

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52278, File No. SR-MSRB-2005-04)

August 17, 2005

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to the Proposed Rule Change Relating to Solicitation of Municipal Securities Business under MSRB Rule G-38

I. Introduction

On March 22, 2005, the Municipal Securities Rulemaking Board (“MSRB” or “Board”), filed with the Securities and Exchange Commission (“SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change deleting existing Rule G-38, on consultants, and replacing it with new Rule G-38, on solicitation of municipal securities business. In addition, the proposed rule change would make related amendments to Rule G-37, on political contributions and prohibitions on municipal securities business, Rule G-8, on recordkeeping, Form G-37/G-38 and Form G-37x, as well as add new Form G-38t. The proposed rule change was published for comment in the Federal Register on April 21, 2005.³ The Commission received four comment letters regarding the proposal.⁴ On August 9, 2005, the MSRB filed Amendment No. 1 to the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 51561 (April 15, 2005), 70 FR 20782 (April 21, 2005).

⁴ See letter from Rick Santorum, Senator, United States Senate, to William H. Donaldson, Chairman, Commission, dated March 31, 2005 (“Senator Santorum’s Letter”); letter from Chris Charles, President, Wulff, Hansen & Co. (“Wulff, Hansen”), to Jonathan G. Katz, Secretary, Commission, dated May 6, 2005

proposed rule change and a response to the four comment letters.⁵ This order approves the proposed rule change, accelerates approval of Amendment No. 1, and solicits comments from interested persons on Amendment No. 1.

II. Description of the Proposal

The proposal would delete existing Rule G-38, on consultants, and replace it with new Rule G-38, on solicitation of municipal securities business. The MSRB believes that it would be appropriate to apply the basic standards of fair practice and professionalism embodied in MSRB rules to all persons who solicit municipal securities business on behalf of dealers. A full description of the proposal is contained in the Commission's Notice.⁶

In Amendment No. 1, the MSRB provides that the proposed rule change would become effective on the first business Monday at least five business days after Commission approval. Amendment No. 1 also deletes the requirement in proposed Rule G-38(c) relating to transitional payments that the broker, dealer or municipal securities dealer ("dealer") must be selected by the issuer for municipal securities business on or prior to the effective date of the proposed rule change while adding a requirement that dealers include on their initial and all subsequent Form G-38t submissions each item of municipal securities business for which a transitional payment remains pending and the

("Wulff, Hansen's Letter"); letter from Lynnette Kelly Hotchkiss, Senior Vice President and Associate General Counsel, The Bond Market Association (the "BMA"), to Jonathan G. Katz, Secretary, Commission, dated May 5, 2005 ("BMA's Letter"); and letter from Jonathan Stein, Director of Regulatory Affairs – Fixed Income, Raymond James & Associates, Inc. ("Raymond James"), to Jonathan G. Katz, Secretary, Commission, dated May 24, 2005 ("Raymond James' Letter).

⁵ Amendment No. 1 is described in Section II, infra.

⁶ See supra note 3.

amount of such pending payment for each item of business. Amendment No. 1 also modifies Form G-38t to reflect the required reporting of pending payments. Finally, Amendment No. 1 modifies the definition of “affiliated person” and adds a definition of “registered person” so that affiliated persons would include independent brokers who are duly qualified registered persons of a dealer under MSRB or NASD professional qualification requirements. The text of Amendment No. 1 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.

III. Discussion

As previously noted, the Commission received four comment letters on the proposed rule change.⁷ Senator Santorum’s Letter opposed changing Rule G-38. Senator Santorum stated that he had been informed that consultants serve a legitimate and important role in the industry by permitting broker-dealers that do not have the resources to maintain an office in a particular jurisdiction to bid for municipal securities business in that jurisdiction. The MSRB stated in its proposal,⁸ and the Commission agrees, that the benefits to the municipal securities market resulting from the proposed rule change outweigh the benefits that would accrue to permitting consultants to continue soliciting municipal securities business on behalf of dealers.

Wulff Hansen’s Letter supported the proposed rule change, stating that “we believe that the social and economic costs of the present system (in the form of overt pay-

⁷ See supra, note 4.

