on broader issues associated with disclosure to customers and the role of the customer confirmation in providing such disclosure. The deadline for written comments is September 15, 1994.

Reorganization of Current Rule Including Codification of Interpretations

The draft amendment would clarify rule G-15(a) by reorganizing the rule and incorporating Board interpretations into the rule. The draft amendment has been subdivided by subject matter into three broad categories—securities identification, securities description (listing the various features of the security), and terms of the transaction. Under each category, Board rules and interpretations are organized by subject matter.

For example, under the securities description section of the draft amendment, all existing rules and Board interpretive notices specifying how the interest rate should be expressed on the confirmation for various categories of municipal securities transactions have been codified.[1] Thus, if a dealer is uncertain how the interest rate should be expressed on the confirmation for different types of municipal securities, the dealer could simply examine the interest rate subparagraph rather than review all previous interpretive notices which might bear upon the subject.

Proposed Changes in the Customer Confirmation

The draft amendment includes a number of changes that the Board feels will strengthen the disclosure and customer protection objectives of the rule while updating the requirements of the customer confirmation.

Call provisions — Appropriate, meaningful, and understandable disclosure of call features on the customer confirmation has long been a Board concern and numerous interpretive releases have been issued in this regard. Currently, for many bonds only a designation of "callable" is required by

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

[1] Categories include zero coupon securities, variable rate securities, securities with adjustable tender fees, stepped coupon securities, and stripped coupon securities.

rule G-15(a)(i)(E), along with the following legend provided by rule G-15(a)(iii)(F) which can be indicated in a footnote: "Call features may exist which could affect yield; complete information will be provided upon request." Rule G-15(a)(i)(I) provides that disclosure of the first in-whole call is required to be noted on the confirmation only if the security is priced to the call.

The Board believes that the effectiveness of confirmation disclosure of call features to customers can be improved. For example, the existing legend draws little notice from customers because it is generally pre-printed on the back of confirmation forms. Another longstanding Board concern has been confusion that may arise when specific call features are noted on the confirmation without adequate descriptive information of what is being described and without mention that other call features also exist. The Board addressed this issue in 1986 through an interpretive notice indicating that, if confirmations include specific call information that is not otherwise required by rule G-15(a), the confirmation must include "a notation that other call features exist and must provide clarifying information about the noted call."[2] Nevertheless, problems still arise because of misunderstandings created when incomplete call information is displayed on confirmations.

The draft amendment would alter call disclosure on customer confirmations in several ways. It would require that the date and price of the first refunding call always be disclosed. The draft amendment also would delete the legend that generally is preprinted on the back of the confirmation. Instead, the draft amendment would require that, if there are any call features in addition to the first refunding call, disclosure must be made on the front of the confirmation that "special call features exist". The draft amendment also utilizes the same approach to advance refunded securities that are callable.

Revenue bonds — Currently, with regard to revenue bonds, rule G-15(a)(i)(E) provides that disclosure of the type of revenue is required "if necessary for a materially complete description of the securities." The draft amendment would require that the revenue source for revenue bonds always be disclosed.

Limited tax — Currently, rule G-15(a)(i)(E) provides that the description of the bonds should specify if they are "limited tax." Traditionally, a limited tax bond is a general obligation bond secured by the pledge of a specified tax (usually the property tax) or category of taxes which is limited as to rate or amount. The draft amendment would delete the "limited tax" designation because its meaning has become ambiguous as various states have implemented a variety of tax limitation measures. The deletion of this provision, however, does not affect a dealer's obligation to disclose all material facts at the time of the transaction. If a general obligation bond has a limitation on taxes that is material to the investment decision, dealers must ensure that their customers are aware of the relevant facts, at or before the time of the transaction.

