

rying party must immediately establish fail-to-receive and fail-to-deliver contracts at the then-current market value as of the date of validation upon their respective books of account against the long/short positions in the customer's accounts that have not been physically delivered/received and the receiving party/carrying party must debit/credit the related money amount. Nontransferable assets and assets in-transfer to the customer are exempt from the requirement that fail-to-receive and fail-to-deliver contracts must be established for positions in a customer's securities account that have not been physically delivered. Zero value fail-to-receive and fail-to-deliver instructions shall be established for delayed delivery assets. The customer's account(s) shall thereupon be deemed transferred.

(ii) To the extent any assets in the account are not readily transferable, with or without penalties, such assets are not subject to the time frames required by the rule; and, if the customer has authorized liquidation of any nontransferable assets, the carrying member must distribute the resulting money balance to the customer within five business days following receipt of the customer's disposition instructions.

(g) *Transfer of Residual Positions.* Each party is required, for a minimum period of six (6) months after the transfer of municipal securities account assets in whole is completed, to transfer credit balances (both cash and securities) that occur in such transferred account assets within ten (10) business days after the credit balances accrue to the account.

(h) *Fail Contracts Established.* Any fail contracts resulting from this account transfer procedure must be closed out in accordance with Rule G-12(h).

(i) *Prompt Resolution of Discrepancies.*

(i) Any discrepancies relating to positions or money balances that exist or occur after transfer of a customer's municipal securities account assets must be resolved promptly.

(ii) The carrying party must promptly distribute to the receiving party any transferable assets that accrue to the account after the transfer of a customer's securities account assets has been effected.

(iii) When a party receives a claim notice relating to a municipal securities account transfer, the party must resolve the claim within five (5) business days from receipt of such claim or take exception to the claiming party by setting forth specific reasons for denying the claim.

(j) *Exemptions.* The Board may exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any dealer or any type of account, security or municipal security.

(k) *Participant in a Registered Clearing Agency.*

(i) When both the carrying party and the receiving party are direct participants in a clearing agency registered with the Securities and Exchange Commission offering automated customer securities account asset transfer capabilities,

the municipal securities account transfer procedure, including the establishing and closing out of fail contracts, must be accomplished pursuant to the rules of and through such registered clearing agency with the exception of specifically designated municipal securities assets transferred pursuant to the submittal of a customer's authorized alternate instructions to the carrying party, indicating such intent and specifying the designated assets to be transferred. The parties must expedite all authorized municipal securities account asset transfers, whether through automated customer account transfer services (ACATS) or via other means permissible, and coordinate their activities with respect thereto.

(ii) When municipal securities account assets are transferred in whole and such registered clearing agency has the capability to transfer residual credit positions (both cash and municipal securities) that have accrued to an account after the account has been transferred (residual credit processing), such capability must be utilized for transferring residual credit positions from the carrying party to the receiving party.

(iii) When both the carrying party and the receiving party are participants in a registered clearing agency having automated customer securities account asset transfer capabilities with a facility permitting electronic transmittal of customer account asset transfer instructions, such facilities shall be used in accordance with the following:

(A) parties using such facilities shall execute an agreement specifying the rights, obligations and liabilities of all participants in or users of such facilities;

(B) customer account transfer instructions shall be transmitted in accordance with the procedures prescribed by the registered clearing agency;

(C) the transmittal of a transfer request through such electronic facilities shall constitute a representation by the receiving party that it has received a properly executed transfer instruction or other actual authority to receive the customer's municipal securities and funds;

(D) transfer instructions transmitted through such facilities shall contain the information necessary for the clearing agency and the carrying party to respond to the transfer instruction as may be specified by this rule and the clearing agency; and

(E) non-standard ACATS processing and reclaim processing shall be transmitted through such facilities, if the facility permits.

(l) *Forwarding of Copy of Form G-26 to Enforcement Authority on Request.* The carrying party shall forward a copy of each customer account transfer instruction issued pursuant to paragraph (c)(i) to the enforcement authority having jurisdiction over the carrying party member, at the request of such authority.

Supplementary Material:

.01 Customer Authorization. For purposes of this rule, customer authorization pursuant to a transfer instruction could be the customer's actual signature, or an electronic signature in a format recognized as valid under federal law to conduct interstate commerce.

.02 Written Procedures. Municipal securities dealers must establish, maintain and enforce written procedures to effect and supervise the transfer of municipal securities account assets pursuant to this rule that are reasonably designed to achieve compliance with applicable securities laws and regulations, including applicable Board rules.

