

## SECTION 3: NEW ISSUE AND RELATED DISCLOSURE RULES

### 3a. OVERVIEW

#### **MSRB Rules Do Not Apply To 529 Plans Sold By State Personnel**

Some States permit investment in 529 college savings plans by purchasing shares directly from State personnel, without the use of a broker-dealer. In a few States, this is the only way investments may be made. MSRB rules do not apply to these purchases.

#### **MSRB Rules Do Apply To 529 Plans Sold By Broker-Dealer Personnel**

Other States allow shares to be purchased either through State employees or through broker-dealers. MSRB rules apply only to those purchases made through broker-dealers that act as agents for the State, selling shares of that State's 529 plan.

Currently, most 529 plans are marketed through broker-dealers. In some States, this is only way that investments can be made. Typically, one broker-dealer will act the primary distributor (or "principal underwriter") of a State's 529 plan. Typically, the underwriter, directly or through an affiliate, acts as the investment manager of the plan's assets. In addition, a distribution network of other broker-dealers, known as selling dealers, is put together to assist the underwriter in marketing the State's plan. The underwriter, as well as the members of the selling group, must conduct their activities in compliance with MSRB rules.

#### **Types Of Sales Charges**

The investment options offered by 529 plans range from money market funds on the one hand, to aggressive equity growth funds, on the other. These options are structured as mutual funds, with the purchase of plan shares typically entailing sales charges. These charges can be set up as:

Front-end sales charges imposed on purchase - commonly known as "Class A Fund Shares;"

Back-end sales charges imposed on redemption - commonly known as "Class B Fund Shares;" or

Annual charges applied against net assets via 12b-1 fees - commonly known as "Class C Fund Shares."

(Note: 12b-1 fees are annual charges, typically between .25% and .75% of net assets annually, that mutual funds can charge for the cost of soliciting new investment to the fund. These fees are permitted under conditions specified by SEC Rule 12b-1.)

In addition, the issuer may charge an annual account maintenance fee.

### **Funding Options**

Investors have numerous options for funding a 529 college savings plan. Funding can be accomplished via:

One-time contribution;

Periodic plan; or

Non-periodic program.

### **Periodic Plan**

A periodic plan is defined as any written agreement allowing a firm, acting as agent, to purchase for a customer, or sell for a customer (redemption), municipal fund securities in specific amounts (shares or dollars) at specific time intervals.

### **Non-Periodic Program**

A non-periodic program differs in only one respect from a periodic plan - it allows the customer to make additional purchases or sales at will.

Some plans offer combinations of these. Also note that some plans offer employee payroll deduction programs for making 529 investments.

Each 529 program must provide the details of plan investment options, sales charges and funding methods, as well as other relevant information designed to assist investors in making a decision. Virtually all plans make this information available on their websites.

For plans where a broker-dealer has been engaged as a primary distributor, SEC Rule 15c-2-12 (covered next) requires that the firm obtain from the issuer (the State) a copy of the disclosure document known as an "Official Statement," that includes, among other things, information concerning the issuer and related topics necessary for an evaluation of the offering. As discussed following, the Official Statement must be provided by the broker-dealer to buyers of 529 plan shares.

## **3b. SECURITIES AND EXCHANGE COMMISSION RULE 15c-2-12**

While municipal securities are exempt from the provisions of the Securities Act of 1933 (registration of new issues), the anti-fraud provisions of the Securities and Exchange Act of 1934 are applicable. The SEC uses a very broad interpretation here, arguing that underwriters of exempt issues (e.g., municipals) are making an "implied recommendation" of these securities to their customers.

If the recommendation is made in a manner deemed "fraudulent," then a violation of the 1934 Act will occur. Because of this potential liability, underwriters must have a reasonable basis for making the "recommendation" of municipal securities to their customers. The information needed to make this determination is provided by the issuer in the disclosure document given to the underwriter. This is the "Official Statement," similar to, but less detailed than, prospectuses used for new non-exempt securities offerings.

The underwriter must exercise care in reviewing the "Official Statement" to make sure that the information provided by the issuer is accurate and complete - this is commonly known as the underwriter performing "due diligence" on the offering.

