(''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on July 17, 2000, the Chicago Stock Exchange, Incorporated (''CHX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange has designated this proposal as one establishing or changing a due, fee, or other charge imposed by the CHX under Section 19(b)(3)(A)(ii) of the Act,[3] which renders the proposal effective upon filing with the Commission. 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 Exchange proposes to amend its membership dues and fees schedule (the ''Schedule'') to reflect a new registration fee and annual fee for certain associated persons of member firms for which the CHX acts as the designated examining authority. The text of the proposed rule change is available upon request at the CHX or 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 Exchange 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 Exchange 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

The proposed rule change amends the Schedule to establish a $500 per person registration fee and a $500 per person annual fee for certain associated persons of member firms for which the CHX acts as the designated examining authority (''DEA''). Specifically, these fees would apply to those persons who are acting as off-floor proprietary securities traders for CHX member firms for which the CHX acts as the DEA.

These fees reflect the increased costs of administration and oversight involved in preparing and processing necessary Series 7[4] registration sponsor forms for these off-floor traders; inputting and maintaining traders' employment, examination and disciplinary histories; tracking adherence to applicable Series 7 continuing education requirements; and conducting on-site examinations of firms that employ these off-floor traders. The new registration fee is designed to apply to all registration sponsor forms received on or after August 1, 2000. The new annual fee will be charged as of January 1, 2001.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(4) of the Act[5] in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were solicited or received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act[6] and subparagraph (f)(2) of Rule 19b–4 thereunder,[7] because it involves a due, fee, or other charge. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. 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 will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to file number SR–CHX–00–23, and should be submitted by August 23, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00–19502 Filed 8–1–00; 8:45 am]

**BILLING CODE 8010–01–M**

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] U.S.C. 78s(b)(3)(A)(ii).

[4] CHX Rules require persons acting as off-floor proprietary securities traders for CHX member firms for which the CHX acts as DEA to successfully complete the Uniform Registered Representative Exam, Series 7, and to meet certain continuing education requirements. *See* Article VI, Rule 3, Interpretation .02; Article VI, Rule 9. The Series 7 examination is designed to ensure that registered representatives, such as CHX off-floor proprietary securities traders, understand the legal requirements applicable to their activities. *See* July 20, 2000 letter from Ellen J. Neely, Vice President and General Counsel, CHX, to Nancy J. Sanow, Assistant director, Division of Market Regulation, SEC.

[5] 15 U.S.C. 78f(b)(4).

[6] 15 U.S.C. 78s(b)((3)(A)(ii).

[7] 17 CFR 240.19b–4(f)(2).

[8] 17 CFR 200.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–43066; File No. SR–MSRB–00–06]**

## Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Municipal Fund Securities

July 21, 2000.

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 April 5, 2000, the Municipal Securities Rulemaking Board (''MSRB'' or ''Board'') filed with the Securities and Exchange Commission (''Commission''

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

or ''SEC'') the proposed rule change described in Items I, II, and III below, which Items have been prepared by the Board. The Board submitted an amendments to the proposed rule change on July 17, 2000.[3] 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 Board has filed with the Commission a proposed rule change consisting of (i) proposed new Rule D–12, defining municipal fund security; (ii) amendments to Rule A–13, on underwriting and transaction assessments for brokers, dealers and municipal securities dealers, Rule G–3, on classification of principals and representatives, numerical requirements, testing and continuing education requirements, Rule G–8, on books and records to be made by brokers, dealers and municipal securities dealers, Rule G–14, on reports of sales or purchases, Rule G–15, on confirmation, clearance and settlement of transactions with customers, Rule G–26, on customer account transfers, Rule G–32, on disclosures in connection with new issues, and Rule G–34, on CUSIP numbers and new issue requirements; and (iii) a Board interpretation on sales or municipal fund securities in the primary market. The text of the proposed rule change is set forth below. Additions were italicized; deletions are bracketed.

***Rule D–12.''Municipal Fund Security''***

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

**Rule A–13. Underwriting and Transaction Assessments for Brokers, Dealers and Municipal Securities Dealers**

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

(i)–(ii) No change.

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

(iv) have authorized denominations of $100,000 or more and are sold to more than thirty-five persons each of whom the broker, dealer or municipal securities dealer reasonably believes: (A) Has the knowledge and experience necessary to evaluate the merits and risks of the investment; and (B) is not purchasing for more than one account, with a view toward distributing the securities*; or*

*(v) constitute municipal fund securities.*

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

(b)-(f) No change.

**Rule G–3. Classification of Principals and Representatives; Numerical Requirements; Testing; Continuing Education Requirements**

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

(a) Municipal Securities Representative.

(i) No change.

(ii) Qualification Requirements.

(A)–(B) No change.

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

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

(iii) Apprenticeship.

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

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

(b)-(h) No change.

[3] The Board submitted a new Form 19b–4, which supplements, the original filing. (''Amendment No. 1''). Specifically, Amendment No. 1 amends Rule G–8(g)(i) to clarify that the Commission does not approve a firm's arrangement with a transfer agent regarding books and records. In addition, Amendment No. 1 makes certain technical corrections to the proposed rule change.

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

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

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

(ii)–(viii) No change.

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

(x) 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)–(G) No change.

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

(I)–(K) No change.

For purposes of this subparagraph, the terms ''general securities representative,'' [and] ''general securities principal'' *and ''limited representative—investment company and variable contracts products''* shall mean such persons as so defined by the rules of a national securities exchange or registered securities association. For purposes of this subparagraph, the term ''institutional account'' shall mean the account of (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered either with the Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million. Anything on this subparagraph to the contrary notwithstanding, every broker, dealer and municipal securities dealer shall maintain a record of the information required by items (A), (C), (F), (H), (I) and (K) of this subparagraph with respect to each customer which is an institutional account.

(xii)–(xix) No change.

(b)–(f) No change.

*(g) Transactions in Municipal Fund Securities.*

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

*(ii) Price Substituted for Par Value of Municipal Fund Securities. For purposes of this rule, each reference to the term ''par value,'' when applied to a municipal fund security, shall be substituted with (A) in the case of a purchase of a municipal fund security by a customer, the purchase price paid by the customer, exclusive of any commission, and (B) in the case of a sale or tender for redemption of a municipal fund security by a customer, the sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.*

**Rule G–14. Reports of Sales or Purchases**

(a) No change.

(b) Transactions Reporting Requirements.

(i) Each broker, dealer or municipal securities dealer shall report to the Board or its designee information about its transactions in municipal securities *to the extent required by, and* using the formats and within the timeframes specified in, Rule G–14 Transaction Reporting Procedures. Transaction information collected by the Board under this rule will be used to make public reports of market activity and prices and to assess transaction fees. The transaction information will be made available by the Board to the Commission, securities associations registered under Section 15A of the Act and other appropriate regulatory agencies defined in Section 3(a)(34)(A) of the Act to assist in the inspection for compliance with and the enforcement of Board rules.

(ii)–(iii) No change.

**Rule G–14 Transaction Reporting Procedures**

(a) No change.

(b) Customer Transactions.

(i)–(ii) No change.

(iii) *The following transactions shall not be required to be reported under this section (b):*

(A) [A] *a* transaction in a *municipal* security that is ineligible for assignment of a CUSIP number by the Board or its designeee; *and* [shall not be required to be reported under this section (b).]

*(B) a transaction in a municipal fund security.*

(iv) No change.

**Rule G–15. Confirmation, Clearance and Settlement of Transactions With Customers**

(a) Customer Confirmations.

(i) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation that complies with the requirements of this paragraph (i):

(A) Transaction information. The confirmation shall include information regarding the terms of the transaction as set forth in this subparagraph (A):

(1)–(2) No change.

(3) Par value. The par value of the securities shall be shown, with special requirements for the following securities:

(a) No change.

*(b) Municipal fund securities. For municipal fund securities, in place of par value, the confirmation shall show (i) in the case of a purchase of a municipal fund security by a customer, the total purchase price paid by the customer, exclusive of any commission, and (ii) in the case of a sale or tender for redemption of a municipal fund security by a customer, the total sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.*

(4) No change.

(5) Yield and dollar price. Yields and dollar prices shall be computed and shown in the following manner, subject to the exceptions stated in subparagraph (A)(5)(d) of this paragraph:

(a)–(c) No change.

(d) Notwithstanding the requirements noted in subparagraphs (A)(5)(a) through (c) of this paragraph[,] above:

(i)–(v) No change.

*(vi) Municipal fund securities. For municipal fund securities, neither yield nor dollar price shall be shown.*

(6) Final Monies. The following information relating to the calculation and display of final monies shall be shown:

(a) No change.

(b) amount of accured interest, with special requirements for the following securities:

(i)–(ii) No change.

*(iii) Municipal fund securities. For municipal fund securities, no figure for accrued interest shall be shown;*

(c) if the securities *pay interest on a current basis but* are traded without interest, a notation of ''flat;''

(d) extended principal amount, with special requirements for the following securities:

(i) No change.

*(ii) Municipal fund securities. For municipal fund securities, no extended principal amount shall be shown;*

(e)–(h) No change.

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

(a) Securities other than bonds *or municipal fund securites.* For securities other than bonds *or municipal fund securities*, denominations to be delivered;

(b) No change.

(c) *Municipal fund securities.* For municipal fund securites, the purchase price, exclusive of commission, of each share or unit and the number of shares or units to be delivered;

*(d)* Delivery instructions. Instructions, if available, regarding receipt or delivery of securities[,] and form of payment, if other than as usual and customary between the parties.

(8) No change.

(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) For stripped coupon securities, the trade name and series designation assigned to the stripped coupon municipal security by the *broker, dealer or municipal securities* dealer sponsoring the program *must be shown:*

*(b) Municipal fund securities. For municipal fund securities, the name used by the issuer to identify such securities and, to the extent necessary to differentiate the securities from other municipal fund securities of the issuer, any separate program series, portfolio or fund designation for such securities must be shown;*

(2) No change.

(3) Maturity date, *if any,* with special requirements for the following securities:

(a) No change.

*(b) Municipal fund securities. For municipal fund securities, no maturity date shall be shown;*

(4) Interest rate, *if any,* with special requirements for the following securities:

(a)–(e) No change.

*(f) Municipal fund securities. For municipal fund securities, no interest rate shall be shown;*

(5) No change.

(C) Securities descriptive information. The confirmation shall include description information about the securities which includes, at a minimum:

(1)–(4) No change.

(5) *Municipal fund securities. For municipal fund securities, the information described in clauses (1) through (4) of this subparagraph (C) is not required to be shown; provided, however, that if the municipal fund securities are puttable or otherwise redeemable by the customer, the confirmation shall include a designation to that effect.*

(D) Disclosure statements:

(1)–(2) No change.

*(3) The confirmation for securities for which a deferred commission or other charge is imposed upon redemption or as a condition for payment of principal or interest thereon shall include a statement that the customer may be required to make a payment of such deferred commission or other charge upon redemption of such securities or as a condition for payment of principal or interest thereon, as appropriate, and that information concerning such deferred commission or other charge will be furnished upon written request.*

(E) Confirmation format. All requirements must be clearly and specifically indicated on the front of the confirmation, except that the following statements may be on the reverse side of the confirmation:

(1) The disclosure statements required in subparagraph (D)(1), *(D)(2) or (D)(3)* [and (2)] of this paragraph, provided that their specific applicability is noted on the front of the confirmation.

(2)–(3) No change.

(ii)–(iii) No change.

(iv) Confirmation to customers who tender put option bonds *or municipal fund securities.* A broker, dealer, or municipal securities dealer that has an interest in put option bonds (including acting as remarketing agent) and accepts for tender put *option* bonds from a customer, *or that has an interest in municipal fund securities (including acting as agent for the issuer thereof) and accepts for redemption municipal fund securities tendered by a customer,* is engaging in a transaction in such municipal securities and shall send a confirmation under paragraph (i) of this section.

(v) No change.

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

(A)–(F) No change.

*(G) The term ''periodic municipal fund security plan'' shall mean any written authorization or arrangement for a broker, dealer or municipal securities dealer, acting as agent, to purchase, sell or redeem for a customer or group of customers one or more specific municipal fund securities, in specific amounts (calculated in security units or dollars), at specific time intervals and setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them).*

*(H) The term ''non-periodic municipal fund security program'' shall mean any written authorization or arrangement for a broker, dealer or municipal securities dealer, acting as agent, to purchase, sell or redeem for a customer or group of customers one or more specific municipal fund securities, setting forth the commissions or charges to be paid by the customer in connection therewith (or the manner of calculating them) and either (1) providing for the purchase, sale or redemption of such municipal fund securities at the direction of the customer or customers or (2) providing for the purchase, sale or redemption of such municipal fund securities at the direction of the customer or customers as well as authorizing purchase, sale or redemption of such municipal fund securities in specific amounts (calculated in security units or dollars) at specific time intervals.*

*(vii) Price substituted for par value of municipal fund securities. For purposes of this rule, each reference to the term ''par value,'' when applied to a municipal fund security, shall be substituted with (i) in the case of a purchase of a municipal fund security by a customer, the purchase price paid by the customer, exclusive of any commission, and (ii) in the case of a sale or tender for redemption of a municipal fund security by a customer, the sale price or redemption amount paid to the customer, exclusive of any commission or other charge imposed upon redemption or sale.*

*(viii) Alternative periodic reporting for certain transactions in municipal fund securities. Notwithstanding any other provision of this section (a), a broker, dealer or municipal securities dealer may effect transactions in municipal fund securities with customers without giving or sending to such customer the written confirmation required by paragraph (i) of this section (a) at or before completion of each such transaction if:*

*(A) such transactions are effected pursuant to a periodic municipal fund security plan or a non-periodic municipal fund security program; and*

*(B) such broker, dealer or municipal securities dealer gives or sends to such customer within five business days after the end of each quarterly period, in the case of a customer participating in a periodic municipal fund security plan, or each monthly period, in the case of a customer participating in a non-periodic municipal fund security program, a written statement disclosing, for each purchase, sale or redemption effected for or with, and each payment of investment earnings credited to or reinvested for, the account of such customer during the reporting period, the information required to be disclosed to customers pursuant to subparagraphs (A) through (D) if paragraph (i) of this section (a), with the information regarding each transaction clearly segregated; provided that it is permissible:*