.03 Transfer Fees. The party at whose instance a transfer of municipal securities is made shall pay all service charges of the transfer agent.

Rule G-26 Interpretation

See:

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

Rule G-26 Amendment History (since 2003)

[Release No. 34-85699 \(April 22, 2019\)](#), 84 FR 17897 ([April 26, 2019](#)); [MSRB Notice 2019-11 \(April 10, 2019\)](#)

[Release No. 34-81233 \(July 27, 2017\)](#), 82 FR 36039 ([August 2, 2017](#)); [MSRB Notice 2017-15 \(July 31, 2017\)](#)

Form G-26
Customer Account Transfer Instructions

Date:

Receiving Party

Carrying Party

Receiving Party
Account Number

Carrying Party
Account Number

Account Title

Tax ID or SS Number

To:

Receiving Party Name and Address

Please receive my entire account from the below indicated carrying party and remit to it the debit balance or accept from it the credit balance in my municipal securities account.

To:

Carrying Party Name and Address

Please transfer my entire municipal securities account to the above indicated receiving party, which has been authorized by me to make payment to you of the debit balance or to receive payment of the credit balance in my municipal securities account. I understand that to the extent any assets or instruments in my municipal securities account are not readily transferable, with or without penalties, such assets or instruments may not be transferred within the time frames required by rule G-26 of the Municipal Securities Rulemaking Board.

I understand that you will contact me with respect to the disposition of any assets in my municipal securities account that are nontransferable. If certificates or other instruments in my securities account are in your physical possession, I instruct you to transfer them in good deliverable form to enable such receiving firm to transfer them in its name for the purpose of sale, when and as directed by me.

Upon validation of this transfer instruction, I instruct you to cancel all open orders for my municipal securities account on your books.

Customer's Signature

Date

Customer's Signature
(If joint account)

Date

It is suggested that a copy of the customer's most recent account statement be attached.

Receiving Party Contact

Name

Phone Number

Rule G-27

Supervision

(a) *Obligation to supervise.* Each broker, dealer and municipal securities dealer (“dealer”) shall supervise the conduct of the municipal securities activities of the dealer and its associated persons to ensure compliance with Board rules and the applicable provisions of the Act and rules thereunder (“applicable rules”).

(b) *Supervisory System.* Each dealer shall establish and maintain a system to supervise the municipal securities activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Board rules. Final responsibility for proper supervision shall rest with the dealer. A dealer’s supervisory system shall provide, at a minimum, for the following:

(i) The establishment and maintenance of written procedures as required by sections (c), (d), (e) and (f) of this rule.

(ii) (A) *General.* The designation of one or more associated persons qualified as municipal securities principals, municipal securities sales principals and municipal fund securities limited principals in accordance with Board rules, or as general securities principals to be responsible for the supervision of the municipal securities activities of the dealer and its associated persons as required by this rule.

(B) *Written Record.* A written record of each supervisory designation and of the designated principal’s responsibilities under this rule shall be maintained and updated as required under Rule G-9.

(C) *Appropriate Principal.*

(1) Each dealer shall designate a municipal securities principal as responsible for its supervision under sections (a), (b), (c), (d), (e) and (f) of this rule, except as provided in this paragraph (C).

(2) A municipal securities sales principal may be designated as responsible for supervision under paragraphs (c)(i)(B), (C) and (G) and subsection (e) (i) of this rule, to the extent the activities pertain to sales to or purchases from a customer of municipal securities.

(3) A general securities principal may be designated as responsible for supervision under paragraph (c)(i)(E) and subparagraph (c)(i)(G)(1) of this rule and under Rules G-7(b) and G-21(f).

(4) A municipal fund securities limited principal may be designated as responsible for supervision under sections (a), (b), (c), (d), (e) and (f) of this rule to the extent that the activities pertain solely to transactions in municipal fund securities.

(iii) The designation as an office of municipal supervisory jurisdiction of each location that meets the definition contained in section (g) of this rule. Each dealer shall also designate such other offices of municipal supervisory jurisdiction as it determines to be necessary in order to supervise its registered representatives, registered principals, and other associated persons with respect to their municipal securities activities in accordance with the standards set forth in this rule, taking into consideration the following factors:

(A) whether registered persons at the location engage in retail sales of municipal securities or other activities involving regular contact with public customers with respect to municipal securities;

(B) whether a substantial number of registered persons conduct municipal securities activities at, or are otherwise supervised from, such location;

(C) whether the location is geographically distant from another office of municipal supervisory jurisdiction of the dealer;

(D) whether the dealer’s registered persons are geographically dispersed; and

(E) whether the municipal securities activities at such location are diverse and/or complex.