Any omissions or misstatements of material fact made by the underwriters in connection with the offering can be fraud under the Act. The liability for fraud extends to the issuer, the bond counsel preparing the Official Statement, the accountants preparing any financial information presented in the Official Statement, and the underwriters selling the issue (under their requirement to perform due diligence).

The SEC has written a specific rule, to which municipal underwriters must adhere. This is:

**Municipal  
Underwriter Must  
Perform  
Due Diligence**

Rule 15c-2-12: Requires underwriters participating in the primary offerings of municipal securities, in the amount of \$1,000,000 or more, to:

Review the Official Statement (that is, perform "due diligence"); and

**Must Distribute  
Official Statement**

Distribute the Official Statement to customers.

Note that this SEC rule does not apply in situations where State employees market the plan directly to investors. It only applies to plans marketed by broker-dealers.

**3c. G-15, INFORMATION REQUIRED ON  
CONFIRMATIONS**

**Disclosure On  
Customer  
Confirmations**

Rule G-15 covers required disclosures to customers on confirmations. Confirmations must be sent or given to customers, at or before, completion of a transaction.

The confirmation must include the following information:

Name, address, and telephone number of the broker-dealer;

Name of customer;

Whether the transaction was a purchase or sale;

Par value of securities;

Description of securities;

Trade date and time of execution (or a statement on the confirmation that the time of the trade is available upon written customer request);

Settlement Date;

Accrued Interest; Extended Principal Amount; Total Dollar Amount of the Transaction;

Capacity of broker-dealer - for municipal fund securities transactions, broker-dealers can only act in an agency capacity - there are no principal transactions.

**Municipal Fund Security Confirm Shows Number Of Shares And Price Per Share**

On a confirmation for a municipal fund securities transaction, the dealer is required to compute the purchase or sale price (number of shares x price per share) rather than par value. Yield, accrued interest, extended principal amount, maturity date and interest rate are all omitted.

Confirmations for municipal fund securities transactions must also include a disclosure to the effect that a deferred commission or other charge may be imposed upon sale, if applicable (a CDSC - Contingent Deferred Sales Charge).

Rule G-15 also makes clear that dealers must confirm redemptions of municipal fund securities, as well as purchases.

In addition, confirmations for municipal fund securities transactions must include the:

Name used by the issuer to identify the security; and

To the extent necessary to differentiate the security for other municipal fund securities of that issuer, any separate program series portfolio or fund designation (this is done because municipal fund securities are **NOT** assigned a CUSIP #).

**Use Of Periodic Statements In Lieu Of Confirms**

Rule G-15 permits a dealer effecting transactions in municipal fund securities under a periodic plan or a non-periodic program, to use periodic statements in lieu of individual transaction confirmations (Note: Do not confuse periodic statements with statements of account. "Periodic Statements" are details of all account transactions - not account balances). The consent of the customer **OR** of the issuer is required before periodic statements can be used. No consent is required if the customer is participating in a group plan (an employer-sponsored salary reduction plan).

**Consent Of Customer Or Issuer To Send Periodic Statements**

Dealers using periodic statements must include certain information that would have been on an individual confirmation. This includes deferred commissions, if applicable, as well as all of the other regular confirmation information, such as capacity of the dealer (always agency in municipal fund securities transactions), time of execution, etc. Also note that a statement must be included on the confirmation or periodic statement that this information will be furnished upon written request.

**Periodic Plan Statements In Lieu Of Confirms Sent Quarterly**

For customers participating in a periodic plan where periodic statements will be sent in lieu of individual confirmations, statements must be sent quarterly, within 5 business days of the end of the quarter.

**Employee Groups Participating In Periodic Plans**

Employee groups participating in periodic plans generally have investments made through payroll deduction. In cases where payroll deduction is not in place, the following rules apply (if the periodic plan consists of an arrangement between 2 or more customers that act through a person designated by the group):

**Required Notices**

The dealer must give or send to the designated person, at or prior to settlement, written notification of the amount paid by the group;

The dealer must send to anyone in the group that was a customer in the prior quarter, and on whose behalf payment has not been received in the current quarter, a written statement reflecting that payment was not received; and

The dealer must advise each customer in the group if payment is not received from the designated person acting on behalf of the group, within 10 days of the date specified for payments from the group.

