2. Statutory Basis

The proposed rule change is consistent with section 6(b) [10] of the Act in general and furthers the objectives of section 6(b)(5) [11] in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of change, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that the proposed rule change will impose no burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change, as amended, has become effective pursuant to section 19(b)(3)(A) of the Act [12] and subparagraph (f)(6) of rule 19b–4 [13] thereunder because it does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate; and the Exchange has given the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Under rule 19b–4(f)(6)(iii) of the Act,[14] the proposal does not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest and the Exchange is required to give the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. The Exchange has given the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. The Exchange contends that this proposed rule is substantially similar to comparable rules the Commission approved for the CBOE, which was published for public notice and comment.[15] As a result, the Exchange believes that the proposed rule change does not raise any new regulatory issues, significantly affect the protection of investors or the public interest, or impose any significant burden on competition. The Commission, consistent with the protection of investors and the public interest, has determined to waive the 30-day operative period,[16] and, therefore, the proposal is effective and operative upon filing with the Commission.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–Amex–2003–19 and should be submitted by April 29, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[17]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03–8446 Filed 4–7–03; 8:45 am]

BILLING CODE 8010–01–P

[10] 15 U.S.C. 78f.

[11] 15 U.S.C. 78f(b)(5).

[12] 15 U.S.C. 78s(b)(3)(A).

[13] 17 CFR 240.19b–4(f)(6).

[14] 17 CFR 240.19b–4(f)(6)(iii).

[15] *See* Securities Exchange Act Release No. 47190 (January 15, 2003), 68 FR 3072 (January 22, 2003) (approving SR–CBOE–2002–62). *See also* Securities Exchange Act Release Nos. 47352 (February 11, 2003), 68 FR 8319 (February 20, 2003) (Notice of Filing and Immediate Effectiveness of SR–PCX–2003–06); and 47483 (March 11, 2003), 68 FR 13352 (March 19, 2003) (Notice of Filing and Immediate Effectiveness of SR–ISE–2003–04).

[16] For purposes only of waiving the 30-day operative period for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[17] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47609; File No. SR–MSRB–2002–12]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Amendments to Rules G–37, on Political Contributions and Prohibitions on Municipal Securities Business, G–8, on Books and Records, Revisions to Form G–37/G–38 and the Withdrawal of Certain Rule G–37 Questions and Answers

April 1, 2003.

On September 26, 2002, the Municipal Securities Rulemaking Board (''Board'' or ''MSRB'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') a proposed rule change (File No. SR–MSRB–2002–12), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act''), and rule 19b–4 thereunder.[1] The proposed rule change is described in items I, II, and III below, which Items have been prepared by the Board. On March 26, 2003, the MSRB filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change and Amendment No. 1 from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Board is filing herewith amendments to rules G–37, on political contributions and prohibitions on municipal securities business, G–8, on books and records, revisions to Form G–37/G–38 and the withdrawal of certain Rule G–37 Questions and Answers . The cumulative amendments made to rules G–37 and G–8, the revisions to Form G–37/G–38 and the withdrawal of certain Rule G–37 Questions and Answers as set forth in the original filing and by Amendment No. 1 are collectively referred to herein as the ''Proposed Rule

[1] 15 U.S.C. 78s(b)(1); 17 CFR 240.19b–4.

Change.'' The Proposed Rule Change revises the exemption process and the definition of municipal finance professional. Amendment No. 1 alters the text of the amendments to the rule language as it appears in the original filing. Below is the text of the Proposed Rule Change. Additions are italicized; deletions are bracketed.

Rule G–37. Political Contributions and Prohibitions on Municipal Securities Business

(a) No change.

(b)(*i*) No broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (A) The broker, dealer or municipal securities dealer; (B) any municipal finance professional associated with such broker, dealer or municipal securities dealer; or (C) any political action committee controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional; provided, however, that this section shall not prohibit the broker, dealer or municipal securities dealer from engaging in municipal securities business with an issuer if the only contributions made by the persons and entities noted above to officials of such issuer within the previous two years were made by municipal finance professionals to officials of such issuer for whom the municipal finance professionals were entitled to vote and which contributions, in total, were not in excess of $250 by any municipal finance professional to each official of such issuer, per election.