(iv) The designation of one or more appropriately registered principals in each office of municipal supervisory jurisdiction, including the main office, and one or more appropriately registered representatives or principals in each municipal branch office that is not an office of municipal supervisory jurisdiction with authority to carry out the supervisory responsibilities with respect to municipal securities assigned to that office by the dealer.

(v) The assignment of each registered person to an appropriately registered representative(s) and/or principal(s) who shall be responsible for supervising that person’s municipal securities activities.

(vi) Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities with respect to municipal securities.

(vii) The participation of each registered representative and registered principal, either individually or collectively, no less than annually, in an interview or meeting conducted by persons designated by the dealer at which compliance matters relevant to the municipal securities activities of the representative(s) and principal(s) are discussed. Such interview or meeting may occur in conjunction with the discussion of other matters and may be conducted at a central or regional location or at the representative’s or principal’s place of business.

(c) *Written supervisory procedures.*

(i) *General provisions.* Each dealer shall adopt, maintain and enforce written supervisory procedures reasonably designed to ensure that the conduct of the municipal securities activities of the dealer and its associated persons are in compliance as required in section (a) of this rule. Such procedures shall codify the dealer's supervisory system for ensuring compliance and, at a minimum, shall establish procedures

(A) that state how a designated principal shall monitor for compliance by the dealer with all applicable rules and supervise the municipal securities activities of associated persons specified in Rule G-3(a)(i);

(B) a designated principal shall follow when a customer complaint concerning the dealer's municipal securities activities is received;

(C) for the regular and frequent review and approval by a designated principal of customer accounts introduced or carried by the dealer in which transactions in municipal securities are effected; such review shall be designed to ensure that such transactions are in accordance with all applicable rules and to detect and prevent irregularities and abuses;

(D) for the periodic review by a designated principal of each office which engages in municipal securities activities pursuant to section (d) of this rule;

(E) for the maintenance and preservation, by a designated principal, of the books and records required to be maintained and preserved by Rules G-8 and G-9 of the Board;

(F) for the supervision by a designated principal of the processing, clearance, and in the case of a non-bank dealer safekeeping of municipal securities; and

(G) for the prompt review and written approval by a designated principal of:

(1) the opening of each customer account introduced or carried by the dealer in which transactions in municipal securities may be effected; and

(2) each transaction in municipal securities on a daily basis, including each transaction in municipal securities effected with or for a discretionary account introduced or carried by the dealer.

(ii) *Provisions concerning tape recording of conversations.*

(A) Each dealer that either is notified by the applicable regulatory authority (as defined in subsection (g)(iii)) or otherwise has actual knowledge that it meets one of the criteria in paragraph (c)(ii)(H) relating to the employment history of its registered persons at a disciplined firm (as defined in subsection (g)(v)) shall establish, maintain, and enforce special written procedures for supervising the telemarketing activities with respect to municipal securities of all of its registered persons.

(B) The dealer must establish and implement the supervisory procedures required by this subsection (ii) within 60 days of receiving notice from the applicable regulatory authority or obtaining actual knowledge that it is subject to the provisions of this subsection.

A dealer that meets one of the criteria in paragraph (c)(ii)(H) for the first time may reduce its staffing levels to fall below the threshold levels within 30 days after receiving notice from the applicable regulatory authority or obtaining actual knowledge that it is subject to the provisions of paragraph (c)(ii)(H), provided the dealer promptly notifies the applicable regulatory authority in writing of its becoming subject to this rule. Once the dealer has reduced its staffing levels to fall below the threshold levels, it shall not rehire a person terminated to accomplish the staff reduction for a period of 180 days. On or prior to reducing staffing levels pursuant to this paragraph (B), a dealer must provide the applicable regulatory authority with written notice identifying the terminated person(s).

(C) The procedures required by this subsection shall include tape-recording all telephone conversations between the dealer's registered persons and both existing and potential customers with respect to municipal securities.

(D) The dealer shall establish reasonable procedures for reviewing the tape recordings made pursuant to the requirements of this subsection to ensure compliance with applicable securities laws and regulations and applicable rules. The procedures must be appropriate for the dealer's business, size, structure, and customers.

(E) All tape recordings made pursuant to the requirements of this subsection shall be retained for a period of not less than three years from the date the tape was created, the first two years in an easily accessible place. Each dealer shall catalog the retained tapes by registered person and date.