**Non-Periodic Program Statements In Lieu Of Confirms Sent Monthly**

For customers participating in a non-periodic program where periodic statements will be sent in lieu of individual confirmations, statements must be sent monthly, within 5 business days of the end of the month.

**If Customer Requests Addit. Info. - 5 Bus. Days To Provide** Any additional information requested by a customer after receiving a confirmation must be provided within 5 business days of the request.

**If Request Made More Than 30 Days After Trade - 15 Bus. Days** However, if the request is made more than 30 calendar days after the trade date, the firm has 15 business days to dig out the records and provide them to the customer.

### **3d. RULE G-32, DELIVERY OF DISCLOSURE DOCUMENTS TO EMMA**

#### **EMMA Primary Market Disclosure**

In mid-2009, the MSRB moved to electronic filing of Official Statements and public access these documents via "EMMA" - Electronic Municipal Market Access.

The EMMA primary market disclosure service:

- receives submissions of Official Statements (OSs), Preliminary Official Statements (POSs) and Advance Refunding Documents (ARDs); and

- makes these submissions available to the public via EMMA at no charge and also offers the data on a "real-time" basis as a paid subscription service (the regulators are always looking for new streams of revenue!).

Submissions to the EMMA primary market disclosure service are accepted between 8:00 AM and 6:00 PM ET and, in general, are posted on the EMMA web portal within 15 minutes of acceptance - but in peak time periods this can be extended to 1 hour. However, anyone who pays the \$20,000 annual subscription fee to EMMA gets access to the documents at the time they are posted!

#### **Official Statements Filed With EMMA**

Rule G-32 requires that underwriters electronically file Form G-32 for all primary offerings of municipal securities, regardless of whether an OS is produced for the offering. In addition, the rule requires the filing of the OS, if it is produced.

#### **Official Statements Filed With EMMA Within 1 Business Day Of Receipt From Issuer, But No Later Than Closing Date**

All submissions of OSs are required to be made:

- within 1 business day after receipt from the issuer, but;

- no later than the closing date (the date the underwriter receives the new issue securities from the issuer) for the offering.

**Must Notify EMMA  
Of Failure To File  
By Closing Date**

If an OS is prepared by the issuer but it is not submitted to EMMA by the closing date, the underwriter must provide notice of failure to file and submit the POS, if any, by the closing date, along with a notice that the OS will be submitted to EMMA when it becomes available.

**Must Notify EMMA  
If No OS Is Prepared  
By Closing Date**

If no OS is being prepared because the offering is exempt under SEC Rule 15c2-12 (covered on page 3 of this section), the underwriter must provide notice to EMMA of this fact, together with the POS, if any, no later than the closing date.

**Amendments Must  
Be Filed Within 1  
Business Day Of  
Receipt**

Underwriters are required to submit amendments to OSs during the primary offering disclosure period within 1 business day of receipt.

Note that the underwriter can designate an agent to make the filings, but the underwriter must retain responsibility for the filings.

### **3 e. G-32, DISCLOSURES IN CONNECTION WITH NEW ISSUES**

This rule basically requires that Official Statements (the disclosure document prepared for new issue municipal offerings) must be given to customers, so that an informed investment decision can be made. The problem is that the MSRB cannot mandate that issuers provide Official Statements - remember, the MSRB has no regulatory authority over municipal issuers.

The SEC wrote Rule 15c2-12, mandating that underwriters of municipal issues in the amount of \$1,000,000 or more, obtain and distribute Official Statements. This fills the legislative gap.

However, the MSRB, without having any regulatory authority over the issuers, had to write its rule from the standpoint of placing the burden on the underwriters, over whom it has jurisdiction. In essence, the rule requires that the underwriter cannot sell the issue unless an Official Statement is provided by the issuer. Thus, the underwriter will require the issuer to provide one, otherwise it will not participate in the underwriting.