*(1) for the name and address of the broker, dealer or municipal securities dealer and the customer to appear once at the beginning of the periodic statement; and*

*(2) for information required to be included pursuant to subparagraph (A)(1)(d), (A)(2)(a) (C)(5) or (D)(3) of paragraph (i) of this section (a) to:*

*(a) appear once in the periodic statement if such information is identical for all transactions disclosed in such statement; or*

*(b) be omitted from the periodic statement, but only if such information previously has been delivered to the customer in writing and the periodic statement includes a statement indicating that such information has been provided to the customer and identifying the document in which such information appears; and*

*(C) in the case of a periodic municipal fund security plan that consists of an arrangement involving a group of two or more customers and contemplating periodic purchases of municipal fund securities by each customer through a person designated by the group, such broker, dealer or municipal securities dealer:*

*(1) gives or sends to the designated person, at or before the completion of the transaction for the purchase of such municipal fund securities, a written notification of the receipt of the total amount paid by the group;*

*(2) sends to anyone in the group who was a customer in the prior quarter and on whose behalf payment has not been received in the current quarter a quarterly written statement reflecting that a payment was not received on such customer's behalf; and*

*(3) advises each customer in the group if a payment is not received from the designated person on behalf of the group within 10 days of a date certain specified in the arrangement for delivery of that payment by the designated person and either (a) thereafter sends to each customer the written confirmation described in paragraph (i) of this section (a) for the next three succeeding payments, or (b) includes in the quarterly statement referred to in subparagraph (B) of this paragraph (viii) each date certain specified in the arrangement for delivery of a payment by the designated person and each date on which a payment received from the designated person is applied to the purchase of municipal fund securities; and*

*(D) such customer is provided with prior notification in writing disclosing the intention to send the written information referred to in subparagraph (B) of this paragraph (vii) on a periodic basis in lieu of an immediate confirmation for each transaction; and*

*(E) such customer has consented in writing to receipt of the written information referred to in subparagraph (B) of this paragraph (viii) on a periodic basis in lieu of an immediate confirmation for each transaction; provided, however, that such customer consent shall not be required if:*

*(1) the customer is not a natural person;*

*(2) the customer is a natural person who participates in a periodic municipal fund security plan described in subparagraph (C) of this paragraph (viii); or*

*(3) the customer is a natural person who participates in a periodic municipal fund security plan (other than a plan described in subparagraph (C) of this paragraph (viii) or a non-periodic municipal fund security program and the issuer has consented in writing to the use by the broker, dealer or municipal securities dealer of the periodic written information referred to in subparagraph (B) of this paragraph (viii) in lieu of an immediate confirmation for each transaction with each customer participating in such plan or program.*

(b)–(e) No change.

**Rule G–26. Customer Account Transfers**

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

(i)–(ii) No change.

(iii) The term ''nontransferable asset'' means an asset that is incapable of being transferred from the carrying party to the receiving party because (*A*) it is an

issue in default for which the carrying party does not possess the proper denominations to effect delivery and no transfer agent is available to re-register the securities*, or (B) it is a municipal fund security which the issuer requires to be held in an account carried by one or more specified brokers, dealers or municipal securities dealers that does not include the receiving party.*

(b) No change.

(c) Transfer Instructions.

(i) No change.

(ii) If an account includes any nontransferable assets, the carrying party must request, in writing and prior to or at the time of validation of the transfer instruction, further instructions from the customer with respect to the disposition of such assets. Such request shall provide the customer with the following alternative methods of disposition of nontransferable assets, if applicable.

(A) No change.

(B) retention by the carrying party for the customer's benefit; *or*

*(C) in the case of a nontransferable asset described in section (a)(iii)(B), transfer to another broker, dealer or municipal securities dealer, if any, which the issuer has specified as being permitted to carry such asset.*

(d)–(i) No change.

**Rule G–32. Disclosures in Connection With New Issues**

(a) *Customer* Disclosure Requirements. No broker, dealer or municipal securities dealer shall sell, whether as principal or agent, any new issue municipal securities to a customer unless such broker, dealer or municipal securities dealer delivers to the customer no later than the settlement of the transaction:

(i) a copy of the official statement in final form prepared by or on behalf of the issuer or, if an official statement in final form is not being prepared by or on behalf of the issuer, a written notice to that effect together with a copy of an official statement in preliminary form, if any; provided, however, that:

*(A) if a customer who participates in a periodic municipal fund security plan or a non-periodic municipal fund security program has previously received a copy of the official statement in final form in connection with the purchase of municipal fund securities under such plan or program, a broker, dealer or municipal securities dealer may sell additional shares or units of the municipal fund securities under such plan or program to the customer if such broker, dealer or municipal securities dealer sends to the customer a copy of a new, supplemented, amended or ''stickered'' official statement in final form, by first class mail or other equally prompt means, promptly upon receipt thereof; provided that, if the broker, dealer or municipal securities dealer sends a supplement, amendment or sticker without including the remaining portions of the official statement in final form, such broker, dealer or municipal securities dealer includes a written statement describing which documents constitute the complete official statement in final form and stating that the complete official statement in final form is available upon request; or*

*(B)* if an official statement in final form is being prepared for new issue municipal securities issued in a primary offering that qualifies for the exemption set forth in paragraph (iii) of section (d)(1) of Securities Exchange Act Rule 15c2–12, a broker, dealer or municipal securities dealer.

*(A)–(B) Renumbered as (1)–(2).*

(ii) in connection with a negotiated sale of new issue municipal securities, the following information concerning the underwriting arrangements:

(A) the underwriting spread*, in any*;

(B) the amount of any fee received by the broker, dealer or municipal securities dealer as agent for the issuer in the distribution of the securities; *provided, however, that if a broker, dealer or municipal securities dealer selling municipal fund securities provides periodic statements to the customer pursuant to rule G–15(a)(viii) in lieu of individual transaction confirmations, this paragraph (ii)(B) shall be deemed to be satisfied if the broker, dealer or municipal securities dealer provides this information to the customer at least annually and provides information regarding any change in such fee on or prior to the sending of the next succeeding periodic statement to the customer; and*

*(C) except with respect to an issue of municipal fund securities,* the initial offering price for each maturity in the issue that is offered or to be offered in while or in part by the underwriters, including maturities that are not reoffered.

*(b) Inter-Dealer Disclosure Requirements.* Every broker, dealer or municipal securities dealer shall send, upon request, the documents and information referred to in [this] section (a) to any broker, dealer or municipal securities dealer to which it sells new issue municipal securities no later than the business day following the request or, if an official statement in final form is being prepared but has not been received from the issuer or its agent, no later than the business day following such receipt. Such items shall be sent by first class mail or other equally prompt means, unless the purchasing broker, dealer or municipal securities dealer arranges some other method of delivery and pays or agrees to pay for such delivery.

*(b)–(c) Relettered as (c)–(d).*

**Rule G–34. CUSIP Numbers and New Issue Requirements**

(a)–(b) No change.

(c) [CUSIP Number Eligibility] *Exemptions.* The provisions of this rule shall not apply to an issue of municipal securities (or for the purpose of section (b) any part of an outstanding maturity of an issue) which (*i*) does not meet the eligibility criteria for CUSIP number assignment *or (ii) consists entirely of municipal fund securities.*

* * * * *

*Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market*

*The Municipal Securities Rulemaking Board (''Board'') has learned that sales of certain interests in trust funds held by state or local governmental entities may be effected by or through brokers, dealers or municipal securities dealers (''dealers''). In particular, the Board has reviewed two types of state or local governmental programs in which dealers may effect transactions in such interests: pooled investment funds under trusts established by state or local governmental entities (''local government pools'')*[4] *and higher education savings plan trusts established by states (''higher education trusts'').*[5] *In response to a request of the Board, staff of the Division of Market*

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

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

*Regulation of the Securities and Exchange Commission (''SEC'') has stated that ''at least some interests in local government pools and higher education trusts may be, depending on the facts and circumstances, 'municipal securities' for purposes of the [Securities] Exchange Act of 1934].''*[6] *Any such interests that may, in fact, constitute municipal securities are referred to herein as ''municipal fund securities.'' To the extent that dealers effect transactions in municipal fund securities, such transactions are subject to the jurisdiction of the Board pursuant to Section 15B of the Securities Exchange Act of 1934 (''Exchange act'').*

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

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

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

*Consistent with SEC staff's view regarding the sale in primary offerings of municipal fund securities, dealers acting as underwriters in primary offerings of municipal fund securities generally would be subject to the requirements of rule G–36, on delivery of official statements, advance refunding documents and Forms G–36(OS) and G–36(ARD) to Board or its designee. Thus, unless such primary offering falls within one of the stated exemptions in Rule 15c2–12, the Board expects that the dealer would receive a final official statement from the issuer or its agent under its contractual agreement entered into pursuant to Rule 15c2–12(b)(3).*[9] *Such final official statement should be received from the issuer in sufficient time for the dealer to send it, together with Form G–36(OS), to the Board within one business day of receipt but no later than 10 business days after any final agreement to purchase, offer, or sell the municipal fund securities, as required under rule G–36(b)(i).*[10] *''Final official statement,'' as used in rule G–36(b)(i), has the same meaning as in Rule 15c2–12(f)(3), which states, in relevant part:*

*The term official statement means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section.*[11]

*The Board understands that issuers of municipal fund securities typically issue and deliver the securities continuously as customers make purchases, rather than issuing and delivering a single issue on a specified date. As used in Board rules, the term ''underwriting period'' with respect to an offering involving a single dealer (i.e., not involving an underwriting syndicate) is defined as the period (A) commencing with the first submission to the dealer of an order for the purchase of the securities or the purchase of the securities from the issuer, whichever first occurs, and (B) ending at such time as the following two conditions both are met: (1) The issuer delivers the securities to the dealer, and (2) the dealer no longer retains an unsold balance of the securities purchased from the issuer or 21 calendar days elapse after the date of the first submission of an order for the securities, whichever first occurs.*[12] *Since an offering consisting of securities issued and delivered on a continuous basis would not, by its very nature, ever meet the first condition for the termination of the underwriting period, such offering would continuously remain in its underwriting period.*[13] *Further, since rule G–36(d) requires a dealer that has previously provided an official statement to the Board to send any amendments to the official statement made by the issuer during the underwriting period, such dealer would remain obligated to send to the Board any amendments made to the official statement during such continuous underwriting period. However, in view of the increased possibility that an issuer may change the dealer that participates in the sale of its securities during such a continuous underwriting period, the Board has determine that rule G–36(d) would require that the dealer that is at the time of an amendment then serving as underwriter for securities that are still in the underwriting period send the amendment to the Board, regardless of*

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

[7] *Id.*

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

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

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

[11] *Dealers seeking guidance as to whether a particular document or set of documents constitutes a final official statement for purposes of Rule G–36(b)(i) may wish to consult with SEC staff to determine whether such document or set of documents constitutes a final official statement for purposes of Rule 15c2–12.*

[12] *See rule G–32(c)(ii)(B). If approved by the SEC, the proposed rule change will redesignate this section as Rule G–32(d)(ii)(B).*

[13] *Similarly, an offering involving an underwriting syndicate and consisting of securities issued and delivered on a continuous basis also would remain in its underwriting period under the definition thereof set forth in Rule G–11(a)(ix).*

*whether that dealer or another dealer sent the original official statement to the Board.*

*In addition, municipal fund securities sold in a primary offering would constitute new issue municipal securities for purposes of rule G–32, on disclosures in connection with new issues, so long as the securities remain in their underwriting period. Rule G–32 generally requires that a dealer selling a new issue municipal security to a customer must deliver the official statement in final form to the customer by settlement of such transaction. Thus, a dealer effecting transactions in municipal fund securities that are sold during a continuous underwriting period would be required to deliver to the customer the official statement by settlement of each such transaction. However, in the case of a customer purchasing such securities who is a repeat purchaser, no new delivery of the official statement would be required so long as the customer has previously received it in connection with a prior purchase and the official statement has not been changed from the one previously delivered to that customer.*[14]

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

## 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 Board 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 texts of these statements may be examined at the places specified in Item IV below. The Board 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

Dealers that effect transactions in municipal securities are subject to the Board's jurisdiction pursuant to Section 15B of the Act.[15] In particular, Section 15B(c)(1)[16] prohibits dealers from effecting transactions in, or inducing or attempting to induce the purchase or sale of, a municipal security in contravention of any Board rule. Thus, since the enactment of Section 15B and the creation of the Board in the Securities Acts Amendments of 1975 (''Securities Acts Amendments''),[17] a transaction effected by a dealer in a municipal security must be effected in conformity with Board rules.

The Board has learned that sales of certain interests in trust funds held by state or local governmental entities may be effected by or through dealers. In particular, the Board has reviewed two types of state or local governmental programs in which dealers may effect transactions in such interests: local government pools and higher education trusts.[18] In response to a request of the Board, staff of the SEC's Division of Market Regulation has stated that ''at least some interests in local government pools and higher education trusts may be, depending on the facts and circumstances, 'municipal securities' for purposes of the Act.''[19] Any such interests that may, in fact, constitute municipal securities are referred to herein as ''municipal fund securities.'' To the extent that dealers effect transactions in municipal fund securities, such transactions would be subject to the jurisdiction of the Board pursuant to Section 15B of the Act.[20]

Board rules do not apply to any interest in a local government pool or a higher education trust that is not a municipal security. In addition, Board rules apply only to activities of dealers that effect municipal securities transactions. Thus, Board rules do not apply to an issuer of, or a non-dealer entity providing advice to issuers on, municipal securities, including municipal fund securities. However, to the extent that interests in a local government pool or a higher education trust are municipal securities and dealers are effecting transactions in them, Board rules automatically govern such dealer transactions, without the necessity of further Board rulemaking.[21] On several previous occasions, the Board has alerted the industry to the applicability of Board rules to (and has adopted rule changes to accommodate) transactions in new forms of municipal securities or pre-existing forms of securities that many in the industry had not previously recognized as municipal securities.[22]

A municipal fund security is defined in proposed Rule D–12 as a municipal security issued by an issuer that, but for Section 2(b) of the Investment Company Act of 1940 (''Investment Company Act''),[23] would constitute an investment

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

[15] 15 U.S.C. 78*o*–4.