Book-entry only — Currently, rule G-15(a)(iii)(B) provides that confirmation disclosure is required if the securities are available only in book-entry form. The draft amendment would delete this requirement. The Board questions whether the book-entry-only form of securities is a factor in investment decisions requiring specific disclosure on all confirmations.[3]

Dealers acting as agent and receiving "other remuneration" — Currently, rule G-15(a)(ii) provides that, in agency transactions, remuneration paid by the customer always must be disclosed, but if the dealer receives "other" remuneration (*i.e.*, remuneration from the other participant in the transaction), it is sufficient for the dealer to indicate that other remuneration was received and details will be furnished to the customer upon written request. In 1991, because of difficulties faced by dealers in some instances in calculating the amount of remuneration that should be allocated to a particular transaction (*i.e.,* when a dealer acts as remarketing agent for the issuer), the Board provided dealers with the above-mentioned alternative for disclosing "other" remuneration.[4]

The draft amendment would clarify this provision by permitting written notification of "other remuneration" only in limited situations, like remarketing programs, that were originally contemplated by the Board. For example, if a dealer acquires a bond from another dealer at a discount (*e.g.*, "net" price less concession) and the customer pays the "net" price, the inter-dealer discount or concession received by the dealer cannot be considered "other remuneration," but rather should be considered remuneration received from the customer. Thus, the amount of the "discount" or concession must be disclosed on the confirmation of agency transactions.

"Ex legal" delivery designation — Currently, rule G-15(a)(iii)(I)(1) requires that the confirmation must note whether a transaction is "ex-legal". "Ex-legal" is a term which refers to the absence of a legal opinion. As currently interpreted, this term refers to the physical delivery of a bond without a written copy of the legal opinion. Given the movement away from the use of certificates, this requirement would be deleted in the draft amendment. However, the Board believes that it is important for a customer to know if a security did not receive a written opinion from counsel at the time of issuance. Thus, the draft amendment would require that the customer confirmation disclose the fact that a security was issued without a legal opinion.

Zero coupon bonds — Currently, rule G-15(a)(v) provides a number of specific confirmation requirements for zero coupon bonds, including a disclosure that the interest rate is "0%" and the following legend: "No periodic payments—

[2] *See* Notice Concerning Confirmation Disclosure Requirements for Callable Municipal Securities (February 20, 1986) *MSRB Manual* (CCH) para. 3571.

[3] Previously, the Board considered deleting this requirement. Specifically, in 1987, the Board requested comment on the deletion of the book-entry-only designation from the confirmation requirements of rules G-12 and G-15. The Board subsequently withdrew the proposal after receiving industry opposition to the amendments. The Board noted that as the industry continued to become familiar with book-entry-only issues, it would review whether it continues to be appropriate to require confirmation disclosure of book-entry-only securities. *See* Confirmation Disclosure of Book-Entry-Only Securities: Rules G-12 and G-15, *MSRB Reports* Vol. 8, No. 2 (March 1988) at 7.

[4] *See* Notice of Approval - Disclosure of Remuneration to Customers: Rule G-15, *MSRB Reports* Vol. 12, No. 1 (April 1992) at 23-24.

callable below maturity value without notice by mail to holder unless registered."

The draft amendment would retain these existing requirements and, in addition, would require the disclosure of any premium paid over accreted value for zero coupon bonds. The accreted value for a zero coupon bond reflects the increase in the security's value as it approaches the redemption date. Requiring dealers to disclose any premium over the accreted value should provide customers with important information regarding the terms of the transaction.

Miscellaneous

The draft amendment also would include a number of minor modifications and clarifications that the Board believes reflect current practices of most municipal securities dealers. These changes include:

Dated date — Currently, rule G-15(a)(iii)(A) requires the dated date on the confirmation only if needed for calculations, but the draft amendment would require that the dated date always be included on the confirmation as part of the securities identification.

Additional obligors — Currently, rule G-15(a)(i)(E) provides that additional obligors are required to be disclosed on the confirmation only "if necessary for a materially complete description of the security." The draft amendment would require that the confirmation must indicate 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.

First interest payment date (including if not semi-annual) — Currently, rule G-15(a)(iii)(I) is ambiguous as to whether the first interest payment date must be included on the confirmation in all instances in which it is not a regular semi-annual interest payment, or only if it is necessary for calculation purposes. The draft amendment would clarify that the first interest payment date is required on the confirmation only in those cases in which it is necessary for the calculation of final money, including those cases in which the first interest payment is not semi-annual.

