

# Financial Services

June 25, 2004 / NUMBER 17

## **MSRB Requests for Comment: Draft Amendments to Municipal Fund Securities Advertising Rule; Draft Interpretive Guidance Regarding Sale of Out-of-State 529 Plans; Draft Rule Amendments Regarding Gifts, Gratuities, and Non-Cash Compensation**

On June 10, 2004 the Municipal Securities Rulemaking Board (“MSRB”) requested comments on draft amendments to Rule G-21 regarding advertising for interests in 529 plans (“municipal fund securities”).<sup>1</sup> The amendments to Rule G-21 would establish specific guidelines for calculating and presenting performance data in municipal fund securities advertising. In the same release, the MSRB requested comments on draft interpretive guidance under Rule G-17 that would broaden existing point-of-sale disclosure requirements relating to sales of a state’s 529 plan interests to individuals of a different state. The draft amendments and interpretive guidance are designed to ensure material information is made available to investors who purchase shares through brokers, dealers and municipal securities dealers (“dealers”).<sup>2</sup> Comments are due by September 15, 2004.

<sup>1</sup> MSRB Notice 2004-16, Request for Comments on Draft Amendments Relating to Advertisements of Municipal Fund Securities and Draft Interpretive Guidance on Disclosures in Connection with Out-of-State Sales of College Savings Plan Shares (June 10, 2004).

<sup>2</sup> Like the NASD, the MSRB’s jurisdiction is limited and these rules would thus not apply to

In a second notice dated June 15, 2004 the MSRB requested comment on draft amendments to Rule G-20 regarding payment of non-cash compensation in connection with primary offerings, including offerings of municipal fund securities.<sup>3</sup> The proposed amendments would also modify the “normal business dealings” exception to require the involvement of the offeror in the entertainment or business function that the offeror is sponsoring. The proposed amendments are generally modeled after the NASD’s restrictions concerning influencing or rewarding the employees of others. Comments are due by July 30, 2004.

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issuers or their personnel who market municipal fund securities directly to customers.

<sup>3</sup> 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). Notice 2004-17 also presents draft amendments to books and records Rule G-8 that would require maintenance of records of all non-cash compensation referred to in Rule G-20(d).

## Advertising of Municipal Fund Securities

Rule G-21 establishes general standards for dealer advertisements. Among other things, the MSRB has interpreted<sup>4</sup> the rule to require a description of the nature and significance of any historical performance data used in an advertisement of municipal fund securities; disclose information about fees or other charges that may have a material effect on the advertised performance data; and disclosure to make clear that performance information (if any) relates to past performance, which may not be indicative of future performance. The MSRB has not, however, previously specified how dealers must calculate or present performance data in advertisements.

The draft amendments to Rule G-21 incorporate, with modifications, the advertising standards set forth in the MSRB's prior guidance, along with performance presentation provisions modeled on Securities Act Rule 482.<sup>5</sup> As drafted, the amendments to Rule G-21 would require that performance data included in advertisements for municipal fund securities be calculated and displayed, together with related legends and disclosures, in a similar manner to the disclosures required of mutual fund advertisements by Rule 482.

Similar to Rule 482, the draft rule would also require the following generalized disclosures: 1) that investors should consider the investment objectives, risks and charges of the municipal fund securities before investing; 2) an explanation that more information about the municipal fund securities is available in the official statement; 3) advice to the investor to carefully read the official statement before investing;

<sup>4</sup> See MSRB Interpretive Notice, Application of Fair Practice and Advertising Rules to Municipal Fund Securities, (May 14, 2002); MSRB Interpretive Notice on Commissions and Other Charges, Advertisements and Official Statements Relating to Municipal Fund Securities (Dec. 19, 2001).

<sup>5</sup> Rule 482 sets forth detailed requirements regarding how performance data published in mutual fund advertising must be calculated and presented.

and 4) identification of where an official statement can be obtained.

Advertisements for 529 plans would be required to include a statement advising investors to consider whether their home state offers tax or other benefits that are only available when investing in their home state's 529 plan. If the issuer holds the municipal fund security out as having the characteristics of a money market fund, the advertisement also would be required to include a statement that investment in the security is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency, unless such guarantee is provided.

The draft amendments also would require performance information included in advertisements to be accompanied by specific related legends and disclosures emphasizing that the data represents past performance and does not guarantee future results, that the value of holdings is subject to fluctuation, and that current performance may be different from the performance data included in the advertisement. Information about the maximum amount of the sales load or other nonrecurring fees would also be required. If the sales load or fee is not reflected in the performance data, dealers would be required to disclose that fact, and the fact that performance would be reduced if the sales load or fees were reflected in the data.

Quotations of performance in advertisements for municipal fund securities would be limited to certain specific data, similar to the limitations imposed in Rule 482(d). A dealer would be permitted to use information provided by the issuer or obtained from other reliable sources to calculate the performance of the municipal fund security, but only to the extent that the information is not available in a balance sheet in the registration statement of an underlying mutual fund. Dealers would be required to base performance data in their advertising materials upon information from the most recently ended calendar quarter prior to the publication of the advertisement. Finally, dealers

would be required to treat municipal fund securities expenses that have the same characteristics as Rule 12b-1 fees as such for purposes of calculating performance.

