Blind Advertisements

Under Rule G-21(e)(i)(B)(2), certain product advertisements for municipal fund securities that promote an issuer and its public purpose without promoting specific municipal fund securities or identifying a dealer or its affiliates may omit the general disclosures otherwise required under Rule G-21(e)(i)(A). Among other things, such a blind advertisement may include contact information for the issuer or an agent of the issuer to obtain an official statement or other information, provided that if such issuer's agent is a dealer or dealer affiliate, no orders may be accepted through such source unless initiated by the customer. Although the contact information may direct a potential customer to a dealer or its affiliate acting as agent of the issuer, the face of the advertisement may not identify such dealer or affiliate.

For example, a blind advertisement may say "call 1-800xxx-xxxx for more information" or "go to www.[state-name]-529plan.com for more information" but may not say "call [dealer name] at 1-800-xxx-xxxx for more information" or "go to www.[dealer-name]-529plan.com for more information." This provision does not preclude the person who answers a phone inquiry, or the website to which the URL links, from identifying the dealer or its affiliate, so long as such dealer or affiliate is clearly disclosed to be acting on behalf of the issuer identified in the advertisement.

If a potential customer initiates an order through the source identified in the advertisement, a distinct barrier between the providing of information and the seeking of orders must be maintained to qualify as a blind advertisement. For example, solely for purposes of Rule G-21(e)(i)(B)(2), a dealer may establish that the customer initiated the order by requiring, in the case of a telephone inquiry, that the customer be transferred from the initial dealer contact person to a different person before the customer provides any information used in connection with an order or, in the case of a web-based inquiry, that the customer navigate from the initial webpage referred to in the advertisement to another page on the same or different web site before entering any information used in connection with an order.[1] Of course, the dealer must be mindful of its obligation under Rule G-17, on fair practice, to provide to the customer, at or prior to the time of trade, all material facts about the transaction known by the dealer as well as material facts about the security that are reasonably accessible to the market, regardless of whether the transaction was recommended or whether an order may be characterized as unsolicited.[2] In addition, if the transaction is recommended, the dealer must fulfill its obligations with respect to suitability under Rule G-19, on suitability of recommendations and transactions.[3]

Required Annual Reports Excluded from Definition of Advertisement

In some cases, a dealer may be required, by state law or the rules and regulations adopted by the state or an instrumentality thereof governing a particular 529 plan or other municipal fund security program, to prepare or distribute an annual financial report or other similar information regarding such plan or program. So long as a dealer provides any such required report or information with respect to a 529 plan or other municipal fund securities program solely in the manner required by such state law or rules and regulations, such report or information will not be treated as an advertisement for purposes of Rule G-21.[4] However, the dealer would remain subject to Rule G-17, which requires that the dealer deal fairly with all persons, prohibits the dealer from engaging in any deceptive, dishonest or unfair practice and requires the dealer to provide to its customer, at or prior to the time of trade, all material facts about a transaction known by the dealer or that are reasonably accessible to the market. In addition, if such information is used in any manner beyond what is narrowly required by such law, rules or regulation, such use of the information would become subject to Rule G-21 as an advertisement.[5]

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[1] These methods are not intended to be the exclusive means by which a dealer could establish that the customer initiated the order.

[2] *See* Rule G-17 Interpretation — Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts, March 20, 2002, *reprinted in MSRB Rule Book*.

[3] *See* Rule G-17 Interpretation — Interpretation on Customer Protection Obligations Relating to the Marketing of 529 College Savings Plans, August 7, 2006, *reprinted in MSRB Rule Book*.

[4] If such information is distributed through the official statement, then it would not be considered an advertisement by virtue of the exclusion of official statements from the definition of "advertisement" in Rule G-21(a)(i).

[5] This guidance is consistent with similar guidance provided by NASD with respect to its advertising rule, Rule 2210, as applied to certain performance information and hypothetical illustrations required by state laws to be provided by dealers in connection with retirement investments and variable annuity contracts. *See* letter dated November 29, 2004, to Therese Squillacote, Chief Compliance Officer, ING Financial Advisers, LLC, from Philip A. Shaikun, Assistant General Counsel, NASD; letter dated September 30, 2002, to Sally Krawczyk, Esq., Sutherland, Asbill & Brennan, LLP, from Mr. Shaikun; and letter dated February 5, 1999, to W. Thomas Conner, Vice President, Regulatory Affairs, National Association of Variable Annuities, from Robert J. Smith, Office of General Counsel, NASD Regulation, Inc.