Yield information for defaulted bonds, bonds that prepay principal and variable rate securities that are not sold on basis of yield to put — Currently, there is not a specific exemption for statement of yield on such transactions, but the draft amendment would include specific exemptions.

Multi-transaction data should not be aggregated on one confirmation. The draft amendment would clarify that a separate confirmation should be provided for each municipal securities transaction when several transactions are done at one time (*e.g.*, several maturities of a serial issue are purchased).

New sections to clarify confirmation format. The draft amendment would specify that all requirements, except the zero coupon disclosure legend, should be clearly and specifically indicated on the front of the confirmation.

Disclosure and the Role of the Customer Confirmation

While the draft amendment will help dealers and customers better understand rule G-15(a) requirements and address certain disclosure issues, the Board believes it is appropriate for dealers to consider some of the basic dis-closure issues that arise out the dealer-customer relationship. As previously noted, the SEC is reviewing its customer con-firmation rule as well as considering a rule that would impose certain confirmation disclosure requirements in municipal securities transactions.

For customer transactions, rule G-17 requires that dealers disclose to customers, at or before the time of trade, all material facts with respect to a proposed transaction, including a complete description of the security and must not omit any material facts which would render other statements misleading. Confirmation disclosure supports the dealer's duty of disclosure to the customer, but does not completely satisfy the dealer's disclosure responsibility because confirmation disclosures are not intended to encompass all material information. Nevertheless, in the past, the customer confirmation, for both municipal securities transactions and non-municipal securities transactions, has been used as a vehicle to provide customers with important information.

As part of the Board's customer protection review, the Board has been reviewing the proliferation of new municipal securities products and the need to ensure that appropriate customer protection standards are being observed in a changing market. Clearly, the terms and features of municipal securities have evolved over time to meet a multitude of borrowing and investment needs. In view of the changing market and regulatory environment, the Board believes that this is an appropriate time to review the Board's requirements regarding disclosure of information to customers. Accordingly, the Board is seeking comment on broader issues associated with disclosure to customers and the role of the customer confirmation, including the possible need for more comprehensive disclosure information to be sent to investors regarding their municipal securities transactions, either on the confirmation or in supplemental documents.

Request for Comments

The Board specifically requests comment on the following:

Content of Information to Customers

1. In a recent letter to the Board regarding the projected movement to three day settlement (T+3), the SEC suggested that the Board consider developing a customer brochure describing typical trade terms and security features that dealers would be required to deliver to customers.[5] The Board requests comment on whether such a brochure would be helpful. If so, what particular information should be included? The SEC noted that such a brochure could highlight the importance of T+3 settlement and the implications for individual investors. Would this be helpful? If such a brochure is developed, when should it be sent to customers?

2. Should dealers be required to deliver Preliminary Official Statements as well as final Official Statements to cus-

[5] Letter from Arthur Levitt, Chairman, SEC to David Clapp, Chairman, MSRB, April 1, 1994.

tomers in new issue transactions, if such documents are prepared?

3. Should dealers be required to deliver Official Statements to customers in secondary market transactions?

4. Should dealers provide customers with a summary sheet of the features of municipal securities? If so, what items should be included and when should this document be provided to customers?

5. The draft amendment includes a number of changes regarding the content of the customer confirmation. Please indicate if there are any other items that would be beneficial to include on the customer confirmation? Are there any existing confirmation requirements that should be eliminated? If so, why?

6. The SEC's proposal to amend Rule 10b-10 includes certain requirements regarding the disclosure of collateralized mortgage obligations (CMOs). Specifically, for CMO transactions, dealers would be required to disclose: (1) estimated yield, (2) weighted average life, and (3) prepayment assumptions underlying the yield. Should rule G-15(a) be amended to require similar disclosure for CMOs that are municipal securities?

7. The draft amendment includes a provision that the confirmation must indicate if a municipal security was issued without a legal opinion. In this regard, should any legal opinion suffice? Should this requirement be limited to a legal opinion regarding the validity of issuance or also indicate the absence of a legal opinion regarding tax status?

