

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52290; File No. SR-MSRB-2005-02)

August 18, 2005

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule Change Relating to Amendments to MSRB Rule G-20, on Gifts and Gratuities, and MSRB Rule G-8, on Recordkeeping

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 13, 2005, the Municipal Securities Rulemaking Board (“MSRB” or “Board”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

The MSRB is filing with the Commission a proposed rule change consisting of amendments to Rule G-20, on gifts and gratuities, and the related recordkeeping requirements of Rule G-8.³ The text of the proposed rule change is available on the MSRB’s Web site (<http://www.msrb.org>), at the MSRB’s principal office, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The New York Stock Exchange, Inc. (“NYSE”) has a pending rule filing with the Commission on gifts and gratuities that is currently being reviewed. The MSRB has agreed to consider filing further amendments to Rule G-20 or other rules, as necessary, to make its rules on gifts and gratuities consistent with future rule changes made by other self-regulatory organizations (SROs) overseen by the Commission.

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

MSRB Rule G-20 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 an employee or partner of the dealer in relation to the municipal securities activities of the recipient's employer. The rule provides certain exemptions from the \$100 annual limit for "normal business dealings," including (i) occasional gifts of meals or tickets to theatrical, sporting and other entertainment; (ii) sponsoring legitimate business functions that are recognized by the IRS as deductible business expenses; and (iii) gifts of reminder advertising. However, such gifts must not be so frequent or excessive as to raise a suggestion of unethical conduct.

MSRB Rule G-20 currently does not mandate specific requirements with respect to non-cash sales incentives, although the general fair practice principles of Rule G-17 apply.⁴ The MSRB has interpreted Rule G-17 in the context of municipal fund securities

⁴ Rule G-17 provides that "In the conduct of its municipal securities activities, each broker, dealer and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

to provide that a dealer may violate the rule by engaging in marketing activities that result in a customer being treated unfairly, or by engaging in any deceptive, dishonest or unfair practice in connection with such marketing activities.⁵ Further, depending on the particular facts and circumstances, a dealer may violate Rule G-17 if it acts in a manner that is reasonably likely to induce another dealer to violate the principles of Rule G-17 or other MSRB customer protection rules.⁶ In contrast, NASD Rules 2710(i), 2820(g)(4) and 2830(l)(5) establish specific requirements with respect to the payment of non-cash compensation in connection with offerings of corporate securities, variable contracts and mutual funds.

The MSRB has determined that similar treatment across the securities markets is appropriate and would facilitate dealer understanding of, and compliance with, requirements relating to sales incentives and non-cash compensation. Thus, the proposed amendments are intended to more fully conform Rule G-20 to NASD requirements relating to gifts and gratuities, and to add new provisions governing non-cash compensation and sales incentives in connection with municipal fund securities and other primary offerings of municipal securities, based on NASD requirements for non-cash compensation and

⁵ MSRB Notice on “Application of Fair Practice and Advertising Rules to Municipal Fund Securities,” May 14, 2002, reprinted in the MSRB Rule Book (July 1, 2004) at page 151.

Municipal fund securities are municipal securities issued by an issuer that, but for the application of Section 2(b) of the Investment Company Act of 1940, as amended, would constitute an investment company within the meaning of that Act. The most common forms of municipal fund securities sold by dealers consist of interests in trusts established by states as qualified tuition programs under Section 529 of the Internal Revenue Code (“529 college savings plans”), and interests in local government investment pools.

⁶ Id.

sales incentives. The proposed amendments would result in the following changes to Rule G-20:

- Modify the existing provision in Rule G-20 that permits occasional gifts of meals or sports and entertainment tickets, and sponsorship of business functions outside of the \$100 per year limitation by requiring that dealer personnel host (accompany) such meals, entertainment and business functions in conformity with NASD gift rule limitations, and further modify the language of the requirement to incorporate NASD language to the effect that such occasional gifts must not call into question the dealer's ethical standards.⁷
- Clarify that NASD interpretations apply to comparable MSRB provisions, unless the MSRB specifically provides otherwise.
- Incorporate definitions of "non-cash compensation," "cash compensation" and "offeror" based on language in NASD Rules 2710, 2820 and 2830, and expand the definition of offeror to include, with respect to securities held as assets underlying municipal fund securities, any person considered an offeror under relevant NASD rules.

⁷ The NASD language with respect to this exception from the \$100 annual gift limitation appears in an interpretive letter relating to NASD Rule 3060. See interpretive letter, dated June 10, 1999, from R. Clark Hooper, Executive Vice President, NASD, to Henry H. Hopkins, Director, and Sarah McCafferty, Vice President, T. Rowe Price Investment Services, Inc.