In new issue municipal offerings, broker-dealers are required to disclose or send the following to customers:

**Deliver Final Official  
Statement, If Prepared  
To Customers**

A final Official Statement (disclosure document) must be delivered to customers no later than settlement of the transaction, if one has been prepared. If a final Official Statement is not being

prepared, a written notice to this effect must be sent to the customer, along with a copy of the preliminary Official Statement if one has been prepared. In the situation where the final Official Statement is being prepared but is not yet ready, sending the preliminary Official Statement on settlement is not permitted - this would violate the rule.

Since EMMA now contains electronic copies of the Official Statement that anyone can access and download, the MSRB has revised the wording of the OS delivery rule, stating that delivery to a customer is satisfied if:

the customer is delivered a copy of the OS by trade settlement; or

the customer is delivered a written notice advising how to obtain a copy of the OS from the EMMA web portal and that a copy of the OS will be provided upon request.

If a customer requests a written copy of the OS, it must be sent within 1 business day of request by first class mail, or other similar delivery means.

In general, municipal underwritings are done either on a competitive bid basis or on a negotiated basis. While municipal fund securities underwritings are negotiated, the basics of competitive bid underwritings are tested.

In competitive bid offerings, the issuer solicits bids from various underwriting groups, with the bid being the interest rate on the issue. The winning bid is the one with the lowest interest cost to the issuer.

In a negotiated underwriting, the issuer selects an underwriter and negotiates the terms of the offering, including the underwriter's compensation.

**Disclosure Of  
Spread In  
Negotiated Offerings**

Under Rule G-32, in a negotiated underwriting of municipal fund securities, broker-dealers are required to disclose, or send, the following information to customers:

The underwriting spread; and

The amount of any fees received by the underwriters acting as agent for the issuer.



**No Disclosure Of  
Spread In  
Competitive Bids**

Note that this disclosure is not required in competitive underwritings because the spreads are narrow and fees are low - since the underwriters had to "compete" to win.

For broker-dealers that are sending periodic statements to customers in lieu of individual confirmations, this requirement is satisfied if the firm provides this information at least annually under the MSRB's rule. If there is a change in the fees associated with the plan, this information must be provided to customers, at, or prior to, the sending the next statement.

(Note: Even though the firm is required to send periodic statements at least monthly for non-periodic programs; and quarterly for periodic plans; and must detail changes in fees no later than with the next statement, the annual disclosure requirement is sort of a "summary and reminder statement" of the details of all fees associated with the plan.)

Furthermore, it is the responsibility of the primary distributor, within 1 business day of a request, to make available to selling dealers, sufficient copies of the Official Statement. The primary distributor must also make available instructions on how to order additional copies of the Official Statement directly from the printer, if requested by a selling dealer.

Under G-32, the requirement to deliver the Official Statement only applies during the underwriting period. Once the issue trades in the secondary market, delivery is not required. Since municipal fund securities are issued and delivered on a continuous basis, the underwriting period never ends. Therefore, every first-time purchaser of a municipal fund security must receive a copy of the Official Statement, at or prior to settlement.

### **3f. G-37, POLITICAL CONTRIBUTIONS**

This rule was written because municipal underwriters gave large political donations to elected officials in the hopes that, in return, the municipality would direct future underwriting business to the firm.

**Contributions By  
Municipal Firms  
To Elected Officials  
Is Prohibited**

Rule G-37 prohibits municipal dealers from engaging in municipal securities business with an issuer within 2 years after any contribution is made to an elected official of that issuer (an "issuer official") by the:

Municipal dealer;

Municipal finance professional ("MFP") associated with the dealer;

Political Action Committee ("PAC") controlled by the municipal dealer or MFP associated with the dealer.

**Only Applies To  
Negotiated  
Underwritings**

(Note that the 2-year ban does not apply to competitive bid underwritings, since there is no way for a municipal dealer to exert influence (by making political contributions) over the selection of the winning bidder. The rule only applies to negotiated underwritings.)

The term "issuer official" means any person who was, at the time of the contribution, an incumbent, candidate, or successful candidate for an office which is directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker-dealer to handle municipal securities business for that issuer.