(ii) For an individual designated as a municipal finance professional solely pursuant to subparagraph (B) of paragraph (g)(iv) of this rule, the provisions of paragraph (b)(i) shall apply to contributions made by such individual to officials of an issuer prior to becoming a municipal finance professional only if such individual solicits municipal securities business from such issuer.

(iii) For an individual designated as a municipal finance professional solely pursuant to subparagraphs (C), (D) or (E) of paragraph (g)(iv) of this rule, the provisions of paragraph (b)(i) shall apply only to contributions made during the six months prior to the individual becoming a municipal finance professional.

(c) through (d) No change.

(e)(i) Except as otherwise provided in paragraph (e)(ii), each broker, dealer or municipal securities dealer shall, by the last day of the month following the end of each calendar quarter (these dates correspond to January 31, April 30, July 31 and October 31) send to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending, two copies of Form G–37/G–38 setting forth, in the prescribed format, the following information:

(A)–(C) No change.

(D) any information required to be disclosed pursuant to section (e) of rule G–38; [and]

(E) such other identifying information required by Form G–37/G–38[.] *; and*

(F) whether any contribution listed in this paragraph (e)(i) is the subject of an automatic exemption pursuant to section (j) of this rule, and the date of such automatic exemption.

The Board shall make public a copy of each Form G–37/G–38 received from any broker, dealer or municipal securities dealer.

(ii) through (iii) No change.

(f) No change.

(g) Definitions. (i) through (iii) No change.

(iv) The term ''municipal finance professional'' means: (A) Any associated person primarily engaged in municipal securities representative activities, as defined in rule G–3(a)(i)*, provided, however, that sales activities with natural persons shall not be considered to be municipal securities representative activities for purposes of this subparagraph (A)*; (B) any associated person who solicits municipal securities business, as defined in paragraph (vii); (C) any associated person who is both (i) a municipal securities principal or a municipal securities sales principal and (ii) a supervisor of any persons described in subparagraphs (A) or (B); (D) any associated person who is a supervisor of any person described in subparagraph (C) up through and including, in the case of a broker, dealer or municipal securities dealer other than a bank dealer, the Chief Executive Officer or similarly situated official and, in the case of a bank dealer, the officer or officers designated by the board of directors of the bank as responsible for the day-to-day conduct of the bank's municipal securities dealer activities, as required pursuant to rule G–1(a); or (E) any associated person who is a member of the broker, dealer or municipal securities dealer (or, in the case of a bank dealer, the separately identifiable department or division of the bank, as defined in rule G–1) executive or management committee or similarly situated officials, if any; provided, however, that, if the only associated persons meeting the definition of municipal finance professional are those described in this subparagraph (E), the broker, dealer or municipal securities dealer shall be deemed to have no municipal finance professionals.

Each person designated by the broker, dealer or municipal securities dealer as a municipal finance professional pursuant to rule G–8(a)(xvi) is deemed to be a municipal finance professional. Each person designated a municipal finance professional shall retain this designation for [two] *one* year[s] after the last activity or position which gave rise to the designation.

(v) through (viii) No change.

(h) No change.

(i) A registered securities association with respect to a broker, dealer or municipal securities dealer who is a member of such association, or the appropriate regulatory agency as defined in section 3(a)(34) of the Act with respect to any other broker, dealer or municipal securities dealer, upon application, may exempt, conditionally or unconditionally, a broker, dealer or municipal securities dealer who is prohibited from engaging in municipal securities business with an issuer pursuant to section (b) of this rule from such prohibition. In determining whether to grant such exemption, the registered securities association or appropriate regulatory agency shall consider, among other factors [whether]:

(i) *whether* such exemption is consistent with the public interest, the protection of investors and the purposes of this rule; [and]

(ii) *whether* such broker, dealer or municipal securities dealer

(A) prior to the time the contribution(s) which resulted in such prohibition was made, had developed and instituted procedures reasonably designed to ensure compliance with this rule;

(B) prior to or at the time the contribution(s) which resulted in such prohibition was made, had no actual knowledge of the contribution(s);

(C) has taken all available steps to cause the [person or persons] *contributor* involved in making the contribution(s) which resulted in such prohibition to obtain a return of the contribution(s); and

(D) has taken such other remedial or preventive measures, as may be appropriate under the circumstances[.], *and the nature of such other remedial or preventive measures directed specifically toward the contributor who made the relevant contribution and all employees of the broker, dealer or municipal securities dealer;*

(iii) whether, at the time of the contribution, the contributor was a municipal finance professional or

otherwise an employee of the broker, dealer or municipal securities dealer, or was seeking such employment;

(iv) the timing and amount of the contribution which resulted in the prohibition;

(v) the nature of the election (e.g., federal, state or local); and

(vi) the contributor's apparent intent or motive in making the contribution which resulted in the prohibition, as evidenced by the facts and circumstances surrounding such contribution.