See also:

Rule G-30 Interpretation — Interpretive Notice on Commissions and Other Changes, Advertisements and Official Statements Relating to Municipal Fund Securities, December 19, 2001.

Interpretive Letters

Legend satisfying requirement. I refer to your letter of June 29, 1979 in which you request advice regarding rule G-21(c) on product advertisements. As you noted in your letter, the notice of approval of rule G-34 [prior rule on advertising] stated that the Board believes that the advertisements may be misleading if they show

only a percentage rate without specifying whether it is the coupon rate or yield and, if yield, the basis on which calculated (for example, discount, par or premium securities and if discount securities, whether before-tax or after-tax yield).

You have requested advice as whether the following legend, to be used in connection with the sale of discount bonds, would be satisfactory for purposes of the rule:

"Discount bonds may be subject to capital gains tax. Rates of such tax vary for individual taxpayers. Discount yields shown herein are gross yields to maturity."

As I previously indicated to you in our telephone conversation, the proposed legend would satisfy the requirements of rule G-21(c). *MSRB interpretation of August 28, 1979.*

Advertisements of securities not owned. This is in response to your letter of May 5, 1982 concerning a dealer bank's advertising practices. Your letter states that the dealer bank has recently published newspaper advertisements which list specific municipal securities as "Current Offerings," and that your review of the dealer's inventory positions has disclosed that "on the date the advertisement was published the dealer held no position in four of the issues advertised and a nominal position in the fifth advertised issue." Your letter reports that the dealer stated that it was his intention to obtain the advertised issues from other dealers when customer orders were received. Your first question is whether "it is misleading and thus in violation of rule G-21, to advertise securities which the dealer does not own..."

The Board has recently considered this advertising practice and concluded that it would not violate Board rules provided that: (1) the advertisement indicates that the securities are advertised "subject to availability;" (2) the dealer placing the advertisement is not aware that the bonds are no longer available in the market; and (3) the dealer would attempt to acquire the bonds advertised if contacted by a potential customer.

Your letter also expresses concern that this type of advertising might be seriously misleading to customers since the advertisement must be prepared and the printer's proof copy approved five days in advance of the date of publication. You note that "significant changes in the market can occur over a five, or even three-day period" and that, if such market changes had occurred between submission and publication of the advertisement, the customer could be seriously misled. The Board is aware that delays occur between the time an advertisement is composed and approved for publication by a municipal securities dealer and the time it is actually published. The Board believes that inclusion in the advertisement of a statement indicating that the securities are advertised subject to change in price provides adequate notice to a potential customer that the prices and yields quoted in the advertisement may not represent market yields and prices at the time the customer contacts the dealer. *MSRB interpretation of July 1, 1982.*

Contents of advertisement: put options. Your letter dated June 15, 1981, has been referred to me for response. In your letter you mention our previous conversation regarding the appropriate definition of "put bonds", which definition your firm would like to use in advertisements offering such securities for sale. You request confirmation of the Board's views concerning the aspects of the "put option" feature on these securities that would be appropriate to cover in such a definition.

The type of "put option" issue with which the Board is familiar, and which we discussed, has a provision in the indenture which permits the holder of the securities to tender or "put" the securities back to the issuer on specified dates at par. This feature typically commences six (or more) years after the date of issuance, is exercisable only once annually (on an interest payment date), and is exercisable only upon the provision of irrevocable prior notice to the issuer (typically three or more months before the exercise date).

If I remember our conversation correctly, you indicated that the firm wished to describe a security of this type in an advertisement as having a "put option" feature, available once annually, permitting redemption of the securities at par. I suggested that, while the items of information you detailed were appropriate, it might also be advisable to mention in the advertisement the "prior notice" requirement under the option exercise procedure. It would also be helpful to make clear the irrevocable nature of such notice.

If the content of your definition of the "put option" feature goes beyond the items we discussed (for example, by indicating that the "put option" is secured by a bank letter of credit,) additional disclosures might also be appropriate. *MSRB interpretation of July 13, 1981.*

Advertising of securities subject to alternative minimum tax. This is in response to your letter concerning the application of rule G-21, on advertising, to advertisements for municipal securities subject to the alternative minimum tax (AMT). You state that advertisements for municipal securities usually note that the securities are "free from federal and state taxes." You ask whether an advertisement for municipal securities subject to AMT should note the applicability of AMT if such advertisements describe the securities as "tax exempt." The Board has considered the issue and authorized this reply.