**Associated Persons  
That Deal With  
Individual Customers  
Are Not MFPs**

The term "municipal finance professional" refers to any associated person who solicits municipal securities business - however, individuals who solicit business from "natural persons" are excluded. This means that regular registered representatives who deal with individual customers are not MFPs.

**Generally, MFPs  
Deal With Issuers**

In essence, an MFP is an associated person who solicits business from municipal issuers, renders financial advisory services to municipal issuers, or who performs research or writes reports on municipal issues. Note that executive officers of municipal firms are generally excluded from this definition.

The term "municipal securities business" only applies to negotiated underwritings (as primary distributor in the case of municipal fund securities offerings) and financial advisory services. Selling group firms are not in a position to influence the selection of the underwriter by the issuer and therefore are not covered under this rule.

The term "contribution" includes any gift, loan, advance, or deposit of any money, for the purpose of:

Influencing the election of any official of an issuer;

Paying or reducing debt incurred in connection with any election; and

Paying transition or inaugural expenses incurred by a successful candidate for office.

The rule cannot be circumvented by making payment through someone not on the prohibited list; nor can it be

**Contributions Of  
Up To \$250 Per  
Election Permitted**

circumvented by making payment to someone affiliated with the candidate (instead of to the candidate directly).

Contributions of up to \$250 or less **per election** are exempt from the rule, and thus are permitted. This "de minimis" exemption only applies to contributions made by MFPs eligible to vote for such official of the issuer (that is, they are registered to vote in that official's district).

Also note that annual contributions of up to \$250 per political party in a State or political subdivision in which an MFP is entitled to vote are permitted as well. Otherwise, the exemption is not available.

To summarize:

If an MFP makes a contribution:

Of any size to an issuer official for whom the MFP is not entitled to vote; or

Of more than \$250 to an issuer official for whom the MFP is entitled to vote;

Then the firm would be prohibited from engaging in municipal securities business with that issuer for 2 years from the contribution date.

Also note that this prohibition carries over if the MFP joins another municipal firm.

For example, if an MFP at municipal dealer "A" makes a contribution resulting in a 2 year prohibition; and less than 2 years later, joins municipal dealer "B;" both firms are subject to the prohibition until the end of the 2 year period.

Similarly, if a person not associated with a municipal firm makes a contribution to an issuer official; and within 2 years, that person joins a municipal firm as an MFP; that firm would be subject to a prohibition which would end 2 years from contribution date.

**2 Year "Look-Back"**

Note that the rule does not prohibit a non-MFP (e.g., an unregistered employee of a municipal dealer) from making a political contribution. However, if this person subsequently becomes an MFP, then the dealer must "look back" over the prior 2 years to see if this person made a political contribution that would violate the rule. If such a contribution was made, the dealer would be subject to the 2-year prohibition from contribution date.

For example, prior to associating with a municipal securities firm, an individual contributes \$1,000 to the campaign of an issuer-official. 1 year later, this person is hired as an MFP at a municipal securities dealer. The dealer will be prohibited from engaging in municipal securities business for 1 more year (that covers the 2-year period that began with the contribution date).

For example, a non-MFP at a municipal securities firm contributes \$1,000 to the campaign of an issuer-official. 6 months later, this person is promoted to an MFP position at that firm. The dealer will be prohibited from engaging in municipal securities business for 18 months (that covers the 2-year period that began with the contribution date).

**1 Year  
"Look Forward"**

If an MFP changes positions at a municipal securities firm to a non-MFP position; or if that person leaves the firm; for 1 year following the change, that person continues to be subject to the rule's prohibitions. This is termed the 1-year "look forward."

Other surrounding issues addressed by the rule are:

**Cannot Solicit  
Contributions**

Dealers and their municipal finance professionals cannot solicit contributions on behalf of the political officials;

**Rule Applies To Issuer  
Officials Seeking  
Federal Office**

The MSRB applies the provisions of the rule to municipal issuer officials that are campaigning for Federal office; but it does not apply the rule to non-issuer officials that are campaigning for Federal office;

**Rule Does Not Apply  
To Ex-Issuer Officials  
Seeking Contributions  
To Pay Off Campaign  
Debt**

The MSRB does not apply the rule to ex-issuer officials that have lost re-election campaigns and that solicit "clean-up" contributions to retire their campaign debt. However, the ex-issuer official must have left office, otherwise the rule still applies;

**Form G-37 Quarterly  
Report To MSRB Of  
Contributions That  
Exceed The De Minimis  
Amount**

Quarterly reports must be filed with the MSRB on Form G-37, detailing any contribution made by the municipal dealer and its professionals, during the preceding quarter, that exceeds the "de minimis" amount (\$250 if the individual is entitled to vote in that election; "0" if the individual is not entitled to vote in that election.)