(j) Automatic Exemptions.

(i) A broker, dealer or municipal securities dealer that is prohibited from engaging in municipal securities business with an issuer pursuant to section (b) of this rule as a result of a contribution made by a municipal finance professional may exempt itself from such prohibition, subject to subparagraphs (ii) and (iii) of this section, upon satisfaction of the following requirements: (1) The broker, dealer or municipal securities dealer must have discovered the contribution which resulted in the prohibition on business within four months of the date of such contribution; (2) such contribution must not have exceeded $250; and (3) the contributor must obtain a return of the contribution within 60 calendar days of the date of discovery of such contribution by the broker, dealer or municipal securities dealer.

(ii) A broker, dealer or municipal securities dealer is entitled to no more than two automatic exemptions per 12-month period.

(iii) A broker, dealer or municipal securities dealer may not execute more than one automatic exemption relating to contributions by the same municipal finance professional regardless of the time period.

* * * * *

Rule G–8: Books and Records To Be Made by Brokers, Dealers and Municipal Securities Dealers

(a) Description of Books and Records Required to be Made. Except as otherwise specifically indicated in this rule, every broker, dealer and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such broker, dealer or municipal securities dealer:

(i)–(xv) No change.

(xvi) *Records Concerning Political Contributions and Prohibitions on Municipal Securities Business Pursuant to Rule G–37.*

Records reflecting:

(A)–(D) No change.

(E) the contributions, direct or indirect, to officials of an issuer and payments, direct or indirect, made to political parties of states and political subdivisions, by the broker, dealer or municipal securities dealer and each political action committee controlled by the broker, dealer or municipal securities dealer [(or controlled by any municipal finance professional of such broker, dealer or municipal securities dealer)] for the current year and separate listings for each of the previous two calendar years, which records shall include: (i) The identity of the contributors, (ii) the names and titles (including any city/county/state or other political subdivision) of the recipients of such contributions and payments, and (iii) the amounts and dates of such contributions and payments;

(F) the contributions, direct or indirect, to officials of an issuer made by each municipal finance professional, *any political action committee controlled by a municipal finance professional,* and non-MFP executive officer for the current year [and separate listings for each of the previous two calendar years], which records shall include: (i) The names, titles, city/county and state of residence of contributors, (ii) the names and titles (including any city/county/state or other political subdivision) of the recipients of such contributions, [and] (iii) the amounts and dates of such contributions, *and (iv) whether any such contribution was the subject of an automatic exemption, pursuant to Rule G–37(j), including the amount of the contribution, the date the broker, dealer or municipal securities dealer discovered the contribution, the name of the contributor, and the date the contributor obtained a return of the contribution;* provided, however, that such records need not reflect any contributions made by a municipal finance professional or non-MFP executive officer to officials of an issuer for whom such person is entitled to vote if the contributions made by such person, in total, are not in excess of $250 to any official of an issuer, per election[; and]. *In addition, brokers, dealers and municipal securities dealers shall maintain separate listings for each of the previous two calendar years containing the information required pursuant to this subparagraph (F) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (A) and (B) of rule G–37(g)(iv) and for any political action committee controlled by such individuals, and separate listings for the previous six months containing the information required pursuant to this subparagraph (F) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (C), (D) and (E) of rule G–37(g)(iv) and for any political action committee controlled by such individuals and for any non-MFP executive officers; and*