Rule G-21(c) prohibits a broker, dealer or municipal securities dealer from publishing any advertisement concerning municipal securities which the broker, dealer or municipal securities dealer knows or has reason to know is materially false or misleading. The Board has stated that the use of the term "tax exempt" in advertisements for municipal securities connotes that the securities are exempt from all federal, state and local income taxes. If this is not true of the security being advertised, the Board has required that the use of the term "tax exempt" in an advertisement must be explained, *e.g.*, by footnote.[1] In regard to municipal securities subject to AMT, the Board has determined that advertisements for such securities

that describe the securities as being exempt from federal income tax also must describe the securities as subject to AMT. *MSRB Interpretation of February 23, 1988.*

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[1] Frequently asked questions concerning advertising, *MSRB Reports*, Vol. 3, No. 2 (April 1983), at 22.

Advertisements showing current yield. This is in response to your letter concerning the application of rule G-21, on advertising, to advertisements that include information on current yield of municipal securities.[1] You have asked for the Board's views whether including current yield information in advertisements for municipal securities, alone or with other yield information, would be materially misleading. You also ask if a dealer may advertise current yield if other yield information is included but is in smaller print. The Board has considered this issue and authorized this reply.

Rule G-21 prohibits a dealer from publishing an advertisement concerning a municipal security that the dealer knows or has reason to know is materially false or misleading. The Board has stated that an advertisement showing a percentage rate of return must specify whether it is the coupon rate or the yield. The Board noted that, if a yield is presented, the advertisement must indicate the basis on which the yield is calculated.[2]

The Board frequently has stated that the yield to call or yield to maturity is the most important factor in determining the fairness and reasonableness of the price of any given transaction in municipal securities. Such yields typically are used as a basis for dealers and customers to evaluate an investment in municipal securities. The disclosure of yield to call or yield to maturity is the longstanding practice of the municipal securities industry and this practice is reflected in rule G-15(a) which requires dealers to disclose yield to call or yield to maturity on customer confirmations.[3] A customer who purchases a municipal security relying only on the current yield information disclosed in an advertisement would be confused upon receipt of the confirmation when the yield to call or yield to maturity of the security is different. Moreover, a customer would not be able to compare municipal securities advertised at a current yield with those advertised at a yield to call or yield to maturity.[4] The Board has determined that the use of current yield information in municipal securities advertisements without other yield information would be materially misleading under rule G-21. Thus, dealers may not show only current yield in municipal securities advertisements.

The Board also has determined that, while showing only current yield information in advertisements is materially misleading, if advertisements also include, at a minimum, the lowest of yield to call or yield to maturity, current yield may be used if all the information is clearly presented as discussed below. The Board notes that including yield to call or yield to maturity in municipal securities advertisements would give customers a more realistic view of the yield they can expect to receive on the investment and would enable them to compare the security advertised with other municipal securities. In addition, the yield to call or yield to maturity information would be consistent with the yield information disclosed on customer confirmations. If the yield to call is used, the call date and price also should be noted.

The Board is concerned that, even if dealers comply with this interpretation of rule G-21 and include current yield and other yield information in municipal securities advertisements, such advertisements still could be misleading due to the size of type used and the placement of the information. For example, it would not be appropriate for the type size of the current yield to be larger than other yield information. Thus, whether a particular advertisement is materially misleading requires the appropriate regulatory body, for example, an NASD District Business Conduct Committee, to consider a number of objective and subjective factors. The Board urges the regulatory authorities to continue to review advertisements on a case-by-case basis to make a determination whether any such advertisements, in fact, are misleading. *MSRB interpretation of April 22, 1988.*

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[1] Current yield is a calculation of current income on a bond. It is the ratio of the annual dollar amount of interest paid on a security to the purchase price of the security, stated as a percentage. If the securities are sold at par, the current yield equals the coupon rate on the securities. Current yield, however, does not take into account the time value of money. Thus, generally, if a bond is selling at a discount, the current yield would be less than the yield to maturity and, if the bond is selling at a premium, the current yield would be greater than the yield to maturity.

[2] Frequently Asked Questions Concerning Advertising, *MSRB Reports*, Vol. 3, No. 2 (Apr. 1983), at 21-23.

[3] Rule G-15(a)(i)(1) [currently codified at rule G-15(a)(i)(A)(5)] requires that the yield or dollar price at which the transaction was effected be disclosed on customer confirmations, with the resulting dollar price (if the transaction is done on a yield basis) or yield (if the transaction is done on a dollar basis) calculated to the lowest of dollar price or yield to call, to par option or to maturity. In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated and the call or option date and price used in the calculation must be shown.