(F) Such procedures shall be maintained for a period of three years from the date that the dealer establishes and implements the procedures required by the provisions of this subsection.

(G) By the 30th day of the month following the end of each calendar quarter, each dealer subject to the requirements of this subsection shall submit to the applicable regulatory authority a report on the dealer's supervision of the telemarketing activities with respect to municipal securities of its registered persons.

(H) The following dealers shall be required to adopt special supervisory procedures over the telemarketing activities with respect to municipal securities of their registered persons:

(1) A dealer with at least five but fewer than ten registered persons, where 40% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years;

(2) A dealer with at least ten but fewer than twenty registered persons, where four or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years;

(3) A dealer with at least twenty registered persons, where 20% or more of its registered persons have been associated with one or more disciplined firms in a registered capacity within the last three years.

(4) For purposes of the calculations required in paragraph (H), dealers should not include registered persons who:

(a) have been registered for an aggregate total of 90 days or less with one or more disciplined firms within the past three years; and

(b) do not have a disciplinary history (as defined in subsection (g)(vi)).

(I) The applicable regulatory authority, upon application and pursuant to such procedures as such authority shall prescribe, may in exceptional circumstances, taking into consideration all relevant factors, exempt such dealer unconditionally or on specified terms and conditions from the requirements of this subsection (ii). A dealer seeking an exemption must file a written application within 30 days after receiving notice from the applicable regulatory authority or obtaining actual knowledge that it meets one of the criteria in paragraph (c)(ii)(H) for the first time may elect to reduce its staffing levels pursuant to the provisions of paragraph (c)(ii)(B) or, alternatively, to seek an exemption pursuant to paragraph (c)(ii)(I), as appropriate; such a dealer may not seek relief from this rule by both reducing its staffing levels pursuant to paragraph (c)(ii)(B) and requesting an exemption.

(iii) *Availability of and revisions to written supervisory procedures.* A copy of a dealer's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each office of municipal supervisory jurisdiction and at each location where supervisory activities with respect to municipal securities are conducted on behalf of the dealer. Each dealer shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in Board or other applicable rules and as changes occur in its supervisory system, and each dealer shall be responsible for communicating amendments through its organization.

(d) *Internal Inspections.*

(i) Each dealer shall conduct a review, at least annually, of the municipal securities activities in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable Board rules. Each dealer shall review the municipal securities activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses.

(A) Each dealer shall inspect at least annually every office of municipal supervisory jurisdiction and any municipal branch office that supervises one or more non-branch locations.

(B) Each dealer shall inspect at least every three years every municipal branch office that does not supervise one or more non-branch locations. In establishing how often to inspect each non-supervisory municipal branch office, the dealer shall consider whether the nature and complexity of the municipal securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location require the non-supervisory municipal branch office to be inspected more frequently than every three years. If a dealer establishes a more frequent inspection cycle, the dealer must ensure that at least every three years, the inspection requirements enumerated in subsection (d)(ii) have been met. The non-supervisory municipal branch office examination cycle, an explanation of the factors the dealer used in determining the frequency of the examinations in the cycle, and the manner in which a dealer will comply with subsection (d)(ii) if using more frequent inspections than every three years shall be set forth in the dealer's written supervisory and inspection procedures.

(C) Each dealer shall inspect on a regular periodic schedule every non-branch location. In establishing such schedule, the dealer shall consider the nature and complexity of the municipal securities activities for which the location is responsible and the nature and extent of contact with customers. The schedule and an explanation regarding how the dealer determined the frequency of the examination schedule shall be set forth in the dealer's written supervisory and inspection procedures.

Each dealer shall retain a written record of the dates upon which each review and inspection is conducted.

(ii) An office inspection and review by a dealer pursuant to subsection (d)(i) must be reduced to a written report and kept on file by the dealer for a minimum of three years, unless the inspection is being conducted pursuant to paragraph (d)(i)(C) and the regular periodic schedule is longer than a three-year cycle, in which case the report must be kept on file at least until the next inspection report has been written. The written inspection report must also include, without limita-

tion, the testing and verification of the dealer's policies and procedures, including supervisory policies and procedures in the following areas as they relate to municipal securities:

- (A) Safeguarding of customer funds and municipal securities;
- (B) Maintaining books and records;
- (C) Supervision of customer accounts serviced by branch office managers;
- (D) Transmittal of funds between customers and registered representatives and between customers and third parties;
- (E) Validation of customer address changes; and
- (F) Validation of changes in customer account information.