The draft amendments also would incorporate elements from prior MSRB interpretations concerning the nature of the issuer and securities, the capacity of the dealer and other parties, tax consequences, and information about the mutual funds in which the municipal fund security assets are invested. Advertisements for a specific municipal fund security would be required to include sufficient information to identify the security in a manner that is not false or misleading, present the name of the issuer in a manner no less prominent than any other entity identified in the advertisement, and not imply that a different entity is the issuer. Inferences that investors are guaranteed against investment losses merely because the municipal fund securities are issued under a government-sponsored plan would not be permitted unless such a guarantee exists. If an advertisement concerns a specific class or category of an issuer's securities, this would be required to be clearly disclosed in a manner no less prominent than the information provided with respect to that class or category.

An advertisement relating to or describing services provided or soliciting purchases to be effected by any party other than the dealer that publishes the advertisement, including the issuer, would be required to clearly indicate the entity providing the services or effecting the transaction.

Information in advertisements about tax benefits or other beneficial features of investments in municipal fund securities must not be misleading or false and must be accompanied by a description of any material limitations based upon residency, purpose for or timing of share redemptions, or other factors, as applicable. Any limitations must be presented with equal prominence and in close proximity to any description of benefits.

The draft rule would require details in an advertisement about underlying assets of the municipal fund security to be presented in a manner that would be in compliance with any SEC or NASD advertising rule that would be applicable to the advertisement if it related solely to the underlying security. Statements also would be required as necessary to ensure the details about the underlying assets would not cause the advertisement to be false or misleading with respect to the municipal fund securities advertised.

### **Point-of-Sale Disclosure for 529 Plans Sold Outside of the Sponsoring State**

The MSRB previously issued interpretive guidance regarding dealers' point-of-sale disclosure obligations when marketing of shares of a state's 529 plan to residents of another state.<sup>6</sup> Rule G-17 generally requires dealers to disclose to customers at or prior to the time of trade all material facts known to the dealer as well as all material facts about the security that are reasonably available to the market. With regard to municipal fund securities, the rule has been interpreted to require any dealer selling an out-of-state 529 plan to disclose to a customer that depending upon the laws of the customer's home state, favorable state tax treatment for investing in a 529 plan may be limited to investments made in a 529 plan offered by the customer's home state. Currently, however, there is no specific requirement that dealers disclose the fact that some states also offer additional benefits, such as scholarships to in-state colleges, matching grants to their college plan savings accounts, or reduced or waived program fees.

The draft interpretive guidance would broaden existing point-of-sale disclosure requirements to include disclosure of other potential benefits offered to

<sup>6</sup> See MSRB Interpretive Notice, Application of Fair Practice and Advertising Rules to Municipal Fund Securities (May 14, 2002); See also MSRB Interpretive Notice Regarding Rule G-17, on Disclosure of Material Facts (Mar. 20, 2002).

customers who purchase an interest in their home state 529 plan. Dealers would be required to suggest to the customer that they consult with a qualified adviser or contact their home state's 529 plan to learn more about potential benefits that might be available to them as a result of purchasing their home state's 529 plan.

Disclosure may be made through the issuer's official statement only if the official statement is provided to the customer at or prior to the time of trade and only if such disclosure meets certain prominence standards. As with the current interpretation, if the issuer does not include the disclosure information in the official statement in the described manner, the dealer would remain obligated to disclose the information separately to the customer.

### Gifts, Gratuities and Non-Cash Compensation

Rule G-20 is designed to prevent municipal securities market participants from using personal gifts or gratuities to induce the recipient to conduct business with the offeror. Rule G-20 currently prohibits dealers from giving any thing of value in excess of \$100 per year to any person in relation to the municipal securities activities of the offeror. A "normal business dealings" exception to the general rule allows occasional gifts of meals, tickets or reminder advertising (e.g., logo items) that are not so frequent so as to raise a suggestion of unethical conduct. Rule G-20 is generally consistent with the NASD's restrictions on influencing or rewarding the employees of others;<sup>7</sup> the draft amendments would improve that consistency and also follow the NASD's lead with regard to non-cash compensation.<sup>8</sup>

<sup>7</sup> See NASD Rule 3060 (Influencing or Rewarding Employees of Others).

<sup>8</sup> See Rule 2710 (Corporate Financing Rule), Rule 2810 (Direct Participation Programs), Rule 2820 (Variable Contracts of an

The first part of the draft amendments to Rule G-20 would adjust the normal business dealings exception to require that the offeror accompany recipients to the meals, entertainment events and business functions permitted under the normal business dealings exception, rather than merely distributing free tickets or paying or reimbursing costs.

The second part of the draft amendments to Rule G-20 would add an entire new sub-section to the rule regarding non-cash compensation that generally follows NASD proscriptions. Payment or receipt of non-cash compensation would be prohibited in connection with a primary offering (including offerings of municipal fund securities) except with regard to (i) gifts that do not exceed \$100 per year and are not preconditioned on achievement of a sales target; (ii) occasional gifts of meals or other entertainment so long as they are not conditioned on a sales target or so frequent or so expensive so as to raise a question of impropriety;<sup>9</sup> (iii) certain training or educational meetings under specified circumstances; and (iv) certain internal non-cash compensation arrangements (the "internal arrangement exception") between the dealer (including certain control affiliates) and the associated persons of the dealer.

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Insurance Company) and Rule 2830 (Investment Company Securities).

<sup>9</sup> This provision differs from the "normal business dealings" exception in that receipt of non-cash compensation may not be conditioned on a sales target. Additionally, this provision does not require the direct participation offeror (under the normal business dealings exception, the offeror must accompany the recipient to the meal or entertainment event).

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