[16] 15 U.S.C. 78*o*–4(c)(1).

[17] Pub. L. 94–29, 89 Stat. 97 (1975).

[18] *See supra* notes 4 and 5.

[19] SEC Letter, *see supra* note 5.

[20] 15 U.S.C. 78*o*–4.

[21] Dealers also should consider the current applicability of Rule 15c2–12 under the Act. *See supra* note 7 and accompanying text. Questions regarding Rule 15c2–12 should be directed to SEC staff. In addition, dealers should distinguish sales of municipal fund securities from sales of securities to, and purchases of securities from, the trust fund underlying such municipal fund securities. The Board believes that the municipal securities industry has been well aware of the applicability of Board rules to dealer transactions that involve the sale or purchase of municipal securities to or from higher education trusts or local government pools.

[22] *See* ''Transactions in Municipal Collateralized Mortgage Obligations: Rule G–15,'' *MSRB Reports*, Vol. 12, No. 1 (April 1992) at 21; ''Stripped Coupon Municipal Securities,'' *MSRB Reports*, Vol. 9, No. 1 (March 1989) at 3; ''Taxable Securities,'' *MSRB Reports*, Vol. 6, No. 5 (Oct. 1986) at 5; ''Tender Option Programs: SEC Response to Board Letter,'' *MSRB Reports*, Vol. 5, No. 2 (Feb. 1985) at 3; ''Tax-Exempt Notes: Notice Concerning Application of Board Rules to Such Notes and of Filing of Rule Change,'' *MSRB Reports*, Vol. 2, No. 7 (Oct./Nov. 1982) at 17; ''Application of Board's Rules to Municipal Commercial Paper,'' *MSRB Reports*, Vol. 2, No. 1 (Jan. 1982) at 9 (''CP Notice''); ''Application of Board's Rules to Participation Interests in Municipal Tax-Exempt Financing Arrangements,'' *MSRB Reports*, Vol. 2, No. 1 (Jan. 1982) at 13; ''Notice Concerning Application of Board's Rules to MAC Warrants,'' [1977–1987 Transfer Binder] *MSRB Manual* (CCH) ¶ 10,171 (Jan. 22, 1981) (''MAC Warrant Notice'').

[23] 15 U.S.C. 80a–2(b). Section 2(b) provides that the Investment Company Act shall not apply to a state, or any political subdivision of a state, or any agency, authority, or instrumentality thereof.

company under the Investment Company Act. Thus, Board rules on municipal fund securities would apply to interests in state or local governmental trusts, such as local government pools and higher education trusts, only if the following three conditions are met:

1. A dealer is engaging in transactions in such interests;

2. Such interests, in fact, constitute municipal securities; and

3. Such interests are issued by an issuer that, but for the exemption under Section 2(b) of the Investment Company Act, would be considered an investment company within the meaning of that Act.

The Board understands the municipal fund securities may not have features typically associated with more traditional municipal securities. Instead, their features are similar to those of investment company securities.[24] Although Board rules generally have been drafted to accommodate the characteristics of debt securities, the Board believes that most current rules can appropriately be applied to municipal fund securities. Nonetheless, the Board feels that certain rules should be amended to recognize the unique characteristics of municipal fund securities. The proposed rule change does not seek to extend the reach of Board rules, because the rules already apply to municipal fund securities, but seeks to tailor certain Board rules to accommodate the nature of municipal fund securities.

**Description of Proposed Rule Change**

The proposed rule change defines a municipal fund security to include any interest in a local government pool or a higher education trust as they have been described to the Board, to the extent such interests are municipal securities. As a general matter, the proposed rule change has been drafted with the view that municipal fund securities should be treated differently from other municipal securities only under circumstances where current rules would not apply properly. In addition, the Board has not attempted to draft any proposed rule changes intended to address secondary market transactions in municipal fund securities because the Board understands that no such market now exists. The Board would undertake appropriate action should a secondary market develop in municipal fund securities.

*Proposed Rule D–12—Definition of Municipal Fund Security.* Proposed Rule D–12 defines municipal fund security as a municipal security that would qualify as a security of an investment company under the Investment Company Act if it had not been issued by a state or local governmental entity.[25] Before a security can be considered a municipal fund security, it must first be considered to be a municipal security. If an investment is deemed a municipal fund security, then dealer transactions are subject to all Board rules because of its status as a municipal security. Municipal securities, however, would receive special treatment in those instances where provisions are proposed to be added to relate specifically to municipal fund securities.[26]

*Rule A–13—Assessments.* Proposed Rule A–13 exempts the sale of municipal fund securities from the underwriting assessment imposed under section (b) thereof because the fee structure for dealers involved in the distribution of municipal fund securities is more like an administrative fee than an underwriting discount or commission given that these dealers do not undertake underwriting risks. As a result, fees generally are fixed and are low relative to traditional underwriting fees and the level of fees generated by the Board from underwriting assessments would be disproportionate to the resulting regulatory costs.

*Rule G–3—Professional Qualifications.* Proposed Rule G–3 permits an associated person qualified as an investment company limited representative to effect transactions in municipal fund securities (but not in other municipal securities).[27] However, a dealer must continue to have one or two municipal securities principals as required under existing section (b) of Rule G–3, even if the dealer's only municipal securities transactions are sales of municipal fund securities.

*Rule G–8—Recordkeeping.* Proposed Rule G–8 ensures consistency with proposed Rules G–3 and G–15. Thus, amended Rule G–8 would recognize that municipal fund securities do not have par values, dollar prices, yields and accrued interest and that investment company limited representatives may be permitted to effect transactions in municipal fund securities. In addition, proposed Rule G–8 requires dealers to retain copies of all periodic statements delivered to customers in lieu of individual confirmations with respect to transactions in municipal fund securities under proposed Rule G–15. Furthermore, proposed Rule G–8 would permit a dealer effecting transactions in municipal fund securities to meet its books and records requirements by having a transfer agent maintain books and records for such municipal fund securities so long as the books and records of the transfer agent meet the requirements of proposed Rule G–8 as proposed to be amended and the dealer remains responsible for the accurate maintenance and preservation of the books and records.

*Rule G–14—Transaction Reporting.* Proposed Rule G–14(b)(i) clarifies that certain types of municipal securities transactions may be excluded from transaction reporting as provided in the Rule G–14 Transaction Reporting Procedures. The Board is proposing to amend the Transaction Reporting Procedures to expressly exempt any transaction in municipal fund securities from the customer transaction reporting system. A number of factors unique to municipal fund securities have contributed to the Board's determination to exempt such securities from proposed Rule G–14 at this time. In particular, municipal fund securities do not trade in the secondary market. Thus, for example, unlike the bulk of data currently received by the Board through the system, any data obtained regarding transactions in municipal fund securities would be limited to one-time sales to customers upon initial issuance and one-time purchases (or redemptions) from customers upon cashing out. Municipal fund securities are sold by dealers on an agency basis generally without payment of commissions by customers; therefore, dealers effecting transactions in municipal fund securities would have little opportunity to alter the pricing on such securities from that set the issuer.

[24] Municipal fund securities generally provide investment return and are valued based on the investment performance of an underlying pool of assets having an aggregate value that may increase or decrease from day to day, rather than providing interest payments at a stated rate or discount, as is the case for more traditional municipal securities. In addition, unlike traditional municipal securities, these interests do not have stated par values or maturity dates and cannot be priced based on yield or dollar price. *See generally* NAST Report; S&P Report; and CSPN Report, *supra* notes 3 and 4.

[25] This should be distinguished from shares in a mutual fund registered under the Investment Company Act with assets invested in municipal securities, which shares would not constitute municipal fund securities.

[26] The definition of municipal fund security is not strictly limited to interests in local government pools or higher education trusts that are municipal securities but would apply as well to any other municipal security issued under a program that would, but for the identity of the issuer as a state or local governmental entity, constitute an investment company under the Investment Company Act.

[27] Thus, an associated person who sells both municipal fund securities and other types of municipal securities must continue to qualify as either a municipal securities representative or a general securities representative.

Furthermore, certain critical data elements that the transaction reporting system currently collects (*e.g.,* dollar price, yield, etc.) would not apply to transactions in municipal fund securities. Nonetheless, should the Board in the future receive information that practices have developed in the municipal fund security market that merit reporting of transaction information, the Board would consider whether to revisit the exemption from Rule G–14.

*Rule G–15—Customer Confirmations.* Various amendments are being proposed to Rule G–15 relating to the concepts of par value, yield, dollar price, maturity date and interest, none of which apply to a municipal fund security. Thus, as proposed, a dealer is required to use the purchase of sale price of the securities, as appropriate, on a confirmation of a municipal fund securities transaction, rather than par value and would be able to omit yield, dollar price, accrued interest, extended principal, maturity date and interest rate. Dealers selling municipal fund securities are required to include the purchase price of each share or unit (rather than denomination) as well as the number of shares or units to be delivered. Confirmations of municipal fund securities transactions are required to include a disclosure that a deferred commission or other charge may be imposed upon redemption, if applicable.[28] The proposal also makes clear that dealers must confirm redemptions of municipal fund securities. A confirmation of a municipal fund security transaction need not show the information required under paragraph (a)(i)(C) other than whether the security is puttable. In addition, the confirmation must include the name used by the issuer to identify the security and, to the extent necessary to differentiate the security from other municipal fund securities of the issuer, any separate program series, portfolio or fund designation.

In addition, the amendment would permit dealers to use periodie statements, rather than transaction-by-transaction confirmations, if customers are purchasing such securities pursuant to certain periodic plans or non-periodic programs, in a manner similar to the periodic reporting provision under Rule 10b–10 under the Act.[29]

*Rule G–26—Customer Account Transfers.* The definition of ''nontransferable asset'' and the transfer instructions for nontransferable assets in proposed Rule G–26 are proposed to be amended to reflect the fact that the issuer of municipal fund securities may limit the dealers that are authorized to carry accounts for customers in such securities.

*Rule G–32—Disclosures in Connection with New Issues.* Proposed Rule G–32 permits a dealer to sell, pursuant to a periodic plan or a non-periodic program as defined in Rule G–15, as proposed to be amended, a municipal fund security to a customer who has previously received the official statement for the security so long as its sends to the customers a copy of any new, supplemented, amended or stickered official statement promptly upon receipt from the issuer (*i.e.,* actual delivery by settlement is not required). The dealer is permitted to satisfy this delivery requirement by delivering the amendment alone (including a notice that the complete official statement is available upon request) so long as the customer already had the official statement that is being amended and the dealer ensures that the amendment makes clear what constitutes the complete official statement. The proposed rule change also excepts municipal fund securities for which periodic statements in lieu of transaction confirmations are provided from the requirement that information on the underwriting fees paid to the dealer by the issuer be provided to customers by settlement so long as such information is disclosed at least annually and information on any fee changes paid by the issuer to the dealer is sent to customers simultaneously with or prior to the sending of the next periodic statement.

*Rule G–34—CUSIP Numbers and Depository Eligibility.* The proposal would exempt municipal fund securities from the requirements of Rule G–34 because no secondary market is expected to develop. [30]

*Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market.* Interpretive guidance is provided in connection with the application of Rules G–23, G–32, G–36, G–37 and G–38 to dealer transactions in municipal fund securities.

2. Statutory Basis

The Board believes the proposed rule change is consistent with Section 15B(b)(2)(C) [31] of the Act, which requires the Board's rules to 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. The Board believes that the proposed rule change is consistent with the Act because it amends existing Board rules to better accommodate the unique characteristics of municipal fund securities, thereby removing impediments to a free and open market in these securities and promoting the protection of investors and the public interest.

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

The Board does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act because it applies equally to all dealers effecting transactions in municipal fund securities.

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

On March 17, 1999, the Board published a notice (''March Notice'') requesting comments on draft rule changes relating to transactions effected by or through dealers in municipal fund securities.[32] The Board received twelve comment letters on the March Notice.[33]

[28] Disclosure of deferred commissions or other charges covers, for example, any deferred sales load or, in the case of interests in certain higher education trusts, any penalty imposed on a redemption that is not for a qualifying higher education expense.

[29] 17 CFR 240.10b–10.

[30] Dealers may still elect to acquire CUSIP numbers for municipal fund securities and to make such securities depository eligible, subject to meeting all of the eligibility requirements of the CUSIP Service Bureau and of any securities depository, respectively.

[31] 15 U.S.C. 78*o*-4(b)(2)(c).

[32] ''Municipal Fund Securities,'' *MSRB Reports,* Vol. 19, No. 2 (April 1999) at 9.

[33] Letters from Laura Bramson, Senior Counsel, Teachers Personal Investors Services, Inc. (''TPIS''), to the Board, dated May 13, 1999 (''First TPIS Letter'') and June 30, 1999 (''Second TPIS Letter''); letter from Barbara L. Hasson, President, Board of Trustees, Pennsylvania Local Government Investment Trust (''PLGIT''), to Ernesto A. Lanza, Associate General Counsel, Board, dated May 13, 1999 (''PLGIT Letter''); letter from Marty Margolis, Managing Director, Public Financial Management (''PFM''), to Ernesto A. Lanza, dated May 14, 1999 (''PFM Letter''); letter from Sarah M. Starkweather, Vice President and Associate General Counsel, The Bond Market Association (''TBMA''), to Ernesto A. Lanza, dated June 1, 1999 (''TBMA Letter''); letter from J. Todd Cook, Vice President and Senior Counsel, Merrill Lynch, Pierce, Fenner & Smith

Continued

After reviewing these comments, the Board re-circulated the draft rule changes, with certain modifications and additions, for further comment from industry participants in a notice published on August 27, 1999 (''August Notice'').[34] The Board received seven comment letters on the August Notice. [35] After reviewing these additional comments, the Board approved the revised draft rule changes, with certain additional modifications and additions, for filing with the SEC. The comments received, and the Board's response, are summarized below.

*A. Authority of Board To Adopt Rules Governing Dealer Transactions in Municipal Fund Securities*

1. Comments Received

Some commentators question the Board's authority to regulate municipal fund securities, particularly local government pool interests.[36] Fidelity, Fubright, MBIA–MISC and Schulte state that such interests are not municipal securities under the Act. They argue that the term ''municipal securities'' as used in the Act is limited to debt obligations of municipal issuers and that interests in local government pools represent equity interests in trust assets, not debt obligations.[37] Duane and Eckert question whether Congress intended that the Board regulate local government pools when it created the Board.