If a dealer does not engage in all of the activities enumerated above, the dealer must identify those activities in which it does not engage in the written inspection report and document in the report that supervisory policies and procedures for such activities must be in place before the dealer can engage in them.

(iii) An office inspection by a dealer pursuant to subsection (d)(i) may not be conducted by the branch office manager or any person within that office who has supervisory responsibilities or by any individual who is supervised by such person(s). However, if a dealer is so limited in size and resources that it cannot comply with this limitation (*e.g.*, a dealer with only one office or a dealer has a business model where small or single-person offices report directly to an office of municipal supervisory jurisdiction manager who is also considered the offices' branch office manager), the dealer may have a principal who has the requisite knowledge to conduct an office inspection perform the inspections. The dealer, however, must document in the office inspection reports the factors it has relied upon in determining that it is so limited in size and resources that it has no other alternative than to comply in this manner.

A dealer must have in place procedures that are reasonably designed to provide heightened office inspections if the person conducting the inspection reports to the branch office manager's supervisor or works in an office supervised by the branch manager's supervisor and the branch office manager generates 20% or more of the revenue of the business units supervised by the branch office manager's supervisor. For the purposes of this subsection (d)(iii) only, the term "heightened inspection" shall mean those inspection procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective inspection because of the economic, commercial, or financial interests that the branch manager's supervisor holds in the associated persons and businesses being inspected. In addition, for the purpose of this subsection only, when calculating the 20% threshold, all of the revenue generated by or credited to the municipal branch office or branch office manager shall be attributed as revenue gener-

ated by the business units supervised by the branch office manager's supervisor irrespective of a dealer's internal allocation of such revenue. A dealer must calculate the 20% threshold on a rolling, twelve-month basis.

(e) *Review of Correspondence.*

(i) Supervision of Municipal Securities Representatives. Each dealer shall establish procedures for the review by a designated principal of incoming and outgoing written (*i.e.*, non-electronic) and electronic correspondence of its municipal securities representatives with the public relating to the municipal securities activities of such dealer. Such procedures must be in writing and be designed to reasonably supervise each municipal securities representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available, upon request, to a registered securities association or the appropriate regulatory agency.

(ii) Review of correspondence. Each dealer shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (*i.e.*, non-electronic) and electronic correspondence with the public relating to its municipal securities activities, including review for compliance with Rule G-21(e)(vii) to the extent applicable to such dealer's business. Procedures shall include the review of incoming, written correspondence directed to municipal securities representatives and related to the dealer's municipal securities activities to properly identify and handle customer complaints and to ensure that customer funds and municipal securities are handled in accordance with the dealer's procedures. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provisions for the education and training of associated persons as to the dealer's procedures governing correspondence; documentation of such education and training; and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

(iii) Retention of correspondence. Each dealer shall retain correspondence of municipal securities representatives relating to its municipal securities activities in accordance with Rules G-8(a)(xx) and G-9(b)(viii) and (xiv). The names of the persons who prepared outgoing correspondence and who reviewed the correspondence shall be ascertainable from the retained records and the retained records shall be readily available, upon request, to a registered securities association or the appropriate regulatory agency.

(f) *Supervisory Control System.*

(i) Each dealer shall designate one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the dealer's supervisory procedures are reasonably designed with respect to the municipal securities activities of the dealer and its registered representatives and associated persons to achieve compliance with applicable rules and (B)

create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the dealer's senior management no less than annually a report detailing each dealer's system of supervisory controls, the summary of the test results and significant identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

(ii) The establishment, maintenance, and enforcement of written supervisory control policies and procedures pursuant to subsection (f)(i) shall include:

(A) procedures that are reasonably designed to review and supervise the customer account activity relating to municipal securities conducted by the dealer's branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function.

(1) General Supervisory Requirement. A person who is either senior to, or otherwise independent of, the producing manager must perform such supervisory reviews. For purposes of this rule, an "otherwise independent" person: may not report either directly or indirectly to the producing manager under review; must be situated in an office other than the office of the producing manager; must not otherwise have supervisory responsibility over the activity being reviewed (including not being directly compensated based in whole or in part on the revenues accruing for those activities); and must alternate such review responsibility with another qualified person every two years or less.

(2) "Limited Size and Resources" Exception. If a dealer is so limited in size and resources that there is no qualified person senior to, or otherwise independent of, the producing manager to conduct the reviews pursuant to subparagraph (1) above (*e.g.*, a dealer has only one office or an insufficient number of qualified personnel who can conduct reviews on a two-year rotation), the reviews may be conducted by a principal who is sufficiently knowledgeable of the dealer's supervisory control procedures, provided that the reviews are in compliance with subparagraph (1) to the extent practicable.