[4] The Board also notes that some dealers have used current yield in municipal securities advertisements in an attempt to compete with municipal securities mutual funds, which often use a "current yield" in their advertisements. However, a mutual fund "yield" is not directly comparable to a municipal securities yield because a mutual fund "yield" represents historical information, while the yield on a municipal security represents a future rate of return.

Disclosure obligations. This is in response to your letters dated March 18, 1998 and March 31, 1998 in which you present an example where a dealer advertises a specific municipal security which it knows, or has reason to know, is subject to a material adverse circumstance such as a technical default. You ask whether a dealer is obligated to include disclosure information indicating that a bond is subject to additional risk in order to avoid publishing a false or misleading advertisement as prohibited by rule G-21(c). The Board reviewed your letters and has authorized this response.

Section (c) of rule G-21 provides, among other things, that no dealer shall publish any advertisement[1] concerning municipal securities which such dealer knows or has reason to

know is materially false or misleading. The Board has previously interpreted the rule as not requiring that any specific statements or information be included in an advertisement but that any statement or information that is included must not be materially false or misleading. Thus, if a dealer makes a statement in an advertisement that explicitly or implicitly refers to the soundness or safety of an investment in the municipal securities described in the advertisement, such dealer must include any information necessary to ensure that the advertisement is not materially false or misleading with respect to the soundness or safety of such investment. The rule establishes a general ethical standard that provides the enforcement agencies with the flexibility that is needed to evaluate advertisements in light of what information is printed and how the information physically is presented. Thus, the enforcement agencies should continue to evaluate advertisements on a case-by-case basis to make a determination whether any such advertisements, in fact, are misleading.

You also ask whether the relative specificity of any such disclosure obligation that may exist depends on the level of detail provided about the municipal security. As stated above, rule G-21 does not require that any specific statements or information be included in an advertisement but that any statement or information that is included must not be materially false or misleading. Thus, the nature and extent of any disclosures or other explanatory statements that must be included in an advertisement is dependent upon the substance and form of the information presented in the advertisement.

The Board wishes to emphasize that the enforcement agencies should remain cognizant of certain other rules of the Board that may be relevant in evaluating whether a dealer's advertisement and such dealer's interactions with customers or potential customers that arise as a result of such advertisement are in conformity with Board rules. Thus, depending upon the facts and circumstances, an advertisement for a particular municipal security that on its face conforms with the requirements of rule G-21 may nonetheless be violative of rule G-17, the Board's fair dealing rule,[2] if, for example, the advertisement is designed as a "bait-and-switch" mechanism that attracts potential customers interested in an advertised security that the dealer is not in a legitimate position to sell (because of its unavailability, unsuitability or otherwise) for the primary purpose of creating a captive audience for the offering of other securities. In addition, a dealer that in fact sells the municipal securities that are described in its advertisement must fulfill its obligations under rule G-19, on suitability, and rule G-30, on pricing. *MSRB interpretation of May 21, 1998.*

[1] "Advertisement" is defined in rule G-21 as any material (other than listings of offerings) published or designed for use in the public, including electronic, media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter, telemarketing script or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by dealers.

[2] Rule G-17 requires each dealer, in the conduct of its municipal securities business, to deal fairly with all persons and prohibits the dealer from engaging in any deceptive, dishonest or unfair practice.

Advertisements on behalf of issuer. You ask whether a certain advertisement is subject to approval by a principal pursuant to rule G-21, on advertising. You state that an issuer asked the bank to act as its agent in producing the advertisement. Rule G-21 defines an advertisement as any material (other than listings of offerings) published or designed for use in the public media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements, but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by dealers. Each advertisement subject to the requirements of rule G-21 must be approved in writing by a municipal securities principal or general securities principal prior to first use. The fact that a bank dealer is acting as an agent of an issuer in the production of an advertisement meeting the definition contained in rule G-21 does not relieve a bank from complying with the requirements of the rule. *MSRB interpretation of June 20, 1994.*

529 college savings plan advertisements. Thank you for your letter of April 21, 2006 in which you request interpretive guidance on the application of Rule G-21, on advertising, with respect to advertisements of 529 college savings plans. Rule G-21 was amended in 2005 by adding new section (e) relating to advertisements by brokers, dealers and municipal securities dealers ("dealers") of interests in 529 college savings plans and other municipal fund securities (collectively referred to as "municipal fund securities"). These new provisions were modeled after the provisions of Securities Act Rules 482 and 135a relating to mutual fund advertisements, with certain modifications.