2. Board Response

A security must first be a municipal security in order to be a municipal fund security. The proposed rule change would not, and existing Board rules do not, apply to local government pool or higher education trust interests that are not municipal securities. Thus, the Board does not overstep its authority by regulating dealer transactions in municipal fund securities because, by definition, regulation is limited to interests that are municipal securities.

A firm wishing to determine if Board rules apply to services it provides to an issuer of local government pool or higher education trust interests may seek advice of counsel as to whether (1) such services constitute broker-dealer activities, or (2) such interests are municipal securities. In addition, the firm may seek no-action relief from SEC staff. If a non-dealer firm's activities do not constitute broker-dealer activities, the firm need not be a registered broker or dealer subject to Board rules, even if the interests re municipal securities.[38] If the interests are not municipal securities, the dealer need not comply with Board rules; however, the dealer's activities may be subject to provisions of the Act, the rules and regulations thereunder, and National Association of Securities Dealers (''NASD'') rules, unless the interests otherwise qualify for an exemption (*e.g.*, as exempted securities other than municipal securities) under the Act.

Of course, the Board's rulemaking proposals meaningful only if municipal fund securities, in fact, exist. As noted above, the Board asked SEC staff whether local government pool and higher education trust interests are municipal securities. SEC staff replied that ''at least some interests in local government pools and higher education trusts may be, depending on the facts and circumstances, 'municipal securities' for purposes of the Act.'' [39] Although the Board is not empowered to determine whether a security is a municipal security within the meaning of Section 3(a)(29) of the Act, the Board believes that, based on the SEC's response as well as a close review of existing no-action letters and legislative history of the Securities Acts Amendments, the Act, and the Securities Act of 1933 (''Securities Act''), as discussed below, at least some interests in local government pools and higher education trusts are municipal securities.

For example, in agreeing not to recommend enforcement action in several no-action letters, SEC staff relied on opinions of counsel that interests in state or local governmental trusts were municipal securities under the Act.[40] In

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Incorporated (''Merrill''), to the Board, dated June 2, 1999 (''First Merrill Letter''); letter from Leonard M. Leiman, Partner, Fulbright & Jaworski LLP (''Fulbright''), as counsel to Fidelity Investment (''Fidelity''), to the Board, dated June 4, 1999 (''Fulbright Letter''); letter from Thomas R. Schmuhl, Duane, Morris & Heckscher LLP (''Duane''), as counsel to the Pennsylvania School District Liquid Asset Fund, to Ernesto A. Lanza, dated June 8, 1999 (''Duane Letter''); letter from Kenneth S. Gerstein, Schulte Roth & Zabel LLP (''Schulte''), as counsel to Cadre Financial Services, Inc., to the Board, dated June 18, 1999 (''Schulter Letter''); letter from Leonard I. Chubinsky, Assistant General Counsel, MBIA Municipal Investors Service Corporation ('MBIA–MISC''), to Ernesto A. Lanza, dated July 1, 1999 (''MBIA–MISC Letter''); letter from Thomas J. Wallace, Executive Director, Florida Prepaid College Board (''Florida''), to Ernesto A. Lanza, dated July 13, 1999 (''Florida Letter''); and letter from Betsy Dotson, Director, Federal Liaison Center, Government Finance Officers Association (''GFOA''), to Ernesto A. Lanza, dated July 16, 1999 (''First GFOA Letter'').

[34] ''Municipal Fund Securities—Revised Draft Rule Changes,'' *MSRB Reports,* Vol. 19, No. 3 (Sept. 1999) at 3.

[35] Letter from David Unkovic, Saul, Ewing, Remick & Saul LLP (''Saul''), as counsel to PLIT, to Ernesto A. Lanza, dated October 27, 1999 (''Saul Letter''); letter from Joseph J. Connolly, Eckert Seamans Cherin & Mellott, LLC (''Eckert''), as counsel to PFM, to the Board, dated October 29, 1999 (''Eckert Letter''); letter from Betsy Dotson, Director, Federal Liaison Center, GFOA, to Ernesto A. Lanza, dated November 1, 1999 (''Second GFOA Letter''); letters from Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Investments (''Fidelity''), to the Board, dated November 1, 1999 (''First Fidelity Letter'') and to each Board member, dated January 20, 2000 (''Second Fidelity Letter''); letter from J. Todd Cook, Vice President and Senior Counsel, Merrill, to the Board, dated November 5, 1999 (''Second Merrill Letter''); and letter from Marshall Bennett, Chairman, CSPN (NAST) and Mississippi State Treasurer, to Ernesto A. Lanza, dated January 11, 2000 (''NAST Letter'').

[36] *See* Duane, Fulbright, MBIA–MISC, Schulte, Eckert, First Fidelity and Second Fidelity Letters. Fulbright states that, although the Board has no authority to regulate either local government pool or higher education trust interests, it believes that interested parties would not resist ''appropriate regulation'' of higher education trust interests. It states that regulation of transactions in such interests is ''arguably both more important and less controversial'' than regulation of local government pool interests, noting that higher education trust interests ''clearly affect public investors and the public interest.'' Fidelity also believes that interests in higher education trusts are not municipal securities but states that such interests ''are distributed to the public investors and therefore may raise unique public policy issues.''

[37] These commentators observe that municipal securities are defined in Section 3(a)(29) of the Act as ''securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof,'' in contrast to the language used in Section 3(a)(2) of the Securities Act of 1933 regarding any ''security issue or guaranteed . . . by any State of the United States, or by any political subdivision of a State or Territory.'' They quote a Senate report statement on the Securities Acts Amendments that '''municipal securities' refers to debt obligations of state and local government issuers.'' Senate Comm. on Banking, Housing and Urban Affairs, Securities Acts Amendments of 1975, S.Rep. No. 75, 94th Cong., 1st Sess. 38 (1975) (''1975 Senate Report''); *but cf.* Securities Acts Amendments of 1975, H.R. Conf. Rep. No. 229, 94th Cong., 1st Sess. 101 (1975) (''1975 Conference Report'') (amendments ''provide a comprehensive pattern for the registration and regulation of securities firms and banks which underwrite and trade *securities issued by* States and municipalities'') (emphasis added). They note references in SEC no-action letters to obligations under the Internal Revenue Code to support their position that municipal securities are limited to debt obligations. *See* Itel Corp., SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 100581018 (Oct. 1, 1981) (''Itel No-Action Letter''); Bedford-Watt Enterprises, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 062678091 (June 9, 1978) (''Bedford-Watt No-Action Letter''). In addition, CERS cites an SEC no-action letter to suggest that an equity security may not be a municipal security. *See* City Employees' Retirement System of the City of Los Angeles, SEC No-Action Letter, [1977–1978 Dec.] Fed. Sec. L. Rep. (CCH) ¶ 81,194 (May 12, 1977) (''CERS No-Action Letter'').

[38] Thus, non-dealer firms may act as investment advisers to local government pool or higher education trust programs and not become subject to Board rules.

[39] *See* SEC Letter, *supra* note 5.

[40] *See, e.g.,* Virginia Higher Education Tuition Trust Fund, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 111599009 (Nov. 16, 1999) (''Virginia No-Action Letter''); Missouri Higher Education Savings Program, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 110199007 (Oct. 25, 1999) (''Missouri No-Action Letter''); Golden State Scholarshare Trust, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 092099002 (Sept. 15, 1999) (''California No-Action Letter'') Maine

one instance, SEC staff agreed not to recommend enforcement action if a dealer, in offering and selling interests in a higher education trust, were to comply with Board rules as they have been proposed to be amended in the March Notice, in lieu of complying with such rules as currently in effect.[41] In another no-action letter, SEC staff agree not to recommend enforcement action against dealers who (1) sold interests in a higher education trust through persons qualified to sell investment company products but who did not meet the Board's professional qualification requirements [42] and (2) complied with Rule 15c2–12(b)(5) [43] through a continuing disclosure undertaking from a dealer affiliate, rather than from the issuer. In reaching this position, SEC staff noted that the higher education trust interests were ''atypical municipal securities.'' [44]

In other instances, SEC staff agreed not to recommend enforcement action if state entities and their employees sold higher education trust interests without registering as brokers.[45] The applicants opined in these cases that the interests were municipal securities under the Act, thereby exempting the issuers from registering as brokers by virtue of the exemption for issuers of municipal securities set forth in Section 3(d) [46] of the Act.[47] SEC staff also agreed not to recommend enforcement action if interests in a state trust were not registered under the Act, in reliance on an opinion that the exemption under Section 3(a)(12) of the Act [48] for exempted securities was available.[49]

SEC staff also has taken the position that non-debt securities may be municipal securities under the Act.[50] In one instance, SEC staff was unable to conclude that receipt/certificates evidencing developers' payments to a city of fees for the issuance of building permits were not municipal securities under the Act.[51] SEC staff also has advised the Board that warrants sold by a municipal corporation entitling the holders to purchase other municipal securities of that corporation are themselves municipal securities under the Act.[52] Finally, in those cases in which SEC staff concluded that an ''obligation'' within the meaning of the Internal Revenue Code would also constitute an ''obligation'' for purposes of Section 3(a)(29) of the Act, SEC staff did not conclude that the failure of a security to be an obligation for purposes of the Internal Revenue Code would mean that such security was not a municipal security for purposes of the Act.[53] In these cases, SEC staff was not presented with the issue of whether a non-debt security could be a municipal security. As noted above, on the last two occasions when SEC staff was confronted with this issue, it concluded that a non-debt security may be a municipal security for purposes of the Act.[54]

A review of legislative history also suggests that the commentator's position that the term ''municipal securities'' in the Act excludes non-debt securities is not justified. The Senate report on the Securities Acts Amendments notes that the legislation created a definition of municipal securities in new Section 3(a)(29) of the Securities Act [55] that, for all relevant purposes, used the same language as in the original version of the definition of exempted municipal securities in Section 3(a)(12) of the Act.[56] It also states that no substantive changes in meaning would be effected by creating Section 3(a)(29).[57] Thus, the import of the term ''municipal securities'' must be viewed, in the first instance, through the eyes of the original drafters of the Act in 1934

College Savings Program Fund, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 080999001 (Aug. 2, 1999) (''Maine No-Action Letter''); Teachers Personal Investors Services, Inc., SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 092898006 (Sept. 10, 1998) (''New York No-Action Letter''); New Hampshire Higher Education Savings Plan Trust, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 070698010 (June 30, 1998) (''New Hampshire No-Action Letter''); Public Employees Retirement Board of the State of Oregon, SEC No-Action Letter, Wash. Serv. Bur (CCH) File No. 041398009 (March 3, 1998) (''Oregon State No-Action Letter''); North Carolina State Education Assistance Authority, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 032497016 (March 24, 1997) (''North Carolina No-Action Letter''); Missouri Family Trust Fund, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 101392001 (Sept. 22, 1992) (''Missouri Family Trust No-Action Letter''); School District No. 1—Mutnomah County, Oregon, SEC No-Action Letter (Mar. 26, 1976) (''Oregon School District No-Action Letter'').

[41] Maine No-Action Letter. SEC staff's position was conditioned on the dealer complying with all existing Board rules, other than those proposed to be amended in the March Notice, and complying with all Board rules upon completion of the current Board rulemaking process. Counsel had opined that the interests were direct obligations of an instrumentality of a state and therefore were municipal securities within the meaning of Section 3(a)(29) of the Act. *See id.* and accompanying letter of inquiry.

[42] New York No-Action Letter. SEC staff stated that this no-action position expires six months after Rule G–3 is amended to establish qualification requirements for persons selling such interests.

[43] 17 CFR 240.15c2–12(b)(5).

[44] *Id.* Counsel had opined that the interests were direct obligations of an instrumentality of a state and, therefore, were municipal securities under the Act. *See id.* and accompanying letter of inquiry. *See also* New York State college Choice Tuition Savings Trust, SEC No-Action Letter, Wash. Serv. Bur. (CCH) file No. 091498008 (Sept. 10, 1998) and accompanying letter of inquiry.

[45] *See, e.g.,* Virginia No-Action Letter; Missouri No-Action Letter; California No-Action Letter; Main No-Action Letter; New Hampshire No-Action Letter; North Carolina No-Action Letter.

[46] 15 U.S.C 78c(d).

[47] *See* Virginia No-Action Letter, and accompanying letter of inquiry; Missouri No-Action Letter, and accompanying letter of inquiry; California No-Action Letter, and accompanying letter of inquiry; Maine No-Action Letter, and accompanying letter of inquiry; New Hampshire No-Action Letter, and accompanying letter of inquiry; North Carolina No-Action Letter, and accompanying letter of inquiry. *See also* Missouri Family Trust No-Action Letter, and accompanying letter of inquiry; Oregon School District No-Action Letter, and accompanying letter of inquiry;

[48] 15 U.S.C. 78c(a)(12).

[49] *See* Oregon State No-Action Letter. Counsel opined that the interests would be exempt from the registration requirements of the Act as securities issued by a state instrumentality. *See also* Pennsylvania Local Government Investment Trust, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 022283009 (Feb. 21, 1983) (''Pennsylvania No-Action Letter'') and accompanying letter of inquiry, in which counsel opined that interests in a local government pool were municipal securities under the Act that qualified for the exemption from the registration requirements of Section 12(g) of the Act. SEC staff did not expressly rely on this opinion in arriving at its no-action position.

[50] *See, e.g.,* City of El Paso de Robles, SEC No-Action Letter, Wash. Serv. Bur. (CCH) File No. 111285020 (June 18, 1985) (''El Paso de Robles No-Action Letter''); MAC Warrant Notice. The SEC's position with respect to these two types of non-debt securities stands in contrast to SEC staff's earlier position regarding call options in the CERS No-Action Letter.

[51] *See* El Paso de Robles No-Action Letter.

[52] *See* MAC Warrant Notice. The MAC Warrant Notice was cited with approval by SEC staff in a letter to the Office of the Comptroller of the Currency. *See* letter dated August 12, 1981 from Thomas G. Lovett, Attorney, SEC, to Owen Carney, Director, Investment Securities Division, Office of the Comptroller of the Currency (''CP Letter''), *reprinted in* CP Notice.