(3) Notification Requirement. If a dealer determines that it must rely on the "limited size and resources" exception set forth in subparagraph (2) above to conduct any of its producing managers' supervisory reviews, the dealer must notify the applicable regulatory authority through an electronic process (or any other process prescribed by such authority) within 30 days of the date on which the dealer first relies on the exception, and annually thereafter. If a dealer subsequently determines that it no longer needs to rely on the exception to conduct

any of its producing managers' supervisory reviews, the dealer must, within 30 days of ceasing to rely on the exception, notify the applicable regulatory authority by using the electronic process or any other process prescribed by such authority.

(4) Documentation Requirement. A dealer relying on subparagraph (2) above must document in its supervisory control procedures the factors used to determine that complete compliance with all of the provisions of subparagraph (1) is not possible and that the required supervisory systems and procedures in place with respect to any producing manager comply with the provisions of subparagraph (1) above to the extent practicable.

(B) procedures that are reasonably designed to review and monitor the following activities relating to municipal securities:

(1) all transmittals of funds (*e.g.*, wires or checks, etc.) or municipal securities from customers to third party accounts (*i.e.*, a transmittal that would result in a change of beneficial ownership); from customer accounts to outside entities (*e.g.*, banks, investment companies, etc.); from customer accounts to locations other than a customer's primary residence (*e.g.*, post office box, "in care of" accounts, alternate address, etc.); and between customers and registered representatives, including the hand-delivery of checks;

(2) customer changes of address and the validation of such changes of address; and

(3) customer changes of investment objectives and the validation of such changes of investment objectives.

The policies and procedures established pursuant to this paragraph (f)(ii)(B) must include a means or method of customer confirmation, notification, or follow-up that can be documented. If a dealer does not engage in all of the activities enumerated above, the dealer must identify those activities in which it does not engage in its written supervisory control policies and procedures and document in those policies and procedures that additional supervisory policies and procedures for such activities must be in place before the dealer can engage in them; and

(C) procedures that are reasonably designed to provide heightened supervision over the activities of each producing manager who is responsible for generating 20% or more of the revenue of the business units supervised by the producing manager's supervisor. For the purposes of this subsection only, the term "heightened supervision" shall mean those supervisory procedures that evidence supervisory activities that are designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commer-

cial, or financial interests that the supervisor holds in the associated persons and businesses being supervised. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the producing manager or the producing manager's office shall be attributed as revenue generated by the business units supervised by the producing manager's supervisor irrespective of a dealer's internal allocation of such revenue. A dealer must calculate the 20% threshold on a rolling, twelve-month basis.

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

(i) "Office of municipal supervisory jurisdiction" means any office of a dealer at which any one or more of the following functions take place with respect to municipal securities:

- (A) order execution and/or market making;
- (B) structuring of public offerings or private placements;
- (C) maintaining custody of customers' funds and/or municipal securities;
- (D) final acceptance (approval) of new accounts on behalf of the dealer;
- (E) review and endorsement of customer orders, pursuant to subparagraph (c)(i)(G)(2) above;
- (F) final approval of advertising for use by persons associated with the dealer, pursuant to Rule G-21(f); or
- (G) responsibility for supervising the municipal securities activities of persons associated with the dealer at one or more other municipal branch offices of the dealer.

(ii) (A) A "municipal branch office" is any location where one or more associated persons of a dealer regularly conducts the business of effecting any transactions in, or inducing or attempting to induce the purchase or sale of any municipal security, or is held out as such, excluding:

- (1) Any location that is established solely for customer service and/or back office type functions where no sales activities are conducted and that is not held out to the public as a branch office;
- (2) Any location that is the associated person's primary residence; provided that
 - (a) Only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, conduct business at the location;
 - (b) The location is not held out to the public as an office and the associated person does not meet with customers at the location;
 - (c) Neither customer funds nor securities are handled at that location;

(d) The associated person is assigned to a designated municipal branch office, and such designated municipal branch office is reflected on all business cards, stationery, advertisements and other communications to the public by such associated person;

(e) The associated person's correspondence and communications with the public are subject to the dealer's supervision in accordance with this rule;

(f) Electronic communications (e.g., e-mail) are made through the dealer's electronic system;

(g) All orders are entered through the designated municipal branch office or an electronic system established by the dealer that is reviewable at the municipal branch office;

(h) Written supervisory procedures pertaining to supervision of sales activities conducted at the residence are maintained by the dealer; and

(i) A list of the residence locations is maintained by the dealer.