The Board expects to undertake a detailed review of issues relating to the implementation of section (e) of its advertising rule in the coming months and your views will be instrumental in that review. We appreciate your interest in the operation of the rule and the commitment of your organization and your individual members to assure that investors receive appropriate disclosures. As you are aware, MSRB rules apply solely to dealers, not to issuers or other parties. The MSRB has previously stated that Rule G-21 does not govern advertisements published by issuers but that an advertisement produced by a dealer as agent for an issuer must comply with Rule G-21. Similarly, a dealer cannot avoid application of Rule G-21 merely by hiring a third party to produce and publish advertisements on its behalf.[1] Pending our detailed review of section (e) of Rule G-21, I would like to address certain basic principles under the current rule language and existing interpretive guidance that may prove helpful in the context of some of the issues you raise in your letter.[2]

Section (a) of the rule provides a broad definition of "advertisement."[3] Sections (b) through (e) of the rule establish requirements with respect to specific types of advertisements. Section (b) establishes standards for professional advertisements, which are advertisements concerning the dealer's facilities, services or skills with respect to municipal securities. Section (c) establishes general standards for product advertisements, with additional specific standards relating to advertisements for new issue debt securities set forth in Section (d) and specific standards relating to advertisements for municipal fund securities set forth in Section (e). In addition, all advertisements are subject to the MSRB's basic fair dealing rule, Rule G-17,[4] and are subject to approval by a principal pursuant to Section (f) of Rule G-21.

Where an advertisement does not identify specific securities, specific issuers of securities or specific features of securities, but merely refers to one or more broad categories of securities with respect to which the dealer provides services, the MSRB would generally view such advertisement as a professional advertisement under Section (b) rather than as a product advertisement. For example, if an advertisement simply states that the dealer provides investment services with respect to 529 college savings plans — without identifying any specific 529 college savings plan, specific municipal fund securities issued through a 529 college savings plan, or specific features of any such municipal fund securities — the advertisement would be subject to Section (b) of Rule G-21, rather than to Sections (c) and (e).

On the other hand, advertisements that identify specific securities, specific issuers of securities or specific features of securities generally are viewed as product advertisements under Rule G-21 and therefore would be subject to Section (c), as well as Section (d) or (e), if applicable. However, in some circumstances, an advertisement that identifies an issuer of securities without identifying its securities or specific features of such securities effectively may not constitute an advertisement of such issuer's securities and therefore would not be treated as a product advertisement under the rule, particularly if the dealer or any of its affiliates is not identified. For example, if an advertisement identifies the state or other governmental entity that operates a 529 college savings plan without identifying its municipal fund securities, the specific features of such securities or the dealer and its affiliates that may participate in the marketing of its municipal fund securities, the MSRB generally would not view such advertisement as a product advertisement subject to Sections (c) and (e) of Rule G-21.[5] *MSRB Interpretation of May 12, 2006.*

[1] The MSRB expresses no opinion at this time as to the applicability of MSRB rules to advertisements relating to municipal fund securities produced and published by issuers with funds provided directly or indirectly by a dealer.

[2] Other issues you raise in your letter will be considered during the upcoming review of Rule G-21.

[3] An advertisement is defined as any material (other than listings of offerings) published or designed for use in the public, including electronic, media, or any promotional literature designed for dissemination to the public, including any notice, circular, report, market letter, form letter, telemarketing script or reprint or excerpt of the foregoing. The term does not apply to preliminary official statements or official statements (including program disclosure documents), but does apply to abstracts or summaries of official statements, offering circulars and other such similar documents prepared by dealers. The MSRB expresses no opinion at this time as to whether the specific communications or promotional materials described in your letter would constitute advertisements under this definition.

[4] Rule G-17 requires each dealer, in the conduct of its municipal securities activities, to deal fairly with all persons and prohibits the dealer from engaging in any deceptive, dishonest or unfair practice.

[5] The advertisement may, in addition to or instead of identifying the state or other governmental entity that operates the 529 college savings plan, include the state's marketing name for such plan so long as such name does not identify the dealer or any dealer affiliates that may participate in the marketing of its municipal fund securities. Further, any contact information (such as a telephone number or Internet address) included in the advertisement should be for the state or other governmental entity and must not be for the dealer or its affiliates.