[53] *See* Itel No-Action Letter (stating that the term ''obligation'' in the Act's definition of municipal security would generally include obligations under the Internal Revenue Code); Bedford-Watt No-Action Letter (stating that the Internal Revenue Code ''provides a useful analogy''). In the Bedford-Watt No-Action Letter, SEC staff recognized that ''obligation'' under Section 3(a)(29) of the Act could include non-financial obligations to take actions needed for payment of the security. *See also* Pennsylvania No-Action Letter and accompanying letter of inquiry. In arriving at its opinion that local government pool interests described in the Pennsylvania No-Action Letter were municipal securities, counsel suggested, in reference to the definition of municipal securities in the Act, ''that the word 'obligations' need not be read as 'debt' in this context. The Trust is under obligation to redeem all Shares of Beneficial Interest presented for redemption.'' In addition, the Chairman of the College Savings Plans Network noted in Congressional testimony that ''state-sponsored college tuition programs are secured by the moral or political *obligation* of the states'' Marshall Bennett, Testimony Before the House Committee on Ways and Means, Hearing on Reducing the Tax Burden: II. Providing Tax Relief to Strengthen the Family and Sustain a Strong Economy, 106th Cong., 1st Sess. (June 23, 1999), *available at,* <http://www.house.gov/ways_means/fullcomm/106cong/6–23–99/6–23benn.htm> (visited April 5, 2000) (emphasis added).

[54] *See* El Paso de Robles No-Action Letter; MAC Warrant Notice.

[55] 15 U.S.C. 77c(a)(29).

[56] *See* 1975 Senate Report, at 90, 92.

[57] *Id.* at 92.

rather than the drafters of the Securities Acts Amendments in 1975.

The purpose of including municipal securities in the definition of exempted securities in the Act was to provide an exemption for municipal securities from most provisions of the Act and the Securities Act. Although commentators suggest that Board regulation of dealer transactions in non-debt securities of municipal issuers is inconsistent with the intent of drafters of the Securities Acts Amendments, the appropriate inquiry is whether the drafters of the original Act would have intended that *only* debt securities of municipal issuers be exempted from most provisions of the Act. That is, would the drafters of the original Act have intended that non-debt securities of state or local governmental entities—had such securities existed at the time—be subject to the entire range of regulation of the Act applicable to other equity securities, including in some instances a requirement for registration of such securities with the SEC? A review of Congressional debates, committee reports and hearing testimony relating to enactment of the Securities Act and the Act reveals that, in spite of differences in statutory language, both Acts were expected to exempt the same universe of municipal securities.

For example, the 1993 House report on the Securities Act speaks of exempted state and local government securities almost exclusively in terms of ''obligations'' and ''bonds,'' not ''securities.'' [58] The report explains the exemption set forth in Section 3(a) of the Securities Act as follows:

> Paragraph (2) exempts United States, Territorial and State obligations, or obligations of any political subdivision of these government units. The term ''political subdivision'' carries with it the exemption of such securities as county, town, or municipal obligations, as well as school district, drainage district, and levee district, and other similar bonds. The line drawn by the expression ''political subdivision'' corresponds generally with the line drawn by the courts as to what obligations of States, their units and instrumentalities created by them, are exempted from Federal taxation. By such delineation, any constitutional difficulties that might arise with reference to the inclusion of State and municipal obligations are avoided.[59]

Furthermore, during Congressional debate and hearings held in 1993 on the Securities Act, members of Congress used the terms ''securities,'' ''obligations'' and ''bonds'' interchangeable.[60] Thus, although the statutory language in the Securities Act uses only the term ''securities'' and not the term ''obligations'' when describing municipal securities, there is no suggestion that Congress had anything in mind when enacting the Securities Act other than the tax-exempt bonds and other debt obligations of state and local governments that are customarily associated with municipal securities. Nonetheless, the commentators all have agreed that local government pool and higher education trust interests are exempt from the Securities from the Securities Act and none has suggested that this exemption is limited to tax-exempt debt obligations.

The initial draft of the Act introduced in Congress the following year exempted federal government securities but not municipal securities. Members of Congress expressed concern regarding the appropriateness of federal regulation of state and local governmental matters,[61] the burden that provisions of the Act would place on state and local issuers [62] and the relative detriment in the market to municipal securities if they were not exempted but federal government securities were exempted.[63] Some discussion focused on whether a distinction should be drawn between defaulted and non-defaulted municipal securities. [64] Ultimately, the language that was added to the Act to exempt municipal securities made no such distinction but instead was drafted in non-exclusive terms that paralleled the language used in the Act to describe federal government securities. This language also employed the same type of terminology that the drafters of the Securities Act had used in the legislative history to explain the statutory language on municipal securities in that Act.[65] Legislative history does not reflect any intent or understanding that the municipal securities contemplated in the Act were any different than those that were already exempted under the Securities Act.[66] It would be inconsistent with legislative intent to limit the exemption under the Act solely to debt securities of state and local governments without similarly limiting the reach of the exemption provided in the Securities Act.

Finally, in using the same term—''municipal securities''—that sets out the exemption from most provisions of the Act to also delineate the Board's rulemaking authority under Section 15B of the Act,[67] Congress elected in the Securities Acts Amendments to grant the Board jurisdiction over dealer transactions in the identical universe of securities as were otherwise exempted from the Act as municipal securities.[68]

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[58] *See, e.g.,* House Comm. on Interstate and Foreign Commerce, Federal Supervision of Traffic in Investment Securities in Interstate Commerce, H.R.Rep. No.85, 73d Cong., 1st Sess. 6, 14 (1933) (''1993 House Report'').

[59] *Id.* at 14. This view was confirmed the following year during House committee hearings on the Act by the Commissioner of the Federal Trade Commission, which was charged with enforcing the Securities Act. *See* Stock Exchange Regulation: Hearing on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 899 (1934) (''1934 House Hearings'') (statement of James M. Landis, Commissioner, Federal Trade Commission). Commissioner Landis stated: ''We had that same problem up in the Securities Act, where the exemption that is given to what might be called municipal bonds, and bonds of States and their instrumentalities, and is drawn according to a line that parallels the line that is drawn which makes tax-exempt municipal bonds, State instrumentalities, and so. In other words, every instrumentality of a State which, like a municipality, or a political subdivision of a State, was exempted from taxation, would be exempted from registration upon an issue of securities. That is the line drawn in the Securities Act. If exempt from taxation they are also exempted from the necessity of registration under that Act.''

[60] *See, e.g.,* Securities Act: Hearings on S. 875 Before the Senate Comm. on Banking and Currency on S. 875 Cong., 1st. Sess. 65 (1993) (''1933 Senate Hearings'') (statement of Sen. Reynolds); *id.* at 228, 232 (statement of Sen. Kean); *id.* at 232 (statement of Sen. Costigan); *id* at 303 (statement of Sen. Norbeck); 77 Cong. Rec. 2925 (1933) (statement of Rep. Studley).

[61] *See* 1934 House Hearings, at 822 (statement of Rep. Pettingill); *id.* at 898–9 (statements of James M. Landis, Commissioner, Federal Trade Commission; Rep. Pettingill). This concern also served as a primary basis for the exemption of municipal securities under the Securities Act. *See* 1933 House Report, at 14, and text accompanying note 59 above.

[62] *See* 1934 House Hearings, at 721, 911–3 (statement of Rep. Holmes); Stock Exchange Practices: Practices: Hearings on S. Res. 84 and S. Res. 56 and S. Res. 97 Before the Senate Comm. on Banking and Currency, 73d Cong., 1st Sesses 7441–52 (1934) (''1934 Senate Hearings'') (statements of Archibald B. Roosevelt, Roosevelt & Weifold, Inc.; George B. Gibbons, George B. Gibbons & Co.; Sen. Gore; Sen. Goldsborough).

[63] *See* 1934 House Hearings, at 720 (statement of Rep. Holmes).

[64] *See* 1934 Senate Hearings, at 7413 (statements of H.H. Cotton, Investment Bank of Los Angeles; Ferdinand Pecora, Counsel to the Committee; Sen. Fletcher); *id.* at 7477 (statement of Tom K. Smith, Assistant to the Secretary of the Treasury; Sen. Adams; Sen. Walcott); 1934 House Hearings, at 7201 (statements for Tom K. Smith, Assistant to the Secretary of the Treasury; Rep. Holmes); *id.* at 819–23 (statements of George B. Gibbons, George B. Gibbons & Co.; Rep. Merritt; Rep. Rayburn; Rep. Pettengill).

[65] *See supra* note 59 and accompanying text.

[66] The phrase ''security issued or guaranteed by'' used in Section 3(a)(2) of the Securities Act introduces bank securities (including bank equity securities) as well as government and municipal securities. In contrast, the phrase ''securities which are direct obligations of or obligations guaranteed as to principal or interest by'' used in Section 3(a)(12) of the Act introduced only municipal and government securities. Thus, even thoughth the drafters of both the Securities Act and the Act thought of municipal and government securities solely as debt securities, the term ''obligation'' (to the extent such term is limited to debt securities) could only be used in the Act.

[67] 15 U.S.C. 78*o*–4.

[68] The conference report on the Securities Acts Amendments states: ''The Senate bill extended the

Thus, even if Congress did not have interests in local government pools or higher education trusts in mind when enacting the Securities Acts Amendments, it did have a specific intent that the Board would have authority over dealer transactions in any security that would constitute an exempted security by virtue of being a municipal security. In creating the Board, the Senate report on the Securities Act Amendments stated that it would not ''be desirable to restrict the Board's authority by a specific enumeration of subject matters. The ingenuity of the financial community and the impossibility of anticipating all future circumstances are obvious reasons for allowing the Board a measure of flexibility in laying down the rules for the municipal securities industry.'' [69] The fact that certain types of instruments (such as non-debt securities of state or local governments) were essentially non-existent at the time of enactment of the Securities Acts Amendments did not, in the minds of the drafters, mean that regulations relating to newly created instruments would not be within the Board's power.[70]

*B. Appropriateness of Regulating Dealer Transactions in Municipal Fund Securities*

1. Comments Received

A number of commentators state that, even if the Board has authority to adopt the proposed rule change, the Board should refrain from doing so.[71] Fulbright, MBIA–MISC and Schulte argue that no need has been demonstrated for regulation to protect investors or the public interest in connection with local government pool interests.[72] They state that investors are local governments and not the typical public investor in municipal securities.[73] Fulbright and Schulte argue that no abuses or other threats to public investors or the public interest have been identified by the Board that would warrant federal regulatory action. They state that offerings of interests in local government pools do not pose risks that are similar to those identified in the legislative history of the Securities Acts Amendments.[74] MBIA–MISC argues that safeguards already exist to provide investor protections comparable to those in the proposed rule change.[75] With respect to interests in higher education trusts, NAST states that the Board ''should not attempt to regulate qualified state tuition program transactions, because there is no demonstrated need for regulation to protect state and local government investors or the public interest.'' [76]

Duane, Eckert, Florida, Fulbright, GFOA and Schulte state that Board rulemaking would adversely affect state and local governments. In particular, they believe that underwriting assessments would be passed on, directly or indirectly, to issuers and issuers would face additional administrative burdens as a result of the application of Board rules. They note that any increased costs to issuers likely would be passed on to investors in the form of lower returns on their investments.[77]

Duane, Fidelity and Fulbright also state that interests in local government pools involve transactions between the state or local government-sponsored pools and participating local governmental entities of that same state.[78] Fulbright believes that Board rulemaking would be inconsistent with the Tenth Amendment because transactions in local government pool interest do not constitute interstate commerce. Furthermore, noting that the Act does not require registration of a broker or dealer whose business is exclusively intrastate, Fulbright suggests that the Board ''follow Congress's restraint in approaching intrastate transactions in securities.'' Finally, Fulbright states that regulation of transactions in these interests would ''improperly intrude on state sovereignty'' by indirectly regulating states by mandating actions by their agents.

2. Board Response

As the Board has previously observed, the current rulemaking proposal would not subject dealer transactions in municipal fund securities to Board rules but instead would make certain Board rules, to which such transactions are already subject, better accommodate the

basic coverage of the Securities Exchange Act of 1934 to provide a comprehensive pattern for the registration and regulation of securities firms and banks which underwrite and trade securities issued by States and municipalities. Municipal securities dealers were required to register with the Commission and comply with rules concerning just and equitable principles of trade and other matters prescribed by a new self-regulatory organization, the Municipal Securities Rulemaking Board, established by the bill and delegated responsibility for formulating rules relating to the activities of all municipal securities dealers. The exemption for issuers of municipal securities from the basic regulatory requirements of the Federal securities laws was continued.'' 1975 Conference Report, at 101.

[69] 1975 Senate Report, at 47. *See also* CP Letter, at note 7.

[70] In testimony at a 1975 Senate committee hearing on the Securities Acts Amendments, a representative of the Municipal Finance Officers Association stated that the municipal securities market ''is completely a debt market.'' Securities Act Amendments of 1975: Hearings on S. 249 Before the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 479 (1975) (statement of Michael S. Zarin, Member, Comm. on Governmental Debt Administration, Municipal Finance Officers Association). Having been so informed, the Senate's description in the 1975 Senate Report of municipal securities as ''debt obligations of state and local government issuers,'' as noted by some commentators on the March Notice, in fact merely reflected an understanding of the nature of the municipal securities market at such time, *not* an understanding that the Act's definition of municipal securities was to be limited only to the debt segment of a broader municipal market that might also include equity securities. *See* 1975 Senate Report at 38.

[71] *See* Duane, Florida, Fulbright, First GFOA, MBIA–MISC, Schulte, Eckert, Second Fidelity, and NAST Letters.

[72] GFOA makes a similar argument in the First GFOA Letter. GFOA also states in the First GFOA Letter that regulation of local government pools should be left to the states.

[73] Both Fidelity and Fulbright concede that interests in higher education trusts raise unique policy issues affecting public investors and the public interest. *See supra* note 36.