(3) Any location, other than a primary residence, that is used for municipal securities activities for less than 30 business days in any one calendar year, provided the dealer complies with the provisions of clauses (ii)(A)(2)(a) through (h) above;

(4) Any office of convenience, where associated persons occasionally and exclusively by appointment meet with customers, which is not held out to the public as an office. Where such office of convenience is located on bank premises, signage necessary to comply with applicable federal and state laws, rules and regulations, and applicable rules and regulations of any self-regulatory organizations and securities and banking regulators, may be displayed and shall not be deemed "holding out" for the purposes of this section;

(5) Any location that is used primarily to engage in non-securities activities and from which the associated person(s) effects no more than 25 municipal securities transactions in any one calendar year; provided that any advertisement identifying such location also sets forth the address and telephone number of the location from which the associated person(s) conducting business at the non-branch locations are directly supervised;

(6) The floor of a registered national securities exchange where a dealer conducts a direct access business with public customers; or

(7) A temporary location established in response to the implementation of a business continuity plan.

(B) Notwithstanding the exclusions in paragraph (ii)(A), any location that is responsible for supervising the municipal securities activities of persons associated with the dealer at one or more non-branch locations of the dealer is considered to be a municipal branch office.

(C) The term “business day” as used in paragraph (ii)(A) shall not include any partial business day provided that the associated person spends at least four hours on such business day at his or her designated municipal branch office during the hours that such office is normally open for business.

(iii) “Applicable regulatory authority” means (i) with respect to a dealer that is a member of a registered securities association, such registered securities association, and (ii) with respect to any other dealer, the appropriate regulatory agency as defined in Section 3(a)(34) of the Act.

(iv) “Registered person” means any person qualified to act as a representative, principal or limited principal pursuant to Rule G-3.

(v) “Disciplined firm” means either a dealer that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer; or a futures commission merchant or introducing broker that has been formally charged by either the Commodity Futures Trading Commission or a registered futures association with deceptive telemarketing practices or promotional material relating to security futures, those charges have been resolved, and the futures commission merchant or introducing broker has been closed down and permanently barred from the futures industry as a result of those charges; or a futures commission merchant or introducing broker that, in connection with sales practices involving the offer, purchase, or sale of security futures is subject to an order of the Securities and Exchange Commission revoking its registration as a broker or dealer.

(vi) “Disciplinary history” means a finding of violation by a registered person in the past means a finding of violation by a registered person in the past five years by the Securities and Exchange Commission, a self-regulatory organization, or a foreign financial regulatory authority of one or more of the following rules (or comparable foreign provision): Sections 15(b)(4)(E) and 15(c) of the Act; Section 17(a) of the Securities Act of 1933; SEC Rules 10b-5 and 15g-1 through 15g-9; FINRA Rules 2010, 2020, 2111, 2150, 2121, 3110 (failure to supervise only), 5210 and 5230; MSRB Rules G-19, G-30, and G-37(b) and (c).

Rule G-27 Interpretations

Notice Concerning Supervisory Responsibility of Municipal Securities Principals and Municipal Securities Sales Principals

December 15, 1981

The Board has received questions concerning the appropriate allocation of supervisory responsibility between municipal securities principals and the new category of municipal securities sales principals. The Board recently amended its rule G-3 to permit a person associated with a securities firm whose activities with respect to municipal securities are limited to supervising sales to and purchases from customers to qualify as a “municipal securities sales principal” (“sales principal”). The Board also amended rules G-8 on recordkeeping, G-26 on the administration of customer accounts, and G-27 on supervision to permit securities firms to designate sales principals as responsible for certain supervisory functions insofar as they relate directly to transactions in municipal securities with customers.

In particular, rule G-27 concerning supervision requires municipal securities dealers to designate at least one municipal securities principal as responsible for supervising its municipal securities activities, including the municipal securities activities of branch offices or similar locations. In addition, rule G-27 permits the municipal securities dealer to designate a sales principal (*e.g.*, a branch office manager) as responsible for the “direct supervision of sales to and purchases from customers.” The rule also requires that a dealer adopt written supervisory procedures which, among other matters, reflect the delegation of supervisory authority to these personnel.