See also:

Rule G-30 Interpretive Letter — Differential re-offering prices, *MSRB interpretation of December 11, 2001.*

Rule G-21 Amendment History (since 2003)

Release No. 34-85223 (February 28, 2019), 84 FR 8141 (March 6, 2019); MSRB Notice 2019-07 (February 26, 2019)

Release No. 34-85222 (February 28, 2019), 84 FR 8132 (February 28, 2019); MSRB Notice 2019-07 (February 26, 2019)

Release No. 34-84999 (January 29, 2019), 84 FR 1525 (February 4, 2019); MSRB Notice 2019-03 (January 28, 2019)

Release No. 34-83177 (May 7, 2018), 83 FR 21794 (May 10, 2018); MSRB Notice 2018-08 (May 7, 2018)

Release No. 34-81432 (August 18, 2017), 82 FR 40199 (August 24, 2017); MSRB Notice 2017-16 (August 21, 2017)

Release No. 34-55830 (May 30, 2007), 72 FR 31122 (June 5, 2007); MSRB Notice 2007-18 (June 5, 2007)

Release No. 34-52289 (August 18, 2005), 70 FR 49699 (August 24, 2005); MSRB Notice 2005-45 (August 23, 2005)

Release No. 34-51736 (May 24, 2005), 70 FR 31551 (June 1, 2005); MSRB Notice 2005-31 (May 27, 2005)

Rule G-22
Control Relationships

(a) *Control Relationship*. For purposes of this rule, a control relationship with respect to a municipal security shall be deemed to exist if a broker, dealer, or municipal securities dealer (or a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) controls, is controlled by, or is under common control with the issuer of the security or a person other than the issuer who is obligated, directly or indirectly, with respect to debt service on the security.

(b) *Discretionary Accounts*. No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for the discretionary account of a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to such security unless such transaction has been specifically authorized by such customer.

(c) *Disclosure*. No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to the security unless, before entering into a contract with or for the customer for the purchase, sale, or exchange of such security, the broker, dealer, or municipal securities dealer discloses to the customer the nature of the control relationship, and if such disclosure is not made in writing, such disclosure must be supplemented by the sending of written disclosure concerning the control relationship at or before the completion of the transaction.

Rule G-22 Interpretations

See:

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

Interpretive Letters

Letters of credit. This is in response to your April 9, 1981, letter asking whether Board rule G-22, regarding control relationships, and G-23, regarding financial advisory agreements, would apply if a bank's issuance of a letter of credit were contingent upon its being named underwriter or manager for the issue, or if a bank issuing a letter of credit retained authority to require an issuer, in effect, to call the securities.

Rule G-22 provides that

> a control relationship with respect to a municipal security shall be deemed to exist if a broker, dealer, or municipal securities dealer (or a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) controls, is controlled by, or is under common control with the issuer of the security or a person other than the issuer who is obligated, directly or indirectly, with respect to debt service on the security.

The existence of a control relationship is a question of fact to be determined from the entire situation. Most recently, the Securities and Exchange Commission suggested that, for purposes of the Regulatory Flexibility Act, a registered broker-dealer would be deemed to be controlled by a person or entity who, among other things, has the ability to direct or cause the direction of management or the policies of the broker-dealer. Based upon the above, it is questionable whether a bank that conditions the issuance of a letter of credit upon being named an underwriter or upon a tie-in deposit arrangement should be deemed to control the issuer. Similarly, it does not appear that a bank that retains discretion under a letter of credit to cause the trustee to call the whole issue has a control relationship with the issuer.

You also ask whether under Board rule G-23 a financial advisory relationship is created if a bank conditions the issuance of a letter of credit upon being named an underwriter or upon obtaining a tie-in deposit arrangement. Under rule G-23, a financial advisory relationship is deemed to exist when a municipal securities professional provides, or enters into an agreement to provide, financial advisory services to, or on behalf of, an issuer with respect to a new issue of securities regarding such matters as the structure, timing or terms of the issue, in return for compensation or for the expectation of compensation. It does not appear that rule G-23 would apply in your example since the bank is not providing financial advisory or consulting services with respect to the structure, timing or other substantive terms of the issue. *MSRB interpretation of July 27, 1981*.

Associated person on issuer governing body. This will respond to your letter to the Municipal Securities Rulemaking Board concerning rule G-22 on disclosure of control relationships. You ask whether the rule requires a dealer to disclose to customers that an associated person of the dealer is a member of a fiveperson town council that issued the securities.

