

## COMMENT LETTER

July 22, 2004

# Comment Letter on MSRB Non-Cash Compensation Proposal, July 2004

July 22, 2004

Ernesto A. Lanza, Esquire  
Senior Associate General Counsel  
Municipal Securities Rulemaking Board  
1900 Duke Street, Suite 600  
Alexandria, Virginia 22314

Re: MSRB Notice 2004-17 Relating to Non-Cash Compensation

Dear Mr. Lanza:

The Investment Company Institute appreciates the opportunity to comment on Municipal Securities Rulemaking Board Notice 2004-17, which seeks comment on the proposed amendments to MSRB Rules G-20 and G-8, relating to gifts, gratuities, and non-cash compensation.<sup>1</sup> The proposed amendments would strengthen the MSRB's regulation of non-cash compensation arrangements and make the MSRB's requirements in this area more consistent with those of the NASD, as set forth in NASD Rule 2830(I). The Institute generally supports the proposed amendments. Our comments on the proposal are largely technical and intended to better conform MSRB Rules G-20 and G-8, as applied to brokers, dealers, and municipal securities dealers (hereafter collectively referred to as "MSDs") to NASD Rule 2830(I). In particular, the Institute recommends:

- Limiting the provisions in Rule G-20 that would be applicable to municipal fund securities to those set forth in proposed subsection (d);
- Expanding the proposed definition of "offeror" to include the issuer of any investment product into which the assets of a municipal fund security are invested; and
- Revising the proposed recordkeeping requirements in MSRB Rule G-8 concerning non-cash compensation payments to conform them to those imposed under NASD Rule 2830.

Each of these recommendations is discussed in more detail below.

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As a preliminary matter, the Institute commends the MSRB for its efforts to tailor its regulation of MSDs to be consistent with the requirements imposed on members of the NASD under the NASD’s rules. We strongly support the MSRB and the NASD regulating similar conduct of their respective members in a similar fashion to the extent practicable. A uniform system of regulation between the MSRB and the NASD reduces the potential that persons subject to both regimes will face conflicting regulatory requirements and facilitates compliance efforts. Moreover, inasmuch as the NASD is charged with inspecting securities firms for compliance with the rules of the MSRB, providing uniformity between the MSRB’s rules and those of the NASD governing non-cash compensation arrangements should facilitate the NASD’s ability to conduct such inspections.

## **I. Restructuring the Provisions of Rule G-20**

Subsection (a) of Rule G-20 currently prohibits, in part, any MSD from giving or permitting to be given any thing or service of value in excess of \$100 per year to a person other than an employee or partner of the MSD. Subsection (b) of the rule currently provides that the prohibitions of subsection (a) of the rule shall not be deemed to prohibit occasional gifts of meals or tickets to theatrical, sporting, and other entertainments provided such gifts are recognized by the Internal Revenue Service as deductible business expenses.

The MSRB has proposed to revise Rule G-20 to preserve the provisions of subsections (a) and (b) as described above<sup>2</sup> and to add a new subsection (d) that would govern non-cash compensation in connection with primary offerings, including an offering of 529 plan securities (i.e., municipal fund securities). Subsection (d) would be substantively similar to the provisions of NASD Rule 2830(I)(5), which governs the payment or receipt of non-cash compensation by NASD members in connection with the sale and distribution of investment company securities. As such, subsection (d) would, in part, include provisions permitting payment or acceptance of a gift (1) that does not exceed \$100 per year so long as such gift is not preconditioned on achievement of a sales target and (2) of an occasional meal or a ticket to a sporting event or the theater or comparable entertainment that is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

As a result, as proposed to be revised, Rule G-20 would include two provisions – one in subsection (a) and one in subsection (d)(i) – relating to the ability of MSDs to pay or receive de minimis gifts. It would also include two provisions – one in subsection (b) and one in subsection (d)(ii)<sup>3</sup> – that would govern gifts of meals or tickets. The Institute is concerned that having two provisions in the same rule governing similar conduct is unnecessary and likely to be confusing to MSDs. To address these concerns, the Institute recommends that the provisions of subsections (a) and (b) of Rule G-32 be revised to exclude MSDs involved in the offer and sale of municipal fund securities from their provisions.<sup>4</sup> This revision would result in MSDs involved in the offer and sale of municipal fund securities being subject only to the provisions of subsection (d) of the rule, which, as noted above, would include prohibitions substantively similar to those in subsections (a) and (b). It would also result in such persons not having to elect whether to utilize the exemptions in subsections (a) and (b) or those in (d).

## **II. Expanding the Proposed Definition of “Offeror”**

The MSRB has proposed to add to Rule G-20 a new subsection (e) that would define certain terms used in the revised rule, including the term “offeror.”<sup>5</sup> This term is used in the provision of the rule that would govern permissible payments in connection with training or educational meetings for an MSD’s associated persons. We are concerned that, as proposed, the definition would omit certain persons that would be appropriate sponsors of such meetings. For example, with respect to 529 plan securities, we note that, as proposed to be defined, the term “offeror” would not include persons that are familiar with the investment products into which 529 plan assets are invested. For instance, while the program manager of State A’s 529 plan would be considered an offeror under the proposed definition, the investment adviser or principal underwriter of Mutual Funds A, B, or C, which are not affiliated with the program manager and into which State A’s plan assets may be invested, would not be offerors. As such, these entities, which may be most familiar with the investment options offered by the 529 plan, could not sponsor training or educational meetings held to familiarize the employees of the MSD with the investment options offered by the plan.