The existing Rule G-20 language relating to "gifts of reminder advertising" is retained in the proposed amendments without change even though such language does not exist under NASD rules.

- Treat non-cash sales incentives relating to municipal fund securities and other primary offerings of municipal securities (i.e., bonds and notes) in a manner similar to NASD’s treatment of non-cash sales incentives relating to mutual funds, variable contracts, and corporate debt and equity offerings, including, among other things, permitting gifts that do not exceed \$100 per individual per year and are not preconditioned on achievement of a sales target; and permitting the giving and receipt of occasional gifts of meals or tickets to theatrical, sporting and other entertainment, but only if such occasional gifts are not preconditioned on achievement of a sales target.
- Limit the circumstances under which dealers or offerors may pay or reimburse costs of training or education, based on NASD rules, including ensuring that attendance at, and payment for, such meetings is not preconditioned on achievement of a sales target; reimbursement is not applied to expenses of associated persons’ guests; and that such meetings are held at appropriate locations.⁸
- Require that non-cash compensation arrangements include the total production and equal weighting requirements under NASD rules,

⁸ The proposed language in Rule G-20 that refers to “a location at which a significant asset, if any, being financed or refinanced in the primary offering is located” is based on language included in draft amendments to NASD Rule 2710 proposed for comment by NASD in Notice to Members 04-07 (February 3, 2004) (the “NASD Corporate Financing Proposal”).

which are designed to ensure that the arrangement does not favor sales of one municipal security over another.⁹

- Amend the recordkeeping requirements in Rule G-8 to require that dealers maintain a record of non-cash compensation received in connection with a primary offering from the issuer or its advisers, the underwriter, or any of their affiliates, as well as records regarding any internal sales incentive program for municipal fund securities.

2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with section 15B(b)(2)(C) of the Act,¹⁰ which requires that the rules of the MSRB shall “be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest”¹¹

The MSRB believes that the proposed rule change is consistent with these provisions in that it would provide for consistent treatment across the securities markets

⁹ These total production and equal weighting requirements currently are included in NASD Rules 2820 and 2830, and are included in draft amendments to Rule 2710 proposed for comment in the NASD Corporate Financing Proposal.

¹⁰ 15 U.S.C. 78o-4(b)(2)(C).

¹¹ Id.

regarding gifts, gratuities, non-cash compensation and sales incentives, thereby facilitating dealer understanding of, and compliance with, these requirements.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the proposed rule change will result in any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In June 2004, the MSRB requested comment on draft amendments to Rule G-20, and the related recordkeeping provisions of Rule G-8, that would:

- Treat non-cash sales incentives relating to municipal fund securities and other primary offerings of municipal securities (i.e., bonds and notes) in a manner similar to NASD's treatment of non-cash sales incentives relating to mutual funds and corporate debt and equity offerings.
- Modify the existing provision in MSRB Rule G-20 that permits occasional gifts of meals or sports and entertainment tickets, and sponsorship of business functions outside of the \$100 per year limitation by requiring that dealer personnel host (accompany) such meals, entertainment and business functions.
- Amend the recordkeeping requirements in Rule G-8 to require that dealers maintain a record of non-cash compensation received in connection with a primary offering from the issuer or its advisers, the underwriter, or any of

their affiliates, as well as records regarding any internal sales incentive program for municipal fund securities.¹²

In response to the draft amendments, the MSRB received comment letters from NASD, The Investment Company Institute (“ICI”), Morgan Keegan, and Bernardi Securities. Three of the commentators (NASD, ICI and Morgan Keegan) expressed general support for the draft amendments, and one commentator (Bernardi Securities) opposed one aspect of the draft amendments. Two of the commentators (NASD and ICI) suggested that the MSRB make certain revisions, discussed below.

The MSRB believes that a number of the commentators’ concerns and suggestions have merit and, accordingly, revised the amendments to (1) incorporate NASD rule language where possible; (2) clarify that NASD interpretations would apply to comparable MSRB provisions, unless the MSRB specifically provides otherwise; and (3) expand the definition of offeror to include, with respect to securities held as assets underlying municipal fund securities, any person considered an offeror under relevant NASD rules.

Consistency between NASD and MSRB Rules. NASD and ICI supported the MSRB’s proposal to make Rule G-20 consistent with NASD’s rules. ICI stated that a “uniform system of regulation between the MSRB and the NASD reduces the potential that persons subject to both regimes will face conflicting regulatory requirements and facilitates compliance efforts. Moreover, inasmuch as the NASD is charged with inspecting securities firms for compliance with the rules of the MSRB, providing

¹² See “Request for Comments on Draft Amendments to Rules G-20 and G-8 Relating to Gifts, Gratuities and Non-Cash Compensation in Municipal Debt Offerings and Sales of Municipal Fund Securities,” MSRB Notice 2004-17 (June 15, 2004), at www.msrb.org.

uniformity between MSRB's rules and those of the NASD . . . should facilitate the NASD's ability to conduct such inspections." NASD suggested that the MSRB, "whenever possible, use precisely the same language as Rule 2830, and clarify that...[NASD's] interpretation of that rule would similarly apply to the interpretation of the Rule G-20 amendments."