Rule G-22(c) states that a dealer may not effect a customer transaction in a municipal security with respect to which the dealer has a control relationship, unless the dealer discloses to the customer the nature of the control relationship prior to executing the transaction. Section (a) of rule G-22 defines a control relationship to exist with respect to a security if the dealer controls, is controlled by, or is under common control with the issuer of the security. This includes any control relationship with an associated person of the dealer.[1] Whether a control relationship exists in a particular case is a factual question. The Board, however, previously has stated that:

A control relationship with respect to a municipal security does not necessarily exist if an associated person of a securities professional is a member of the governing body or acts as an officer of the issuer of the security. However, if the associated person in fact controls the issuer, rule G-22 does apply.

For example, rule G-22 applies if the associated person is the chairman of an issuing authority and, in that capacity, actually makes the decision on behalf of the issuing authority to issue securities. The rule does not apply if the associated person as chairman does not make that decision and does not have the authority alone to make the decision, or if the decision is made by a governing body of which he is only one of several members.[2]

MSRB interpretation of June 25, 1987.

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[1] Rule D-11 states that references to "brokers", "dealers", "municipal securities dealers", and "municipal securities brokers" also mean associated persons, unless the context indicates otherwise.

[2] Notice of Approval of Fair Practice Rules, October 24, 1978, at 6.

Rule G-23
Activities of Financial Advisors

(a) *Purpose*. The purpose and intent of this rule is to establish ethical standards and disclosure requirements for brokers, dealers, and municipal securities dealers who act as financial advisors to issuers with respect to the issuance of municipal securities.

(b) *Financial Advisory Relationship*. For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue. For purposes of this rule, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter and not as a financial advisor, a broker, dealer or municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning the issuance of municipal securities.

(c) *Agreement with Respect to Financial Advisory Relationship*. Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences). Such writing shall set forth the basis of compensation, if any, for the financial advisory services to be rendered, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such broker, dealer, or municipal securities dealer or by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer in connection with the rendering of such financial advisory services and shall be delivered to the issuer.

(d) *Prohibition on Engaging in Underwriting Activities*.

(i) Subject to provisions of subsections (d)(ii) and (iii), no broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or act as agent for the issuer in arranging the placement of such issue.

(ii) Notwithstanding subsection (d)(i), a broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance of municipal securities shall not be prohibited from acting as agent for the issuer in arranging the placement of the entire issue with any state, local or federal governmental entity as part of a plan of financing by such entity for or on behalf of the issuer, but only if such broker, dealer or municipal securities dealer does not receive compensation from any person other than with respect to financial advisory services related to such placement and does not receive compensation from any person for underwriting any contemporaneous financing transaction directly or indirectly related to such issue undertaken by the state, local, or federal governmental entity with which such issue was placed.

(iii) The limitations set forth in this section (d) shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a financial advisory relationship with respect to the issuance of municipal securities. The use of the term "indirectly" in this section (d) shall not preclude a broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to the issuance from purchasing such securities from an underwriter, either for its own trading account or for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule.

(e) *Remarketing Activities*. No broker, dealer, or municipal securities dealer that has a financial advisory relationship with an issuer with respect to the issuance of municipal securities shall act as the remarketing agent for such issue; provided, however, that this section shall not prohibit such broker, dealer, or municipal securities dealer from thereafter serving as successor remarketing agent for such issue if the financial advisory relationship in connection with such issue has been terminated for a period of at least one (1) year prior to such broker, dealer, or municipal securities dealer being selected to serve as successor remarketing agent.

(f) *Applicability of State or Local Law*. Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or local law applicable to the activities of financial advisors.

Rule G-23 Interpretations

Notice on Application of Board Rules to Financial Advisory Services Rendered to Corporate Obligors on Industrial Development Bonds

May 23, 1983

In a recent letter to the Office of the Comptroller of the Currency, the staff of the Securities and Exchange Commission has taken the position that private placements of industrial development bonds ("IDBs") constitute transactions in municipal securities as defined in the Securities Exchange Act of 1934, as amended. The Municipal Securities Rulemaking Board has received a number of inquiries concerning this letter. The Board is publishing this notice for the purposes of: (1) reviewing the application of its rules to private placements of municipal securities and (2) expressing its views concerning whether certain Board rules apply to financial advisory services rendered by municipal securities dealers and brokers to corporate obligors on IDBs.