[74] For example, Fulbright and Schulte list Congressional concern about unconscionable markups, churning of accounts, misrepresentations, disregard of suitability standards, high-pressure sales techniques, fraudulent trading practices resulting in substantial losses to public investors, and threats to the integrity of the local government capital-raising system. They argue that there is no opportunity for unconscionable markups and little incentive for churning of accounts or use of high-pressure sales techniques for these interests because they are purchased and redeemed at the current net asset value and purchasers do not pay commissions. They also argue that suitability concerns are not raised because local government pools are operated like money market funds and invest solely in the types of investments that their participants are permitted by state law to purchase.

[75] MBIA–MISC states that protections exist under the Investment Advisers Act of 1940, state regulations, voluntary adherence to the Investment Company Act and related federal regulations applicable to investment company securities, and Governmental Accounting Standards Board Statement No. 31 relating to accounting and financial reporting for certain investments and for external investment pools.

[76] NAST further states that the Board ''has not identified any abuses or other threats to public investors or the public interest that are sought to be avoided by applying existing rules to transactions in qualified state tuition programs. Rather, the Board appears to * * * intend to apply its rules to all transactions in state and local government securities, regardless of whether such regulation is needed.''

[77] As discussed below, the Board has decided to exempt sales of municipal fund securities by or through dealers from the underwriting assessment imposed under Rule A–13. *See infra* note 105 and accompanying text.

[78] Fidelity argues in the Second Fidelity Letter: ''State and local governments use LGIPs to manage their internal cash positions. They are organized under state statute for the performance of a governmental function and are available exclusively to state and local governments within the sponsoring state or locality. No legitimate federal purpose is served by interposing the MSRB in these arrangements.''

nature of these securities. Making Board rules fit the characteristics of municipal fund securities is an appropriate Board undertaking. Also, Board rules do not govern the actions of issuers; instead, they impose standards on dealers effecting transactions in the securities of such issuers.[79] In establishing the Board, Congress determined that dealer regulation was the appropriate manner of providing investor protection in the municipal securities market while maintaining the existing exemption for issuers.[80]

The definition of customer under Rule D–9 includes issuers, except in connection with sales of an issuer's new issue municipal securities, and therefore board rules contemplate that governmental entities acting as investors are entitled to the protections afforded by such rules to all customers.[81] The Board understands that local government pools exist in nearly every state and that, in many states, more than one pool may be available to a local government.[82] One market observer states that these pools ''can differ in their level of risk taking, internal oversight, shareholder services, and external reporting.'' [83] Although a number of pools have been rated, the vast majority remain unrated. Most local government pools appear to be designed to maintain, as nearly as possible, a constant net asset value (similar to regulated money market mutual funds), but some operate as variable net asset value pools that do not seek to maintain a constant share value. Furthermore, a number of local government pools have experienced financial difficulties.[84] These factors suggest that investor protection issues may be raised in connection with the sale by dealers of interests in local government pools.[85] The Board believes that investor protection issues also may arise with respect to sales by dealers of interests in higher education trusts.[86] For example, the Board believes that dealers have suitability obligations if they recommend a transaction in a local government pool or higher education trust interest to a local government or an individual, respectively, if such interest constitutes a municipal security.[87]

Local government pools are described by certain commentators as being operated ''consistent with'' the federal securities laws applicable to investment companies and managed and administered in a manner ''similar'' to money market mutual funds, ''where practicable'' [88] These comments imply that may programs in fact deviate to some degree from their voluntary compliance with existing federal regulations that would be applicable to these programs if they were not operated by state or local governmental entities. However, the Board notes that its rulemaking would not impose requirements on issuers and in fact has been drafted with the understanding that dealers may be effecting transactions in securities that are similar, but not identical, to investment company securities. In that respect, the Board believes that is rulemaking is more suitable for dealers effecting transactions in investment company securities because some SEC and NASD rules impose obligations on dealers based on the assumption that issuers, as registered investment companies, must comply with federal investment company laws are regulations. Thus, a dealer might have difficulty complying with the letter of existing regulations relating to securities of registered investment companies where the issuer of a local government pool or higher education trust interest has chosen not to voluntarily comply with the provisions that would be obligatory if it were a registered investment company. As is the case with all exiting Board rules, the proposed rule change recognizes that issuers, as largely unregulated entities, may act in widely divergent manners. Thus, obligations placed on dealers are sufficiently

[79] After reviewing the August Notice, GFOA states in the Second GFOA Letter that ''the revised draft is persuasive in explaining the limitations of the rule changes under consideration [and] * * * indicates a narrow regulatory design which should not affect those local government investment pools (LGIPs) that do not utilize brokers or dealers in their transactions (non-dealer entities) or which are not municipal securities.''

[80] *See supra* note 68.

[81] As originally proposed, Rule D–9 would have excluded from the definition of customer ''the issuer of securities which are the subject of the transaction in question.'' *See* ''Notice of Filing of Fair Practice Rules,'' [1977–1987 Transfer Binder] *MSRB Manual* (CCH) ¶ 10,030 (Sept. 20, 1977). In amending the original proposed rule language to limit this exclusion solely to ''the issuer in connection with the sale of a new issue of its securities,'' the Board stated that it believed ''that the protections afforded customers by its rules should be extended to issuers when they act in secondary market transactions.'' *See* ''Notice of Filing of Amendments to Fair Practice Rules,'' [1977–1987 Transfer Binder] *MSRB Manual* (CCH) ¶ 10,058 (Feb. 28, 1978). Give that the Board has always felt that the issuers should be considered customers even in secondary market transactions involving their own securities, state and local governmental entities certainly should be considered customers in transactions involving securities of other such entities. Furthermore, in Congressional testimony on the bankruptcy filing of Orange County, California and its local government pool, SEC Chairman Arthur Levitt discussed customer protection rules of self-regulatory organizations as they may apply to state or local governmental entities acting as customers. *See* Derivative Financial Instruments Relating to Banks and Financial Institutions: Hearings Before the Senate Comm. on Banking, Housing and Urban Affairs, 104th Cong., 1st Sess. (1995) (''SEC Testimony'').

[82] S&P Report, at 3, 6–11. The Board takes no position as to which of these local government pools may issue interests that would constitute municipal fund securities.

[83] *Id.* at 3.

[84] PFM identifies several state-run and country-run pools (including the Orange County, California pool) as having had recent financial difficulties. *See* PFM Letter. *See also* NAST Report, at 2, 5, 38; S&P Report, at 5.

[85] NAST has stated that it: ''recognizes that potential pool participants have numerous alternative investment vehicles from which to choose. The goal of the * * * [NAST Guidelines for Local Government Investment Pools] is to insure that local government investment officials, when choosing among their available investment options, are fully aware of significant investment and administrative policies, practices and restrictions of the pool and are thereby able to make informed investment decisions on behalf of the local governments * * * NAST further recommends that the broker/dealer community govern itself to follow the same standards of conduct NAST has recommended for treasurers'' NAST Report, at 8. As the self-regulatory organization established by Congress to adopt rules for dealer transactions in municipal securities, the Board has created a body of rules that, together with this proposed rule change, constitute the self-governance and standards of conduct that NAST has recommended be established.

[86] The Board understands that investment strategies, pay-out restrictions, and fees and redemption charges or penalties of the existing higher education trust vary. At least some higher education trusts permit sales of interests to persons living in other states and permit redemption proceeds to be used to pay higher education expenses in any state. In other cases, redemption proceeds may be limited for use within a specific state. *See generally* CSPN Report. Thus, a single customer may have a choice of investments in various higher education trusts having widely differing strategies and terms. Furthermore, recent press reports regarding higher education trust programs have suggested that investor protection issues may exist in this section. *See, e.g.,* ''Saving for College—Strategies for Putting Your Plan on Course,'' *Consumer Reports* (Feb. 2000) at 56; Julie Vore, ''College Savings Plan: A Guide to How They Work,'' *AAII Journal,* Vol. 22, No. 2 (Feb. 2000) at 11; Thomas Easton and Michael Maiello, ''The College Saving Fund Scandal,'' *Forbes* (Mar. 6, 2000) at 172; Mike McNamee, ''Piling Up Those bucks for College,'' *Business Week* (Mar. 13, 2000) at 155. The Board takes no position on which of these higher education trusts may issue interests that would constitute municipal fund securities.

[87] NAST Report, at 8 (stating the ''[t]he investment alternatives offered by broker/dealers to public finance officials should be suitable for the public entity's objectives.''). The fact that a local government pool's assets are invested in investments that are legally available as direct investments by local governments does not resolve suitability issues. *See supra* note 74. As with transactions in any other municipal security, Rule G–19 would require a dealer recommending a transaction in a municipal fund security to have reasonable grounds for believing that the recommendation is suitable, based upon information available from the issuer or otherwise and the facts disclosed by or otherwise known about the customer. These suitability requirements do not differ in substance from those of the NASD, to which dealers effecting transactions in such interests might otherwise be subject if these interests are not municipal securities. *See also* SEC Testimony.

[88] *See* MBIA–MISC, PFM and PLGIT Letters.

flexible to permit dealers to act in a lawful manner in view of this wide divergence of circumstances while maintaining an adequate level of customer protection.

The Board believes that state regulation, federal rules applicable to investment advisors and Governmental Accounting Standards statements, although providing important protections in the areas governed by such rules and standards, do not serve as a substitute for regulation tailored specifically toward dealer activities in municipal fund securities. Furthermore, the Board believes that voluntary adherence to the substance of existing rules applicable to investment company securities and/or other equity securities provides inadequate protection to investors since dealers are free to deviate from these rules in any manner and at any time they choose without any apparent legal consequence. The existence of these collateral safeguards do not justify the Board refraining from making its rules more rational with respect to such securities.

With respect to NAST's comments, the Board notes that its rules generally apply to all transactions effected by dealers in municipal securities, regardless of whether there has been a demonstration that each type of municipal security has been the subject of some kind of specific abuse or other specific threat to public investors. Board rules generally focus on dealers' fair dealing duties to customers, including in particular the obligation of dealers to disclose to customers all material information regarding a municipal security transaction. The Board believes that some of the very arguments made by NAST in support of its position that Board regulation of dealer transactions in higher education trust interests is inappropriate in fact lend greater support to the position that the Board is acting in accordance with its statutory mandate to protect investors and the public interest by adopting the proposed rule change. For example, NAST states:

> substantial disincentives exist to discourage contributors from using the programs for any purpose other than the prepayment of tuition. Under the federal Internal Revenue Code, if the beneficiary does not use the contributions for qualified higher education purposes, except in cases of scholarship, death, or disability, the contributor is entitled to a limited refund and [in] most states the refund amount is reduced by a penalty and other charges. Generally, no earnings attributable to the account will be refunded. Moreover, tuition payments normally do not exceed the actual cost of a beneficiary's tuition. In addition, there is very limited opportunity to transfer program benefits.[89]

The Board believes that its existing rules, as amended by the proposed rule change, would provide great benefit to potential purchasers of interests in higher education trusts by ensuring that the unique characteristics of such interests are disclosed by the selling dealers to their customers. In addition, as described above, NAST has previously noted that there are significant investor protection issues with respect to the investment by local governments in local government pools.[90]

With regard to the argument that interests in local government pools are strictly intrastate in nature and therefore are not the appropriate subject of federal regulation, Board rules currently do not apply to any entity that, by virtue of the fact that its business is exclusively intrastate, is not registered as a broker or dealer under Section 15 of the Act.[91] Beyond this, the federal securities laws provide that, once an entity engages in some interstate activities that require it to register under the Act, the broker-dealer rules applicable to such entity apply to both its interstate and intrastate transactions. The Board believes that Congress has made clear its policy determination that intrastate transactions of registered broker-dealers should be subject to broker-dealer regulation.[92]

*C. Applicability of Existing Board Rules to Transactions in Municipal Fund Securities Effected Prior to Effectiveness of Proposed Rule Change*

1. Comments Received

Fulbright and Schulte argue that, to the extent that the Board may have authority to regulate dealer transactions in these interests, existing Board rules relating to municipal securities do not currently apply to transactions in local government pool interests.[93] They state that existing Board rules were never intended to apply to securities other than debt obligations, as evidenced by the Board's statement in the March Notice that its rules ''generally have been drafted to accommodate the characteristics of debt obligations and not investment interests such as municipal fund securities.'' As a result, they believe that any interpretation by the Board that existing rules apply to municipal fund securities can only be effected through the rulemaking process.

2. Board Response

The Board believes that Section 15B(c)(1) of the Act[94] automatically subjects any dealer transactions in municipal fund securities to Board rules. This is true regardless of whether dealers effecting such transactions are aware that municipal fund securities are, in fact, municipal securities. It is incumbent upon dealers to be aware of the nature of the securities in which they deal and it is not a defense against the applicability of Board rules that the dealer did not know that the securities were municipal securities. Thus, the Board's statement that any interest in a local government pool or a higher education trust that is a municipal security currently is subject to Board rules was a statement of fact rather than an interpretation.[95]

The Board recognizes, however, that, prior to publication of the March Notice, it may not have been readily apparent to the vast majority of dealers, as well as to most regulatory agencies, that interests that constitute municipal fund securities were municipal securities. Although the Board does not have authority to direct enforcement of its rules it is statutorily charged with determining the best means of protecting investors and the public interest in regard to dealer transaction in municipal securities. As such, the Board believes that, under the unique circumstances relating to municipal fund securities, enforcement of its rules with regard to transactions in such securities that occurred prior to the industry having been put on notice of their applicability would serve no substantial investor protection purpose, absent extraordinary circumstances or a showing of investor harm resulting from a material departure from standards of fairness generally applicable under the federal securities laws.

*D. Structure of Proposed Rule Change*

1. Comments Received

Certain commentators express concern that the Board's rulemaking proposal contemplates amendments to existing rules rather than creation of a

[89] *See* NAST Letter.

[90] *See supra* notes 84–85. *See also supra* notes 81–85 and accompanying text.

[91] 15 U.S.C. 78*o*.

[92] *See, e.g.,* Sections 15 (b)(3) and 15B(a)(3) of the Act. 15 U.S.C. 78*o*(b)(3); 15 U.S.C. 78*o*–4(a)(3).

[93] *See* Fulbright and Schulte Letters.

[94] 15 U.S.C. 78*o*–4(c)(1).