Timing and Form of Information to Customer

1. Currently, many dealers use a standardized, nine-by-five inch confirmation form. Should the written disclosure provided to customers continue to be effectively limited by the size of the standardized, nine-by-five inch confirmation form?

2. Currently, the rule does not specify when the confirmation should be mailed, only that it shall be given or sent to the customer at or before the completion of a transaction. Should confirmations be required to be mailed no later than T+1?

3. In the previously referenced SEC letter to the Board regarding T+3 settlement, the SEC also suggested that the Board consider requiring dealers to send confirmations to customers by over-night mail or by facsimile transmission. Do dealers currently do this? If so, under what circumstances? Would the benefits of such a requirement exceed its costs?

May 26, 1994

Text of Draft Amendment*

G-15(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 an agent for the customer,

(iii) as an agent for a person other than the customer, or

(iv) as an 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, provided, however, that if a bond is acquired at a discount (*e.g.*, "net" price less concession) and sold at a "net" price to a customer, the discount must be disclosed as remuneration received from the customer pursuant to G-15(a)(i)(A)(6)(f).

(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.

(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 (d):

(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,

* The draft amendment is a complete revision to the current rule language. The current rule language of rule G-15(a) and related interpretations are contained in the *MSRB Manual*.

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 (c), 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 the rules in subparagraph (c), 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 (c).

(ii) For purposes of computing yield 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.

(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 paragraph (6)(e) below, 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 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 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 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) through (c), 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.

(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, accrued interest shall not 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), accrued interest shall not be shown;

(c) if the securities 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;

(e) the nature and amount of miscellaneous fees, such as special delivery arrangements or a flat 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 zero coupon securities, any premium paid over the accreted value of the securities

(7) *Delivery of securities.* The following information regarding the delivery of securities shall be shown:

(a) *Securities other than bonds.* For securities other than bonds, 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) *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 dealer sponsoring the program;

(2) CUSIP number, if any, assigned to the securities;

(3) maturity date, 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;

(4) interest rate, 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;

(5) the dated date, 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, regardless of whether such designation appears in the formal title of the security, and a notation of the source or sources of revenue.

(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 first pricing call shall be included and so designated. Other specific call features are not required to be listed unless required by paragraph (A)(5)(c)(ii) 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 first pricing call, disclosure must be made on the confirmation that "special call features exist;"

(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;

(f) *Issued without legal opinion.* If the securities were issued without a legal opinion regarding the validity of issuance and/or tax status, a designation to that effect;

(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 "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;

(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;"

(4) *Tax information.* The following information that may 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.

(D) *Disclosure statements.* The confirmation for zero coupon securities shall include a statement to the effect that "No periodic payments—callable below maturity value without notice by mail to holder unless registered."

(E) *Confirmation format.* All applicable requirements of paragraphs (A),(B), and (C) above must be clearly and specifically indicated on the front of the confirmation. The disclosure statements required in paragraph (D) may be on the reverse side of the confirmation provided that its specific applicability is noted on the front of the confirmation.

(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.

(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 prior to determination of settlement date. If such a confirmation is sent, it shall include all information required by the rule with the exception of settlement date, total monies, accrued interest, extended principal and delivery instructions.

(iv) *Confirmations to customers who tender put option bonds.* 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 bonds from a customer is engaging in a transaction in such municipal securities and shall send a confirmation under section (i) of this rule.

(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 of the Board or Rule 17a-3 of the Commission.

(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 defined in SEC staff letter (stripped coupon municipal securities) dated January 19, 1989.

(F) The term "price 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.

Route to:

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

Enforcement Initiative

Notice: Rule G-12

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)(i).

The Board believes that comparison rates for inter-dealer transactions must increase to facilitate the implementation of T+3 settlement in the municipal securities market.[1] It has come to the Board's attention that a significant number of transactions do not compare in the initial comparison cycle because introducing brokers fail to provide their clearing brokers with timely and accurate trade information. Rule G-12(f)(i) requires that introducing brokers achieve comparison of their transactions in a registered securities clearing agency. Accordingly, introducing brokers who compare through clearing brokers must submit trade information to their clearing brokers within sufficient time for comparison to occur in the initial comparison cycle.