The MSRB agrees that, whenever possible, incorporating identical language between comparable provisions of MSRB and NASD rules would facilitate dealer understanding of and compliance with such provisions, as well as facilitate the inspection and enforcement thereof. The MSRB has, therefore, incorporated NASD language in the proposed amendments to Rule G-20, including those provisions relating to the requirement that dealers host meals, tickets to events and the like; technical language on gifts that call into question the dealer's ethical standards; non-cash compensation arrangements, including payment or reimbursement for education and training meetings; and the definitions of "non-cash compensation," "cash compensation," and "offeror."

NASD interpretations. NASD asked the MSRB to clarify whether NASD's interpretation of the exception for training and education meetings, as set forth in its Summer 2000 Regulatory and Compliance Alert, would apply to the training and education meeting exception in the draft amendments.¹³ The MSRB agrees that this interpretation should apply to the similar provisions of amended Rule G-20.

Moreover, the MSRB intends generally that the provisions of Rule G-20 be read consistently with the analogous NASD provisions, unless the MSRB specifically indicates otherwise. Thus, relevant NASD interpretations would be presumed to apply to

¹³ See NASD "Regulatory & Compliance Alert" (Summer 2000) at 13.

the comparable MSRB provision, subject to the MSRB's right to make distinctions when necessary and appropriate in the context of municipal fund securities and other primary offerings of municipal securities.

Definition of "offeror." NASD suggested that the draft definition of "offeror," which includes the issuer's service providers in connection with the marketing and maintenance of its municipal fund securities, also should include the investment adviser to the underlying funds. Similarly, ICI recommended expanding the draft definition of "offeror" to include the issuer of any investment product into which the assets of a municipal fund security are invested, as well as any investment adviser, fund administrator, underwriter, or affiliated person of such entities with respect to such underlying investments. The MSRB agrees, and revised the proposed rule language to reflect this change, with minor adjustments to more fully conform to municipal fund securities and other primary offerings of municipal securities.

Applicability of basic gift limitation to municipal fund securities. ICI suggested that the MSRB limit the provisions that would be applicable to municipal fund securities to those set forth in draft subsection (d) of Rule G-20. ICI noted that the draft amendments would result in there being two provisions governing "de minimis" gifts, and two provisions governing gifts of meals or tickets. ICI stated that this is unnecessary and will create confusion. It recommended that subsections (a) and (b) be revised to exclude the offer and sale of municipal fund securities, and that such offers and sales be subject solely to subsection (d). The MSRB does not agree with this suggestion; the two provisions are intended to apply in different contexts. Rule G-20(a) applies to gifts and gratuities in relation to the municipal securities activities of the employer of the recipient.

Rule G-20(d) applies to non-cash compensation in connection with the sale and distribution of a primary offering of municipal securities. The MSRB believes that both provisions are important and both should apply to municipal fund securities as well as to other primary offerings of municipal securities. The MSRB observes that dealers selling mutual fund shares also are currently subject to both NASD Rule 3060 and NASD Rule 2830(l)(5).

Records of de minimis gifts. ICI recommended that the MSRB revise the draft recordkeeping requirement in Rule G-8 regarding non-cash compensation to conform to NASD Rule 2830, on investment company securities. ICI stated that the NASD rule does not require dealers to keep records of de minimis gifts (i.e., those under \$100 per year) or occasional meals or tickets to theatrical and sporting events. ICI suggested that the MSRB similarly exclude these items from the recordkeeping requirements of Rule G-8 “based on the conclusion that these de minimis items do not raise regulatory concerns and, therefore, the burden of making and keeping such records would exceed any benefits of requiring them.” ICI further noted that this revision would provide uniformity between MSRB and NASD recordkeeping requirements. The MSRB does not agree with this recommendation. The provisions in NASD Rule 3060, on influencing or rewarding employees of others, require firms to keep a separate record of all payments or gratuities in any amount. The MSRB believes that a recordkeeping requirement for de minimis gifts is necessary for both the dealer and the appropriate regulatory agency to determine whether a rule violation has occurred.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

Within 35 days of the date of publication of this notice in the Federal Register or

within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or

(ii) as to which the self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2005-02 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-MSRB-2005-02. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site

<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only

information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2005-02 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).