[95] Actual interpretations relating to how certain rules would be applied to transactions in municipal fund securities, such as the Board's Interpretation Relating to Sales of Municipal Fund Securities in the Primary Market included in the proposed rule change, would be filed with the SEC to the extent required under Section 19(b) of the Act and Rule 19b–4 under the Act.

separate body of regulations.[96] TBMA states that the ''attempt to fit a totally new product or way of doing business into existing regulation that was created to address fundamentally different products and a different market structure is fraught with danger.'' [97] TBMA also states that transactions in municipal fund securities should be regulated in a manner as similar as possible to the existing regulatory scheme for investment company securities.

2. Board Response

The Board reviewed its existing rules and compared them, where relevant, to rules that govern dealer transactions in securities of registered investment companies. In many resects, Board rules are functionally identical to these rules. In other cases, existing SEC or NASD rules provide a more appropriate method of regulating municipal fund securities and the Board sought to modify its rules in a manner that was consistent with those rules. In yet other cases, the regulation of registered investment companies has been effected by regulating issuers, an approach which the Board cannot, and does not seek to, duplicate. Finally, certain NASD and SEC rule provisions arise out of specific Congressional authorization in the Investment Company Act applicable to securities of registered investment companies but not applicable to unregistered municipal fund securities.

Under the circumstances, the Board believes that its approach is appropriate. The Board sought industry comment on the proposed rule change on two separate occasions and, in those circumstances where commentators noted specific shortcomings, the Board considered the merits of the comments and made revisions where appropriate. As noted previously, the Board believes that its rules, as amended by the proposed rule change, are in many respects particularly well suited to dealers effecting transactions in municipal fund securities because they recognize that issuers, being unregulated entities, may act in widely divergent manners. Thus, Board rules provide a greater degree of flexibility than existing rules governing dealer transactions in registered investment company securities.[98]

*E. Specific Rule Provisions*

1. Proposed Rule D–12, on Definition of ''Municipal Fund Security''

Proposed Rule D–12 defines municipal fund security as a municipal security that would be an investment company security under the Investment Company Act but for the fact that the issuer is a state or local governmental entity or instrumentality. For a security to constitute a municipal fund security, the security must first constitute a municipal security. As discussed in detail above, existing Board rules do not, and the proposed rule change would not, apply to any local government pool or higher education trust interest that is not a municipal security.

Fulbright and MBIA–MISC suggest that the Board explicitly exclude local government pool investment from the definition of ''municipal fund security.'' [99] In addition, Eckert urges ''that the Board adopt a definition of 'Broker' which excludes federally registered investment advisors that do not engage in the sale or distribution of securities except in connection with services as investment advisor and administrator to the issuers of Municipal Fund Securities.'' [100] Eckert expresses concern that investment advisory firms that otherwise do not undertake broker or dealer activities will have difficulty in assessing standards applicable to dealers.

The Board has not revised the proposed definition. The Board believes that there is no basis for excluding interests in local government pools from the definition of municipal fund securities, as discussed above. With respect to registered investment advisors, the Board has noted that its rules do not apply to activities of non-dealers. A firm wishing to determine if Board rules apply to services it provides to an issuer of municipal fund securities may seek advice of counsel as to whether such services constitute broker-dealer activities and may seek comfort on counsel's opinion from SEC staff through the SEC's no-action procedure. If a non-dealer firm's activities do not constitute broker-dealer activities, the firm need not be a registered broker or dealer subject to Board rules. Thus, non-dealer firms may act as investment advisers to local government pool or higher education trust programs and not become subject to Board rules. However, once a firm does in fact undertake broker-dealer activities with respect to municipal securities, the Board believes that such firm must be cognizant of and comply with all Board rules, regardless of how infrequently such dealer may transact business in municipal securities or how narrow a range of municipal securities activities in which such dealer is involved.

2. Rule A–13, on Underwriting Assessments

The draft amendment to Rule A–13 included in the March Notice imposed an underwriting assessment on sales of municipal fund securities. Most commentators express concern regarding the assessment of underwriting fees on sales of municipal fund securities.[101] Fulbright, GFOA, Merrill, PLGIT and TPIS suggest that these sales should be exempted from the underwriting assessment. TBMA states that the fee structure for dealers involved in the distribution of municipal fund securities is more like an administrative fee than an underwriting discount or commission because these dealers do not undertake underwriting risks. As a result, fees generally are fixed and are low relative to traditional underwriting fees. Because of these small margins, Duane, Florida, GFOA, PFM, PLGIT, Schulte and TPIS state that underwriting assessments would be passed on to issuers and therefore would represent a financial burden on the issuers' programs.[102]

Merrill and TPIS state that given the volume of investments and redemptions in many local government pools,[103] the level of fees generated by the Board from underwriting assessments would be disproportionate to the resulting regulatory costs. Merrill stats that, if assessments are imposed, they should be at a significantly lower level than the assessments charged in connection with

[96] *See* PRM, Schulte and TBMA Letters.

[97] *See* TBMA Letter. Similarly, PFM comments that ''if the MSRB is intent on regulating activities relating to these funds, it should do so by developing a separate set of rules rather than by attempting to shoe horn the funds into the rules designed for underwritten fixed income securities.'' Schulte believes that ''regulating the marketing of interests in * * * [local government pool investments] under existing MSRB rules, even if those rules are revised as the MSRB has proposed, would be like trying to put a square peg in a round hole.''

[98] *See supra* note 88 and accompanying text.

[99] *See* Fulbright and MBIA–MISC Letters.

[100] *See* Eckert Letter.

[101] *See* Duane, Florida, Fulbright, First GFOA, Merrill, PLGIT, PFM, Schulte and Second TPIS Letters.

[102] Merrill and TBMA, on the other hand, suggest that the Board exempt municipal fund securities from the prohibition in Rule A–13(e) from passing through underwriting assessments to issuers.

[103] PFM and PLGIT note that many local government pools have annual share turn-over rates of approximately 3 to 4 times their assets, due to the fact that many participants are investing short-term funds that move in and out of the pools frequently during the course of the year. Schulte believes that this multiplier may reach as high as 10 times assets. PFM estimates that total issuances of interests in local government pools may be on the same order of magnitude as issuances of traditional municipal securities.

more traditional municipal securities offerings.[104]

Based on these comments, the Board revised the draft amendment to Rule A–13 to exempt sales of municipal fund securities from the underwriting assessment.[105] The continuous nature of offerings in municipal fund securities, the predetermined and automatic nature of most customer investments and the heightened potential that underwriting assessments could create significant financial burdens on issuers to their customers' detriment justify exempting municipal fund securities from the underwriting assessment. The Board also wishes to make clear that it does not intend to seek payment of any previously accrued underwriting assessments that may technically be due and owing on prior sales of municipal fund securities.

3. Rule G–3, on Professional Qualifications

The proposed amendment to Rule G–3 permits an associated person qualified as an investment company limited representative to effect transactions in municipal fund securities (but no other municipal securities).[106] A dealer must continue to have municipal securities principals as required under Rule G–3(b), even if the dealer's only municipal securities transactions are sales of municipal fund securities.

Schulte states that the amendment should be modified to exempt dealers in local government pool investments from the requirement that they have at least one municipal securities principal, provided that such dealers meet the requirements regarding principals established by the NASD.[107] Similarly, Fidelity states that investment company principals should be permitted to supervise sales representatives that sell municipal fund securities and to approve advertisements.[108]

The Board believes that requiring a dealer effecting transactions in municipal fund securities to have at least one municipal securities principal is appropriate because dealers must have at least one associated person who is familiar with Board rules. Consistent with this view, the Board believes that supervision of municipal securities activities is appropriately vested in individuals who have such familiarity with Board rules. The Board has not revised this proposed amendment.[109]

4. Rule G–8, on Recordkeeping

As published in the March Notice, the draft amendment to Rule G–8 would recognize that municipal fund securities do not have par values, dollar prices, yields and accrued interest and that some investment company limited representatives would be permitted to effect transactions in municipal fund securities.

Fidelity suggest that Rule G–8 be amended to permit a dealer to rely on a transfer agent for municipal fund securities to meet applicable books and records requirements under the rule, noting that a transfer agency system is typically used for mutual fund-type products.[110] Fidelity points to the existing provision in the rule that permits a non-clearing or introducing dealer to rely on records maintained by a clearing dealer.

The Board believes that it would be appropriate to permit a dealer effecting transactions in municipal fund securities to meet its books and records requirements by having its books and records maintained by a transfer agent so long as those books and records meet the requirements of Rule G–8 and the dealer remains responsible for the accurate maintenance and preservation of the books and records.[111] Therefore, the Board has proposed to revise Rule G–8(g) as suggested.

Fidelity also suggests that the definition of ''institutional account'' in Rule G–8(a)(xi) be amended to include states and their political subdivisions and instrumentalities, noting that the additional information required under this provision for non-institutional accounts is ''simply inapposite'' with respect to such entities.[112] The Board notes, however, that this definition is also used in Rule G–19, on suitability of recommendations and transactions, in connection with the requirement that dealers make reasonable efforts to obtain certain information about non-institutional accounts (but not institutional accounts as defined in Rule G–8(a)(xi)) prior to recommending a municipal security transaction.[113] This information is then required to be used by the dealer when making a suitability determination under Rule G–19 in connection with a recommended transaction.

The definition of institutional account under Rule G–8 is identical to the definition used under NASD rules and the Board believes that it should not diverge from this common definition without substantial cause. Further, because the definition of institutional account includes any entity with total assets of at least $50 million, a substantial proportion of state or local government customers would qualify as institutional accounts under the current

[104] In the alternative, Merrill, PFM, Schulte and TPIS suggest that underwriting assessments should be based on net issuances of municipal fund securities, taking into account all securities retired. TPIS also suggests that a flat annual or monthly fee set at a modest level might be more appropriate.

[105] The Board published this revised version of the draft amendment to Rule A–13 in the August Notice. Commentators supported the Board's decision to exempt sales of municipal fund securities from the underwriting assessment. *See* Second GFOA and Saul Letters. Another commentator states, however, that ''there is no assurance that the assessment will not be imposed at a future time.'' *See* Eckert Letter. The Board believes that no further revisions to Rule A–13 are warranted.

[106] Thus, an associated person who sells both municipal fund securities and other types of municipal securities would be required to qualify as a municipal securities representative or general securities representative.

[107] *See* Schulte Letter.

[108] *See* First Fidelity Letter. Rule G–21, on advertising, requires that each advertisement be approved by a municipal securities principal or general securities principal. Rule G–27, on supervision, requires either a municipal securities principal or municipal securities sales principal to supervise municipal securities sales activities. Fidelity incorrectly states that the draft amendment to Rule G–3 would require those who supervise sales representatives for local government pool investments to be qualified as a municipal securities sales principal. In fact, under Board rules, municipal securities principals may also supervise municipal sale activities.

[109] If at some future time the Investment Company and Variable Contracts Products Principal Examination (Series 26) were to include questions on relevant Board rules, including but not limited to those rules relating to municipal fund securities, the Board could reconsider the requirement that such supervisory activities be undertaken by a municipal securities principal.

[110] *See* First Fidelity Letter.

[111] This provision would parallel an existing provision in Rule G–8(c) permitting maintenance for a non-clearing dealer of records by clearing agencies that are not themselves dealers.

[112] An institutional account is defined as (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) a registered investment adviser; or (iii) any entity with total assets of at least $50 million. The additional information that dealers are required to record under Rule G–8(a)(xi) for non-institutional accounts as compared to institutional accounts includes (i) the customer's age, (ii) the customer's occupation and employer and (iii) any beneficial owner of the account if other that the customer.

[113] The information that dealers are obligated to make reasonable efforts to obtain prior to recommending a municipal security transaction to a non-institutional account (but not to an institutional account) includes 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 the dealer in making recommendations to the customer. The collection of this information can have an impact on the nature of a dealer's suitability obligation because suitability determinations are required to be based on information disclosed by or otherwise known about the customer. Depending upon the specific facts and circumstances, Rule G–19 may require that dealers make a greater effort to obtain information on which to base a suitability determination from a non-institutional account than from an institutional account.

definition.[114] Finally, excluding state and local governments from the definition of institutional account could serve to weaken the Board's suitability requirement with respect to recommended transactions with smaller state and local governments (*i.e.,* those with assets of less than $50 million), which are the governmental entities arguably most likely in need of investor protection.[115] Therefore, the Board did not amend the rule as suggested.

Furthermore, in conjunction with revisions to the proposed amendment to Rule G–15, relating to periodic statements in lieu of individual transaction confirmations, as described below, the Board revised the amendments to Rule G–8 to require that dealers retain as part of their books and records copies of all periodic statements delivered to customers in lieu of individual confirmations.

5. Rule G–15, on Customer Confirmations

The draft amendments to Rule G–15, as published in the March Notice, change the concepts of par value, yield, dollar price, maturity date and interest, none of which would appropriately apply to a municipal fund security. Thus, on a confirmation of a municipal fund securities transaction, a dealer would use the purchase or sale price of the securities (as appropriate) rather than par value and would omit yield, dollar price, accrued interest, extended principal, maturity date and interest rate. Dealers selling municipal fund securities would be required to include the denomination or purchase price of each share or unit as well as the number of shares or units to be delivered. Confirmations of municipal fund securities transactions would require a disclosure to the effect that a deferred commission or other charge may be imposed upon redemption, if applicable.[116] The amendment also would make clear that dealers must confirm redemptions of municipal fund securities. Finally, the amendment would permit dealers to use quarterly statements, rather than transaction-by-transaction confirmations, if customers are purchasing the securities in an agreed amount on a periodic basis (''periodic plan''), in a manner similar to the periodic reporting provision of Rule 10b–10[117] under the Act.