⁸ See supra, note 3, at 20785.

to-play, more subtle forms of influence peddling, or similar undesirable practices) have come to outweigh the benefits.”⁹

The BMA’s Letter requested modification of the requirements for making transition payments to consultants and clarification of the definitions of “solicitation” and “affiliated employees.” The proposed rule change provided that a dealer could pay an outside consultant after the effective date of the amendment (the date that the Commission approved the amendment) only if, among other requirements, such payment was made with respect solely to solicitation activities undertaken on or prior to the effective date pursuant to a Consultant Agreement under former Rule G-38 and the dealer had been selected by the issuer to engage in such municipal securities business on or prior to the effective date. The BMA’s Letter stated that as a practical matter, dealers will have no meaningful notice as to when the Commission will approve the amendment and thus will not have an opportunity to effectively close out their relationship with consultants. For example, the BMA’s Letter stated that a dealer would be prohibited from paying consultants compensation, which they had legitimately earned, and be forced to renege on its contractual obligations simply because the dealer had not yet been selected for the deal. In addition, the BMA’s Letter stated that other problems arise in those instances where a broker-dealer is part of a pool of selected underwriters and rotated to a senior manager position periodically or in instances where consultants are paid on a retainer basis (as opposed to a success fee arrangement) where they earn their compensation regardless of whether the broker-dealer is selected and moneys may still be contractually due for time worked but not paid as of the effective date.

⁹ See supra, note 4, at 1.

The MSRB believes, and the Commission agrees, that Amendment No. 1, including the new effective date and modified transitional payment provisions, as well as the modification to Form G-38t, addresses the BMA's concerns about transition payments and will facilitate dealer compliance with revised Rule G-38 in an orderly and timely manner while reducing the opportunity for circumvention of the purposes of the proposed rule change. The MSRB further believes, and the Commission agrees, that as modified, the transitional payment provision should avoid the potential for exposing dealers to legal liability under their contracts with consultants for failure to pay for services rendered.

The BMA's Letter also stated that the definition of "solicitation" should be clarified. The MSRB has filed with the Commission a proposed interpretation providing such further clarification.¹⁰

The BMA's Letter also requested clarification of the definition of affiliated employees, stating that the amendment prohibited a broker-dealer from paying anyone other than an "employee" of the broker-dealer or an affiliate for soliciting municipal securities business. The BMA's Letter stated that there are registered representatives who work for a dealer or an affiliate but do so as independent contractors, not as employees. The BMA's letter noted that as NASD licensed representatives of the dealer these independent contractors are also subject to the full array of MSRB rules. The BMA's Letter requested that the proposal be modified to permit a dealer to pay any licensed representative of that dealer or an affiliate to solicit municipal securities business.

¹⁰ File No. SR-MSRB-2005-11.

Raymond, James' Letter stated that Raymond James participated in BMA's Letter and fully supported that letter. Raymond, James' Letter also expressed concern that the proposed rule change did not recognize the important role that independent contractor financial advisors play in the market today, and stated that the definition of "affiliated person" should be expanded to include independent contractor registered representatives, by including NASD licensed representatives within the definition.

The MSRB believes, and the Commission agrees, that the modified definition of "affiliated person" in Amendment No. 1 will address this concern and will further minimize the potential burden on competition of the proposed rule change in that it would treat dealer business models using independent brokers equally with dealer business models using directly employed brokers without reducing the effectiveness of the proposed rule change.

After careful consideration, the Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB¹¹ and, in particular, the requirements of Section 15B(b)(2)(C) of the Act and the rules and regulations thereunder.¹² Section 15B(b)(2)(C) of the Act requires, among other things, that the MSRB's rules 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,

¹¹ In approving this rule the Commission notes that it has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78o-4(b)(2)(C).

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.¹³ In particular, the Commission finds that the proposed rule change will further investor protection and the public interest by ensuring that solicitations of municipal securities business are undertaken in a manner consistent with standards of fair practice and professionalism, thereby helping to maintain public trust and confidence in the integrity of the municipal securities market.

IV. Accelerated Approval of Amendment No. 1

The MSRB requested in Amendment No. 1 that the Commission find good cause, pursuant to Section 19(b)(2) of the Act, for approving Amendment No. 1 (simultaneously with the proposed rule change) prior to the thirtieth day after publication of the notice of filing of Amendment No. 1 in the Federal Register. The Commission finds good cause to approve Amendment No. 1 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. The MSRB believes, and the Commission agrees, that (i) the new effective date and modified transitional payment provisions, as well as the modification to Form G-38t, will facilitate dealer compliance with revised Rule G-38 in an orderly and timely manner while reducing the opportunity for circumvention of the purposes of the proposed rule change, and (ii) the modified definition of “affiliated person” would further minimize the potential burden on competition of the proposed rule change in that it would treat dealer business models using independent brokers equally with dealer business models using directly employed brokers without reducing the effectiveness of the proposed rule change.

¹³ Id.

For these reasons, the Commission finds good cause, consistent with Sections 15B(b)(2)(C) and 19(b)(2) of the Act, to accelerate approval of Amendment No. 1 to the proposed rule change.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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-2005-04 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-2005-04. 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 MSRB's offices. 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-2005-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-MSRB-2005-04) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).