As a result of these amendments, in designating under rule G-27 one or more municipal securities principals as responsible for supervising the business and activities of the firm’s associated persons, a securities firm may choose to designate a qualified sales principal with limited responsibility for the direct supervision of sales to and purchases from customers. If so, the firm’s written supervisory procedures may allocate responsibility to a sales principal for reviewing and approving (to the extent that they relate to sales to and purchases from customers) the suitability of the opening of, and transactions in, customer accounts, the handling of customer complaints and other correspondence, and other matters permitted by Board rule to be reviewed or approved by a sales principal. A municipal securities principal, however, must be responsible for directly supervising the firm’s other municipal securities activities such as underwriting, trading, and pricing of inventories.

With respect to the relationship between a sales principal and the designated municipal securities principal, Board rule G-27 provides that a branch office manager who acts as the sales principal for his office will be responsible for the municipal securities sales activities under his direct supervision. Rule G-27 also provides that a designated municipal securi-

ties principal will be responsible for all municipal securities activities of the branch office including those that may be under the direct supervision of a sales principal. However, the branch office manager, under the particular organizational structure of a firm, may be responsible to some other designated supervisor for the discharge of his other duties.

Supervisory Procedures for the Review of Correspondence with the Public

March 24, 2000

On March 16, 2000, the Securities and Exchange Commission approved amendments to rules G-8, on books and records, G-9, on preservation of records, and G-27, on supervision.¹ The amendments will become effective on September 19, 2000. The amendments will allow brokers, dealers and municipal securities dealers (“dealers”) to develop flexible supervisory procedures for the review of correspondence with the public. This notice is being issued to provide guidance to dealers on how to implement these rules.

Background

Technology has greatly expanded how communications between dealers and their customers take place. These new means of communication (*e.g.*, e-mail, Internet) will continue to significantly affect the manner in which dealers and their associated persons conduct their business. While these changes allow timely and efficient communication with customers, prospective customers, and others, the significant changes in communications media and capacity raise questions regarding supervision, review, and retention of correspondence with the public.

In May 1996, the SEC issued an Interpretive Release on the use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisors for Delivery of Information.² That release expressed the views of the SEC with respect to the delivery of information through electronic media in satisfaction of requirements in the federal securities laws, but did not address the applicability of any self-regulatory organization (“SRO”) rules. In its release the SEC did, however, strongly encourage the SROs to work with broker/dealer firms to adapt SRO supervisory review requirements governing communications with customers to accommodate the use of electronic communications.³

On December 31, 1997, the SEC approved proposed rule changes filed by the National Association of Securities Dealers (“NASD”)⁴ and the New York Stock Exchange (“NYSE”)⁵ to update rules governing supervision of communication with the public. NASD *Notice to Members 98-11* announced approval of the proposed rule change, provided guidance to firms on how to implement these rules and stated that the amendments to NASD Rules 3010 and 3110 would be effective on February 15, 1998. Over the next year, further amendments were made to NASD Rules 3010 and 3110. NASD Regulation

received final SEC approval of amendments to Rule 3010 on November 30, 1998.⁶ The rule amendments were effective on March 15, 1999.⁷

As amended, NASD Rule 3010(d)(1) provides that procedures for review of correspondence with the public relating to a member’s investment banking or securities business be designed to provide reasonable supervision for each registered representative, be described in an organization’s written supervisory procedures, and be evidenced in an appropriate manner. NASD Rule 3010(d)(2) requires each member to develop written policies and procedures for review of correspondence with the public relating to its investment banking or securities business tailored to its structure and the nature and size of its business and customers. These procedures must also include the review of incoming, written correspondence directed to registered representatives and related to the member’s investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures.

The Board has determined to adopt substantially similar rule changes. The Board believes that conforming its rule language to the language in the NASD rules will help ensure a coordinated regulatory approach to the supervision of correspondence.

Amended Rules

Rule G-27(d)(i), as revised, provides that procedures for review of correspondence with the public relating to a dealer’s municipal securities activities be designed to provide reasonable supervision for each municipal securities representative, be described in the dealer’s written supervisory procedures, and be evidenced in an appropriate manner.

Rule G-27(d)(ii) requires each dealer to develop written policies and procedures for review of correspondence with the public relating to its municipal securities activities, tailored to its structure and the nature and size of its business and customers. The rule requires that any dealer that does not conduct either an electronic or manual pre-use review will be required to:

- develop appropriate supervisory procedures;
- monitor and test to ensure these policies and procedures are being implemented and complied with;
- provide education and training to all appropriate employees concerning the dealer’s current policies and procedures governing correspondence, and update this training as policies and procedures are changed; and
- maintain records documenting how and when employees are educated and trained.

The rule change states that these procedures must also include the review of incoming, written correspondence directed to municipal securities representatives and related to the dealer’s municipal securities activities to properly identify and han-