Introducing brokers share the responsibility for complying with rule G-12(f)(i) 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)(i).

May 13, 1994

Questions about this notice may be directed to Judith A. Somerville, Uniform Practice Specialist.

[1] *See* "Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market," *MSRB Reports*, Vol. 14, No. 2 (March 1994) at 8.

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MSRB REPORTS

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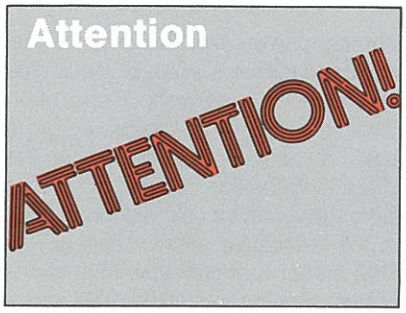

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [X] Trading
- [X] Sales
- [X] Operations
- [ ] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

Use of the OASYS Global Trade Confirmation System to Satisfy Rule G-15(a)

Notice of Interpretation: Rule G-15(a)

The Board has interpreted the requirement in rule G-15(a) to provide customers with a written confirmation to be satisfied by a "contract confirmation message" sent through the OASYS Global system when certain conditions are met. The interpretation is effective immediately.

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 confirmations 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 CCM's sent through the OASYS Global system to satisfy the requirements to confirm a transaction under Rule 10b-10.

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.[2] A copy of the October 8, 1993 no-action letter is contained on pages 38-39.

June 6, 1994

Questions about this notice may be directed to Judith A. Somerville, Uniform Practice Specialist.

[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 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.

Securities and Exchange Commission's October 8, 1993 No-Action Letter

October 8, 1993

Mari-Anne Pisarri, Esq.
Pickard and Djinis
1990 M Street, N.W.
Washington, D.C. 20036

Re: *Thomson Financial Services, Inc.*

Dear Ms. Pisarri:

In your letters of December 28, 1992 and April 22, 1993, as supplemented by conversations with the staff, you request on behalf of Thomson Financial Services (TFS), assurances that the staff will not recommend enforcement action to the Commission with respect to TFS's electronic trade confirmation system, known as "OASYS Global". Specifically, TFS is seeking assurances that OASYS Global's contract confirmation messages can be treated as confirmations in accordance with Rule 10b-10[1] under the Securities Exchange Act of 1934 (Exchange Act), and that electronic storage of such confirmation messages is consistent with the recordkeeping requirements of Rules 17a-3 and 17a-4 under the Exchange Act and Rule 204-2 under the Investment Advisers Act of 1940 (Advisers Act).

We understand the facts to be as follows:

OASYS Global is a post-trade confirmation network whose subscribers include domestic and foreign broker-dealers and their institutional clientele. OASYS Global provides broker-dealers and institutional investors with a means of communicating electronically between the time a securities order is executed and the time the trade is settled. The institutional trade confirmation takes place during this period. OASYS Global also may be used for broker-to-broker trade confirmations and affirmations.

Access to OASYS Global is obtained through OASYS Global software resident on a personal computer which communicates through telephone connections between each broker-dealer or institutional investor subscriber and OASYS Global's host computer in Boston. To confirm an institutional transaction, a broker-dealer first notifies its client of the details of the purchase or sale that has just been effected for the client's account. The client then transmits a message either affirming or rejecting the trade. If the trade is affirmed, the parties instruct their settlement agents (*e.g.,* custodian banks, clearing network organizations, or depositories) to transfer title to the securities and the funds for such securities according to the terms of the confirmation. If the trade is rejected, or "DK'd",[2] the broker must correct any errors in the trade details and recommence the confirmation process.

OASYS Global affords broker-dealers and their institutional clients the ability to transmit three different types of messages through the system's communications network, using standardized screen fields. The first kind of message, a "block level information message", is sent by the broker to the institution and contains basic information relating to trades that have been effected for the institution's account. The second type of message, the "allocation detail message," is sent by the institution to the broker and contains instructions regarding the allocation of the trade to the institution's various sub-accounts.