The Board received a number of technical comments on various provisions in the draft amendments to Rule G–15 published in the March Notice. In response, the Board published revised draft amendments to Rule G–15 in the August Notice. The revised amendments generated additional comments and, in certain cases, resulted in the Board making further revisions. The comments received and the Board's responses are set forth below:

*a. Periodic Statements—Rule G–15(a)(vi)(G) and (a)(viii).* Several commentators state that the draft amendments, as published in the March Notice, would require individual confirmations for each transaction in local government pool interests.[118] Schulte suggests that dealers effecting transactions in local government pool investments be permitted to use monthly statements. Merrill states that transactions in higher education trust interests that are not effected pursuant to a periodic plan should nonetheless qualify for periodic statements in lieu of individual transaction confirmations.[119]

As a result, the Board revised the draft amendment to Rule G–15 to provide that information regarding transactions in municipal fund securities effected in connection with a program that does not provide for periodic purchases or redemptions of municipal fund securities (a ''non-periodic program'') may be disclosed to customers on a monthly statement in lieu of transaction confirmations.[120] With respect to natural persons who participate in a non-periodic program, this monthly reporting would require the written consent of such individual or of the issuer. If the issuer directs that monthly statements be used in lieu of transaction confirmations, the revised amendment to Rule G–15(a)(viii) would permit dealers effecting transactions in such municipal fund securities to use monthly statements without obtaining the consent of any customers. In addition, the amendment has been revised to eliminate the requirement that customers participating in a group periodic plan consent to the use of periodic statements in lieu of transaction confirmations.[121]

In commenting on the revised amendments published in the August Notice, Merrill suggested that the revision inadvertently imposes a more onerous condition on dealers using periodic statements for customers participating in periodic plans that are not part of a group plan, as compared to customers participating in a non-periodic program, because the issuer would not be permitted under the language of the draft amendment to provide consent on behalf of customers as in the case of non-periodic programs.[122] As a result, the Board has further revised the amendment to Rule G–15(a)(viii)(E) to allow issuers to provide consent for the use of periodic statements in these circumstances.[123]

*b. Rule G–15(a)(i)(A)(7).* One commentator states that municipal fund securities will not be issued in certificated form and therefore the

[114] Because those state or local government customers do not qualify as an institutional account, the dealer would merely indicate in its records that such information (such as customer's age, occupation, etc.) is inapplicable, as with any other customer that does not qualify as an institutional account and is not a natural person.

[115] Because state and local governments with assets of less than $50 million are not considered institutional accounts under NASD rules, the suggested amendment would have the effect of making the Board's suitability requirements with respect to recommendations of municipal securities transactions to such entities weaker than NASD's suitability requirements with respect to recommendations of transactions in other types of securities to these same entities.

[116] Disclosure of deferred commissions or other charges would cover, for example, any deferred sales load or, in the case of interests in certain higher education trusts, any penalty imposed on a redemption that is not for a qualifying higher education expense.

[117] 17 CFR 240.10b–10.

[118] *See* PLGIT, PFM and Schulte Letters. PFM and PLGIT state that individual confirmations for the frequent purchases and redemptions of local government pool interests would impose high administrative and cost burdens. PLGIT notes that its program processes over 500,000 check redemptions each year, with some program participants using checks for such purposes as paying payroll.

[119] *See* First Merrill and Second Merrill Letters. Merrill states that this would be ''analogous to and consistent with'' the provisions of Rule 10b–10 permitting periodic statements in lieu of confirmations for non-periodic transactions in tax-qualified individual retirement and individual pension plans.

[120] In addition, the Board made a minor language change to paragraph (a)(vi)(G) of Rule G–15 to clarify that quarterly statements in lieu of individual confirmations for periodic plans also would be available for arrangements involving a group of two or more customers.

[121] TPIS states that requiring customer consent to receive quarterly statements would impose administrative burdens on dealers that are not justified by any investor protection interest. It notes practical difficulties with sending confirmations to some members of a group plan and quarterly statements to others, stating that if the dealer fails to receive consent from any customer, it might be forced to send individual confirmations to all customers. TPIS states that, in adopting the investment company plan exception to the confirmation requirements in Rule 10b–10, the SEC recognized that securities sold through such plans do not require the same level of reporting as other securities transactions because their regularized nature raised fewer concerns about whether a particular transaction was executed consistent with the expectations of the customer. *See* First TPIS Letter.

[122] *See* Second Merrill Letter.

[123] The Board believes that this further revision addresses any remaining concerns regarding the availability of periodic statements in lieu of confirmations alluded to by Fidelity in the First Fidelity Letter. The Board understands that these revisions to the confirmation provisions have adequately addressed PLGIT's concerns regarding the need for individual confirmations for each redemption. *See* Saul Letter.

delivery provisions under subparagraph (a)(i)(A)(7) would not be relevant.[124] In order to avoid the potential for ambiguity, this subparagraph has been revised to eliminate reference to denomination and to refers solely to the share purchase price.[125]

*c. Rule G–15(a)(i)(C) and (A)(i)(B)(1).* TPIS notes that the Board did not provide guidance regarding certain descriptive information regarding purchased securities required to be included in the confirmation under paragraph (a)(i)(C) and states that this paragraph should not be applicable to municipal fund securities. In the alternative, it suggests that confirmations should not be required to state that municipal fund securities are unrated.[126] The Board has revised the amendment to (i) provide that a confirmation of a municipal fund security transactions need not show the information required under paragraph (a)(i)(C) other than whether the security is puttable and (ii) include a requirement in subparagraph (a)(i)(B)(1) that the confirmation include the name used by the issuer to identify the security and, to the extent necessary to differentiate the security from other municipal fund securities of the issuer, any separate program series, portfolio or fund designation. A statement to the effect that the security is unrated would not be required.

*d. Rule G–15(a)(viii)(B).* Merrill argues that certain information required to be disclosed on a periodic statement with respect to municipal fund security transactions would be unnecessarily repetitive and might best be disclosed in a separate disclosure document that is applicable to all transactions in these securities.[127] This information includes disclosure of deferred commissions or other charges, whether the security is redeemable, the capacity of the dealer, and the time of execution. The Board believes that dealers using a periodic statement where the information is identical for all transactions shown on the statement should be permitted to provide the information only once on the statement rather than repeatedly for each transaction. In addition, the Board believes that if the information is included in disclosure materials previously delivered to the customer and the periodic statement clearly indicates that the information is included in the disclosure material, the information may be omitted from the periodic statement. Of course, a dealer would not be able to rely on this provision if the disclosure materials have not in fact been delivered to the customer or if the information included in the disclosure materials is not accurate with respect to any transaction disclosed on the periodic statement (*e.g.,* if the information has subsequently been changed). As a result, the Board revised Rule G–15(a)(viii)(B) to this effect.

6. Rule G–21, on Advertising

The Board did not propose amending Rule G–21 in the March Notice. Schulte states that this rule should be revised to eliminate references to price and yield for purposes of municipal fund securities.[128] Section (d)(i) provides that an advertisement for new issue municipal securities may show the initial reoffering price or yield, even if they have changed, so long as the date of sale is shown. In addition, it provides that if the price of yield shown in the advertisement is other than the initial price or yield, the price or yield shown must have been accurate at the time the advertisement was submitted for publication. The Board believes that these provisions do not unnecessarily restrict the manner in which municipal fund securities may be advertised nor do they mandate that an advertisement for a municipal fund security specify a price or yield.[129] Therefore, no change has been proposed on Rule G–21.

7. Rule G–32, on New Issue Disclosures

No amendments to Rule G–32 were proposed in the March Notice. However, the Board stated that municipal fund securities sold in a primary offering would constitute new issue municipal securities for purposes of Rule G–32 so long as the securities are in the underwriting period. Because the Board understands that issuers of municipal fund securities are continuously issuing and delivering the securities as customers make purchases, the Board believes that municipal fund securities would remain in their underwriting period so long as such issuance and delivery continues.[130] Thus, a dealer effecting a transaction in a municipal fund security would be required to deliver to the customer the official statement, if one exists, by settlement of the transaction. However, in the case of any customer making repeat purchases of a municipal security (including but not limited to a municipal fund security), no new delivery of the official statement would be required so long as the customer has previously received it in connection with a prior purchase and the official statement has not been changed from the one previously delivered to that customer.[131]

TBMA expresses concern regarding the timing requirement of Rule G–32 in the limited circumstances where a revision has just been made to the official statement and a customer that participates in a periodic plan makes an automatic purchase of additional shares of municipal fund securities.[132] In spite of the best efforts of the dealer and the issuer, it may be impossible for the revised official statement to be delivered to the customer by settlement. TBMA suggests that, under these circumstances, the timing requirement under Rule G–32 should be based on the

[124] *See* First TPIS Letter.

[125] Subparagraph (a)(i)(A)(7) would require that the confirmation for a municipal fund security transaction indicate the purchase price (exclusive of commission) of each share or unit and the number of shares or units to be delivered, regardless of whether a physical or book-entry delivery of the securities will occur.

[126] TPIS states that such securities are ineligible for ratings and such notation might be misleading. *See* First TPIS Letter. However, the Board notes that a relatively small number of local government pools have in fact been rated. *See* NAST Report, at 36. *See generally* S&P Report.

[127] *See* Second Merrill Letter. Fidelity believes that information regarding redemptions need not be disclosed at all. *See* First Fidelity Letter.

[128] *See* Schulte Letter.

[129] The Board understands that, in the context of local government pools, the terms ''yield'' may be used to refer to historical returns that may be used as a basis for comparing investment performance. *See* NAST Report, at 8. References in Rule G–21 to yield, consistent with its use in other Board rules, refer to a future rate of return on securities and do not refer to historical yields. The Board notes that any use of historical yields would be subject to section (c) of Rule G–21, which provides that no dealer shall publish or cause to be published any advertisement concerning municipal securities that the dealer knows or has reason to know is materially false or misleading. Thus, a dealer advertisement of municipal fund securities that refer to yield typically would require a description of the nature and significance of the yield shown in the advertisement in order to assure that the advertisement is not false or misleading.

[130] Rule G–32 defines underwriting period for securities purchased by a dealer (not in a syndicate) as the period commencing with the first submission to the dealer of an order for the purchase of the securities or the purchase of the securities from the issuer, whichever first occurs, and ending at such time as the following two conditions both are met: (1) the issuer delivers the securities to the dealer, and (2) the dealer no longer retains an unsold balance of the securities purchased from the issuer or 21 calendar days elapse after the date of the first submission of an order for the securities, whichever first occurs. However, because the issuer continuously delivers municipal fund securities, the first condition for the termination of the underwriting period remains unmet.

[131] In addition, in the case of a repeat purchaser of municipal fund securities for which no official statement in final form is being prepared, no new delivery of the written notice to that effect or of any official statement in preliminary form would be required so long as the customer has previously received it in connection with a prior purchase. However, if an official statement in final form is subsequently prepared, the customer's next purchase would trigger the delivery requirement with respect to such official statement.

[132] *See* TBMA Letter.

sending rather than the delivery of the official statement.

As a result, the Board published in the August Notice a draft amendment to Rule G–32 that provided that, in the situation where the official statement is being amended or otherwise changed, a dealer may sell, pursuant to a periodic plan, a municipal fund security to a customer who has previously received the official statement so long as it sends to the customer a copy of any new, supplemented, amended or stickered official statement by first class mail promptly upon receipt from the issuer (*i.e.,* actual delivery by settlement would not be required). This draft amendment was designed to address the limited circumstances where an amendment to the official statement for a municipal fund security has just been produced but, because of standing arrangements with a customer under a periodic plan, a transaction in such security will automatically be effected and the securities delivered before the dealer is able to deliver the amended official statement to the customer, as would otherwise be required under the rule.

Fidelity suggests that this draft amendment to Rule G–32 be made to apply equally to periodic plans and non-periodic programs.[133] The Board believes that, although the problem that was intended to be addressed by the draft amendment would most likely arise under a periodic plan, such problems also may arise from time to time with respect to non-periodic programs. In addition, Merrill states that, in the case of an amendment to an official statement, dealers should be permitted to satisfy the delivery requirement under Rule G–32 with respect to the amended official statement by delivering the amendment alone (including a notice that the complete official statement is available upon request).[134] The Board understands that this is a typical practice in connection with amendments to mutual fund prospectuses. Although the Board believes that Rule G–32 currently would permit delivery of the amendment alone so long as the customer already has the official statement that is being amended and the dealer ensures that the amendment makes clear what constitutes the complete official statement as amended, the Board has determined that clarifying language consistent with Merrill's comment should be added to Rule G–32. as a result, the Board has made further revisions to Rule G–32 to effect both of these suggested changes.

Finally, Eckert implies that requiring dealers selling municipal fund securities to comply with the official statement delivery requirements of Rules G–32 and G–36 may not conform Section 15B(d)(2)[135] of the Act.[136] Except for the technical changes to Rule G–32 included in the proposed rule change, the provisions of Rules G–32 and G–36 apply to dealers effecting transactions in municipal fund securities in a manner identical to dealer transactions in other forms of municipal securities. The Board believes that its authority to require the delivery of official statements by dealers in the manner provided in these rules has long since been settled.

8. Rule G–33, on Calculations

The Board did not propose amendment Rule G–33 in the March Notice. Schulte states that this rule should be revised to eliminate references to par value, yield dollar price, maturity date and interest for purposes of municipal fund securities.[137] By its terms, Rule G–33 applies only to municipal securities that bear interest or are sold at a discount. Because municipal fund securities do not bear interest and are not sold at a discount, Rule G–33 would by its nature not apply. Therefore, no change has been made to Rule G–33.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the 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 Board consents, the Commission will:

(A) by order approve the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. 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 the filing will also be available for inspection and copying at the principal offices of the Board. All submissions should refer to the File No. SR–MSRB–00–06 and should be submitted by August 2, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[138]

**Margaret H. McFarland,**

*Deputy Secretary.*

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[133] *See* First Fidelity Letter.

[134] *See* Second Merrill Letter.

[135] 15 U.S.C. 78*o*–4(d)(2).

[136] *See* Eckert Letter. Section 15B(d)(2) of the Act provides that the Board is not authorized to require any issuer, directly or indirectly, to furnish to the Board or a customer any document or information with respect to such issuer; provided that the Board may require dealers to furnish to the Board or customers such documents or information which is generally available from a source other than the issuer.

[137] *See* Schulte Letter.

[138] 17 CFR 200.30–3(a)(12).

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–43075; File No. SR–NYSE–00–20]**

## Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to Listing Fees for Closed-End Funds

July 26, 2000.

## I. Introduction

On May 3, 2000 the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') submitted to the Securities and Exchange Commission (''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. The proposed rule change was published for comment in the **Federal Register** on June 23, 2000.[3] The Commission did not receive any comment letters with respect to the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 34–42948 (June 15, 2000), 65 FR 39216.