A. Private Placements of IDBs

The Board's rules apply, of course, to all transactions in municipal securities, including securities which are IDBs. The SEC letter dealt in particular with the activities of commercial banks. That letter pointed out that if a commercial bank has a registered municipal securities dealer department, under Board rule G-1, which defines the term "separately identifiable department or division of a bank," any private placement activities of the bank in securities which are IDBs must be conducted as a part of the registered dealer department. The Board urges all bank dealers which have registered as a separately identifiable department or division to review their organizations and assure that all departments or units which engage in the private placement of IDBs are designated on the bank's Form MSD registration and other applicable bank records as part of its separately identifiable department or division. The Board also notes that such activities must be under the supervision of a person designated by the bank's board of directors as responsible for these activities. In addition, under Board rule G-3, concerning professional qualifications, persons who are engaged in privately placing municipal securities must be qualified as municipal securities representatives and be supervised with respect to that activity by a qualified municipal securities principal.

B. Financial Advisory Services Rendered to Corporate Obligors on IDBs

Board rules G-1 and G-3 provide that rendering "financial advisory or consultant services for *issuers*" is an activity to which those rules are applicable (emphasis added). Similarly, Board rule G-23, on the activities of financial advisors, applies to brokers, dealers, and municipal securities dealers who agree to render "financial advisory or consultant services to or on behalf of an *issuer*" (emphasis added). Clearly these rules are applicable to financial advisory services rendered to state or local governments and their agencies, as well as to municipal corporations. In the Board's view, however, rules G-1, G-3, and G-23 do not apply to financial advisory services which are provided to corporate obligors in connection with proposed IDB financings.

The Board wishes to emphasize that the scope of its definition of financial advisory services is limited to "advice with respect to the structure, timing, terms, and other similar matters" concerning a proposed issue.[1] If persons providing such advice to the corporate obligor on an IDB issue also participate in negotiations with prospective purchasers or are otherwise engaged in effecting placement of the issue, then, as indicated above, rules G-1 and G-3 would apply to their activities.

[Excerpts of the Commission letter follow:]

This is in response to your letter of December 1, 1981, requesting our views concerning certain activities by commercial banks in connection with industrial development bonds ("IDBs").[2] Specifically, you asked (1) whether the private placement activities of banks in IDBs involve transactions in municipal securities, (2) whether involvement in such activities alone would require such banks to register with the Commission under Section 15B of the Securities Exchange Act of 1934 (the "Exchange Act") as municipal securities dealers, (3) whether a bank that had registered a separately identifiable department or division with the Commission as a municipal securities dealer would be required to conduct such activities through such separately identifiable department or division, and (4) if such bank activities are required to be conducted in the separately identifiable department or division, whether the advisory services provided by those banks to the corporate obligor on an IDB should be regarded as advisory services provided to an issuer of municipal securities in connection with the issuance of municipal securities. Pursuant to your letter and subsequent telephone conversations, we understand the following facts to be typical of the activities in question.

A commercial bank offers private placement and financial advisory services to corporate entities on a regular and continuous basis. From time to time the bank recommends to the corporate entity that IDBs be used to raise capital. The bank advises the corporate entity regarding the terms and timing of the proposed IDB issuance, prepares the Direct Placement Memorandum describing the terms of the IDB, and contacts potential purchasers of the IDB. Such purchasers then make independent reviews of the corporate entity's financial status. The bank then obtains comments from the potential buyers and relays such comments to the corporate entity. The bank might also assist the corporate entity in subsequent negotiations with the purchasers. An industrial development authority nominally issues the IDB on behalf of the corporate entity which becomes the economic obligor on the issue.

The bank engages in these activities in order to assist the corporate obligor in the sale of the IDBs. In return for its services, the bank receives from the corporate entity either a fixed fee or a percentage of the proceeds of the sale. The bank does not purchase any of the IDBs. The bank could, however, supply "bridge loans" to the corporate entity pending receipt of the proceeds of the IDB sale. In addition, the bank might provide investors with a letter of credit committing the bank to pay any interest or principal not paid by the corporate issuer. The bank might also act as trustee or paying agent for the nominal issuer of the IDB, for which the bank would receive a set fee.

IDBS As Municipal Securities

Section 3(a)(10) of the Exchange Act defines a "security" as, among other things, "any note… bond, debenture… investment contract, …or in general, any instrument commonly known as a 'security'… " Section 3(a)(29) of the Exchange Act defines "municipal securities" to include any security which is an industrial development bond as defined in Section 103(b)(2) of the Code the interest on which is tax-exempt under Sections 103(b)(4) or 103(b)(6) of the Code. In our opinion, the private placement activities you have described involve transactions in municipal securities as defined in the Exchange Act.[3]