The third type of message is the "contract confirmation message" or "CCM," which is sent by the broker to the institution to confirm the final details of the transaction. Upon receipt of a contract confirmation message, the institution responds through the system, either affirming or rejecting the trade. If the institution rejects a trade, its response also indicates which portions of the confirmation are in error. The broker-dealer and the institution continue to communicate electronically until all appropriate corrections have been made and the trade is affirmed. An affirmed trade is considered binding between the parties, and proceeds to settle through normal channels (*i.e.*, through international depositories and custodian banks).

Although the broker-dealer does not provide its institutional customers with a paper copy of the CCM, such customers can print hard copies of CCMs from their own terminals. Customers also can download CCMs onto their own computer or a disk.

All messages sent via OASYS Global originate at the sender's computer terminal and are routed through the system's host computer before being directed to the recipient's computer. Although the host computer copies and stores the data that passes through it, OASYS Global does not match trades, maintain a balance of open positions between buyers and sellers, or mark securities to the market.

OASYS Global is currently available in North America and Europe, and is expected to be available in South America and Asia by the end of 1993. OASYS Global adheres to International Standards Organization (ISO) and Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.) standards for information interchange, and is one of three commercial electronic trade confirmation systems approved by the European Industry User Group. In addition, the U.K. Securities and Futures Authority has approved the use of OASYS Global trade confirmations as a substitute for the traditional paper contract used in that country.[3]

All of the information required by Rule 10b-10 will be included in the OASYS Global confirmations. OASYS Global will amend its subscription agreement to provide that CCMs may be used to satisfy the requirements of Rule 10b-10, and that institutional investors subscribing to the OASYS Global service agree to accept such CCMs in lieu of traditional hard-copy confirmations.

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[1] This rule requires broker-dealers to disclose specified information in writing to customers at or before the completion of a transaction. The requirements under this rule that particular information be disclosed is not determinative of a broker-dealer's obligation under the general antifraud provisions of the federal securities laws to disclose additional information to a customer at the time of the customer's investment decision.

[2] A trade is "DK'd" (meaning "don't know"), when the details of a transaction, as recorded by the parties to the transaction, do not match.

[3] Letter from Mr. W. Nixon, Secretary to the Board of the U.K. Securities and Futures Authority to Mr. Bob Hayim, General Manager of Thomson Financial Services, Ltd. (November 5, 1992).

TFS has represented that the OASYS Global system will provide sufficient capacity to handle the volume of data reasonably anticipated to be entered into the OASYS Global system. OASYS Global has conducted system capacity tests to ensure that the volume of users on the OASYS Global system allowed by the current number of dedicated telephone lines will not cause response time of the host computers to fall below an acceptable level. OASYS Global has represented that it intends to review and test the OASYS Global system periodically to ensure adequate system capacity, identify potential weak points, and reduce the risk of system failures and threats to system integrity.[4]

In addition, TFS has represented that the OASYS Global system has the capacity to handle at least twice the average daily trade volume, and thus can handle volume surges. In the event the system capacity level is exceeded, the OASYS Global system automatically stores the excess and forwards it back through the system shortly thereafter.

TFS has represented that the OASYS Global system has a number of automatic processes designed to ensure the integrity of the system. Among these processes are several back-up systems of data storage and an independent, back-up power supply.

TFS has represented that it has in place security procedures designed to prevent unauthorized access to the OASYS Global system by employees of TFS and OASYS Global, by participants in the OASYS Global system, and by persons who are unrelated to either TFS or OASYS Global. The OASYS Global data center is physically secure. All messages are transmitted on the OASYS Global system using a frame-based proprietary protocol which includes internal error checking. Moreover, all communications into OASYS Global are password protected.

Response:

Based on the foregoing facts and representations, and particularly on the representations that the system participants will agree between themselves to use CCMs instead of hard-copy confirmations, that the CCMs can be printed or downloaded by the participants, that the recipient of a CCM must respond through the system affirming or rejecting the trade, that the CCMs will not be automatically deleted by the system, and that the use of the system by the participants ensures that both parties to the transaction have the capacity to receive the CCMs, the staff would not recommend enforcement action to the Commission if broker-dealers rely on the OASYS Global contract confirmation messages to satisfy the requirements of a confirmation of Rule 10b-10 under the Exchange Act.