To address this concern, the Institute recommends that, with respect to any registered investment company into which the proceeds of a 529 plan may be invested, the term “offeror” be revised to include any person that would be an offeror under NASD Rule 2830(1)(E).<sup>6</sup> This revision is intended to (1) recognize that the operations of registered investment companies (mutual funds), into which most 529 plan assets are invested, are largely carried out by service providers to the mutual fund and (2) enable such service providers to sponsor training or educational meetings for the associated persons of MSDs. This revision would also permit the same persons that may reimburse NASD members for training and educational seminars under the NASD’s comparable rule to reimburse MSDs for similar types of events.<sup>7</sup>

## **III. Revising the Corresponding Recordkeeping Requirements in Rule G-8**

The MSRB has proposed to revise Rule G-8(a)(xvii), which requires a MSD to maintain records demonstrating compliance with Rule G-20, to require MSDs to maintain records relating to compliance with proposed new subsection (d). This provision is substantively similar to the recordkeeping requirement imposed on NASD members under NASD Rule 2830(l), with one exception. Unlike the NASD’s rule, the MSRB’s rule would not exclude from the recordkeeping requirements those records relating to (1) de minimis gifts (i.e., the \$100 per year gift) and (2) the occasional gift of a meal or ticket. The NASD rules excludes from its recordkeeping requirements (i.e., in Rule 2830(l)(3)) records relating to such gifts based on the conclusion that these de minimis items do not raise regulatory concerns and, therefore, the burden of making and keeping such records would exceed any benefits of requiring them. We believe the same rationale would apply in the context of the MSRB’s proposal. For this reason and to provide uniformity between the MSRB’s recordkeeping requirements and those of the NASD, we recommend that the MSRB except from the recordkeeping requirements of proposed Rule G-8(a)(vii)(C) records corresponding to proposed Rule G-20(d)(i) and (ii).<sup>8</sup>

\* \* \*

The Institute appreciates the opportunity to provide these comments on the MSRB's proposal. If you have any questions concerning these comments or our views on the MSRB's proposal, please contact the undersigned.

Sincerely,

Tamara K. Salmon  
Senior Associate Counsel

cc: Jill C. Finder, Assistant General Counsel

#### **ENDNOTES**

[1](#) See MSRB Notice 2004-17, Request for Comments on Draft Amendments to Rules G-20 and G-8 Relating to Gifts, Gratuities, and Non-Cash Compensation in Municipal Debt Offerings and Sales of Municipal Fund Securities (June 15, 2004) (the "MSRB Notice").

[2](#) The MSRB has, however, proposed to condition the exception in subsection (b) for the occasional gift of a meal or a ticket to those events that are "hosted" by the MSD. As discussed in the MSRB's Notice, this condition is intended to require personnel of the MSD "to accompany recipients of such gifts, rather than merely distributing free tickets to events or paying or reimbursing costs of meals or other functions attended by the recipient without the dealer participating in such activities." MSRB Notice at p. 2.

[3](#) With respect to the provisions in Rule G-20 that would relate to gifts of meals or tickets, the provision in subsection (b) would require the meal or event to be hosted by the MSD; the provision in subsection (d) would not include this condition.

[4](#) Alternatively, the MSRB might consider deleting subsections (a) and (b) in their entirety, leaving the provisions of new subsection (d) to govern non-cash compensation arrangements for all MSDs. We are uncertain as to what impact this recommendation might have on MSDs that are not involved in the offer and sale of municipal fund securities, which is why the Institute has recommended the MSRB retain these two provisions and apply them to MSDs not involved in the offer and sale of municipal fund securities.

[5](#) As proposed, "offeror" would be defined to mean, "with respect to a primary offering, the issuer, any adviser to the issuer (including but not limited to the issuer's financial adviser, bond or other legal counsel, or investment or program manager in connection with the primary offering), the underwriter of the primary offering, or any person controlling, controlled by, or under common control with any of the foregoing."

[6](#) We note that, for purposes of NASD Rule 2830(1)(E), the term "offeror" includes "an investment company, an adviser to an investment company, a fund administrator, an underwriter, and any affiliated person . . . of such entities."

[7](#) Our recommendation relating to expansion of the definition of "offeror" is limited to the use of this term in the proposed amendments to MSRB Rule G-20 and should not be construed as a broader recommendation to expand the meaning of this term in other contexts.

[8](#) Consistent with our recommended revision to Rule G-20 in Section I, above, the Institute also recommends that the MSRB clarify that the provisions of Rules G-8(a)(xvii)(A) and (B) only apply to those MSDs that are subject to the provisions of Rule G-20(a) and (c),

respectively.

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