As part of the report, the firm must list all issuers with which it engages in "municipal securities business." Because FINRA enforces MSRB rules, it can use this report when it audits broker-dealers to

see if the contributions were made to elected official with which the firm did municipal securities business. If so, this will result in a ban and probably a fine for a rule violation.

Copies of Form G-37 must be kept on file for 6 years.

Rule G-37 also prohibits dealers and their MFPs from soliciting any person or PAC to make a contribution (of any size) to an issuer official. If the name of a dealer or MFP appears on fund raising literature for an issuer official, there is a presumption of solicitation. Any solicitation on behalf of an issuer official will trigger a 2-year prohibition.

Note that this prohibition is not intended to restrict MFPs from engaging in personal volunteer work. However, if the MFP uses the dealer's resources in the conduct of volunteer work (such as hosting a reception on the dealer's premises), then the value of this would be considered a contribution.

#### **Form G-37x - For Municipal Firms That Are Exempt From The Rule**

A municipal broker-dealer that does not engage in municipal underwritings for issuers (e.g., a municipal firm that only effects transactions for customers or that only sells municipal fund securities) can choose to file a Form G-37x with the MSRB. This form certifies that the dealer did not engage in municipal securities business with issuers during the prior eight consecutive calendar quarters (2 years). This filing shows the MSRB that the municipal firm was exempt from the requirement to file Form G-37 each quarter during that time period.

#### **Exemptive Relief**

A dealer that becomes subject to a prohibition under this rule may seek exemptive relief from its SRO. The rule permits a dealer to appeal its case to the appropriate SRO if circumstances warrant. For example, if a disgruntled MFP who has been terminated makes a large political contribution resulting in a ban, the dealer will probably be able to get this overturned.

#### **Self-Exemption**

If a dealer discovers within 4 months of occurrence:

that a contribution of no more than \$250 was made by an MFP to an election of an official for which the MFP is not entitled to vote; and

the contribution is returned within 60 days of discovery; then

the dealer can exempt itself from the ban.

Note that this "self exemption" is only good for contribution amounts up to \$250 in elections where the

## **Pre-Existing Contracts**

contributor is not entitled to vote. If the amount exceeds \$250, this exemption does not apply.

If a contractual commitment with an issuer is in effect prior to the date that a prohibited political contribution is made, the dealer is allowed to fulfill the terms of that contract, as long as it is "issue specific." For example, a pre-existing contract to provide financial advisory services on structuring a new issue offering can be completed under the contract terms. Note, however, that any other new municipal business with that issuer would be subject to a 2-year prohibition.

### **3g. RULE G-38, SOLICITATION OF MUNICIPAL SECURITIES BUSINESS**

Rule G-38 deals with the use of "outside" consultants, which used to be hired by municipal firms to obtain municipal business from issuers; or to retain existing municipal business with issuers. The rule, passed in mid-2005, prohibits municipal broker-dealers from paying anyone who is not affiliated with the member firm for soliciting municipal securities business

Thus, only the employees of municipal securities firms may be paid by that firm to solicit municipal securities business from issuers. Unaffiliated persons such as political lobbyists, lawyers and accountants who assist in obtaining or retaining business, cannot receive payments from the municipal broker-dealer for soliciting business from municipalities. Of course, these persons can still be retained by the municipal broker-dealer for rendering their "professional services."

Also note that the predecessor rule was not as "black and white." Instead of outright prohibiting payments to unaffiliated persons for soliciting municipal securities business, it required that municipal dealers have written agreement with these "outside consultants" and make quarterly reports to the MSRB of payments made.