The staff, however, is unable to assure you that it would not recommend enforcement action to the Commission if participants in the OASYS Global system electronically store CCMs as a method of compliance with the recordkeeping requirements of Rules 17a-3 and 17a-4 under the Exchange Act.

The Division of Investment Management has asked us to inform you that it would not recommend enforcement action to the Commission under Rule 204-2(a)(7) and Rule 204-2(b)(3)[5] under the Investment Advisers Act of 1940 if investment advisers that participate in OASYS Global treat the CCM as an original communication, and do not require broker-dealers to send a separate hard copy confirmation. Further, the Division of Investment Management would not recommend enforcement action to the Commission under Rules 31a-1(b)(1) and 31a-1(b)(12)[6] under the Investment Company Act of 1940 (1940 Act) if registered investment companies treat a CCM as a record of original entry. The Division of Investment Management's position is based, in particular, on your representation that the CCMs will contain all the information required under Rule 10b-10 of the Securities Exchange Act of 1934.[7]

This response is based on the facts and representations in your letter; any different facts or representations may require a different conclusion. This response expresses the positions of the Divisions of Market Regulation and Investment Management on enforcement action only and does not purport to express any legal conclusions on the issues presented.

Sincerely,

Catherine McGuire
Chief Counsel

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[4] Results of such reviews will be kept by OASYS Global for a minimum of three years after such results are obtained, and will be made available to the Commission promptly upon request.

[5] Rule 204-2(a)(7) provides, in pertinent part, that a registered investment adviser shall keep and maintain true, accurate, and current originals of all written communications it receives relating to any receipt, disbursement, or delivery of funds or securities, or the placing or execution of any order to purchase or sell any security.

Rule 204-2(b)(3) requires a registered investment adviser with custody or possession of client funds or securities to make and keep copies of confirmations of all transactions effected by or for the account of any such client.

In the view of the Division of Market Regulation, the advised account (and not the investment adviser) is the customer for purposes of Rule 10b-10 under the Exchange Act.

[6] Rule 31a-1(b)(1) requires a registered investment company to maintain and keep current, among other things, "journals (or other records of original entry) containing an itemized daily record in detail of all purchases and sales of securities." Rule 31a-1(b)(12) defines "other records" as voucher checks, confirmations, and similar documents.

[7] *See* Depository Trust Co. (pub. avail. Sept. 4, 1992). Registered investment advisers that participate in OASYS Global must preserve CCMs, whether received electronically or otherwise, in an accessible form in a manner that complies in all respects with rules under the Advisers Act. *See, e.g.*, Rule 204-2(e) (adviser must maintain and preserve books and records in an easily accessible place); Rule 204-2(g) (adviser may produce or reproduce records in a computer storage medium, and may maintain and preserve records created or received on electronic media in a computer storage medium).

Registered investment companies that treat the CCM as a confirmation must preserve CCMs, whether received electronically or otherwise, in an accessible form in a manner that complies in all respects with rules under the 1940 Act. *See, e.g.*, Rule 31a-2(a) (registered investment company must maintain and preserve books and records in an easily accessible place); Rule 31a-2(f) (registered investment company may produce or reproduce records on magnetic tape, disk, or other computer storage medium, and maintain and preserve records created or received by or on behalf of investment company on electronic media in a computer storage medium).

Publications List

Manuals and Rule Texts

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

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

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

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

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

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

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

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

Reporter and Newsletter

MSRB Reports
The MSRB's reporter and newsletter to the municipal securities industry. Includes notices of rule amendments filed with and/or approved by the SEC, notices of interpretations of MSRB rules, requests for comments from the industry and the public and news items.
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Outline for Test Series 52
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Study Outline: Municipal Securities Principal Qualification Examination
Outline for Test Series 53
January 1993 ..... no charge

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