(G) the payments, direct or indirect, to political parties of states and political subdivisions made by all municipal finance professionals, *any political action committee controlled by a municipal finance professional,* and non-MFP executive officers for the current year [and separate listings for each of the previous two calendar years], which records shall include: (i) The names, titles, city/county and state of residence of contributors, (ii) the names and titles (including any city/county/state or other political subdivision) of the recipients of such payments, and (iii) the amounts and dates of such payments; provided, however, that such records need not reflect those payments made by any municipal finance professional or non-MFP executive officer to a political party of a state or political subdivision in which such persons are entitled to vote if the payments made by such person, in total, are not in excess of $250 per political party, per year. *In addition, brokers, dealers and municipal securities dealers shall maintain separate listings for each of the previous two calendar years containing the information required pursuant to this subparagraph (G) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (A) and (B) of rule G–37(g)(iv) and for any political action committee controlled by such individuals, and separate listings for the previous six months containing the information required pursuant to this subparagraph (G) for those individuals meeting the definition of municipal finance professional pursuant to subparagraphs (C), (D) and (E) of rule G–37(g)(iv) and for any political action committee controlled by such individuals and for any non-MFP executive officers.*

(H)–(K) No change.

* * * * *

Form G–37/G–38

Name of dealer: _____

Report period: _____

I. CONTRIBUTIONS MADE TO ISSUER OFFICIALS

[List by state]

State	Complete name, title (including) any city/county/state or other political subdivision) of issuer official.	Contributions by each contributor category (*i.e.*, dealer, dealer controlled PAC, municipal finance professional controlled PAC, municipal finance professionals and executive officers). For each contribution, list contribution amount and contributor category (for example, ($500 contribution by non-MFP executive officer). *If any contribution is the subject of an automatic exemption pursuant to Rule G–37 (j), list amount of contribution and date of such automatic exemption.*

II. Payments Made to Political Parties of States or Political Subdivisions (List by State)

No change.

III. Issuers With Which Dealer Has Engaged in Municipal Securities Business (List by State)

No change.

IV. Consultants

No change.

* * * * *

Rule G–37 Questions & Answers To Be Withdrawn

May 24, 1994 (Q&A #12)

[Q: A dealer may discover that a ''disgruntled'' municipal finance professional made a contribution to an issuer official deliberately to prohibit the dealer from engaging in municipal securities business with the issuer. Is there a procedure in place whereby the dealer can seek an exemption from the prohibition on municipal securities business in such circumstances?]

[A: The Board recognizes that there may be limited circumstances in which a dealer should be able to request an exemption from the prohibition on business. Thus, the Board has filed with the SEC an amendment to rule G–37 that allows bank regulatory authorities (the Office of the Comptroller of the Currency, Federal Reserve Board and Federal Deposit Insurance Corporation), upon application by a dealer, to grant such exemption, conditionally or unconditionally, in certain circumstances. See the rule filing, SR–MSRB–94–5, for more information about this procedure.]

June 15, 1995 (Q&A #4)

[Q: Rule G–37(i) provides a procedure whereby dealers may request that the NASD or the appropriate regulatory agency (*i.e.,* federal bank regulatory authorities) grant an exemption from the rule's two-year ban on municipal securities business with an issuer which resulted from political contributions made to officials of that issuer by the dealer, a PAC controlled by the dealer, or a municipal finance professional. If a municipal finance professional made a contribution to an issuer official which triggered the ban, what factors would be relevant to the dealer's decision to request an exemption from that ban, and to the NASD or appropriate regulatory agency in determining whether the exemption should be granted?]

[A: In determining whether to grant such an exemption, rule G–37(i) requires the NASD or the appropriate regulatory agency to consider, among other factors, whether (i) such exemption is consistent with the public interest, the protection of investors and the purposes of rule G–37; and (ii) such dealer (A) prior to the time the contribution(s) which resulted in such prohibition was made, had developed and instituted procedures reasonably designed to ensure compliance with the rule; (B) prior to or at the time the contribution(s) which resulted in such prohibition was made, had no actual knowledge of the contribution(s); (C) has taken all available steps to cause the person or persons involved in making the contribution(s) which resulted in such prohibition to obtain a return of the contribution(s); and (D) has taken such other remedial or preventive measures as may be appropriate under the circumstances.

In reviewing the facts and circumstances presented by the dealer, as well as the factors set forth above, the NASD or the appropriate regulatory agency will consider whether, prior to the time the contribution was made, the dealer had developed and instituted procedures reasonably designed to ensure compliance with the rule. Such procedures are required by rule G–27 on supervision. Effective compliance procedures are essential because rule G–37 requires the dealer to have information regarding each contribution made by the dealer, dealer-controlled PACs and municipal finance professionals so that the dealer can determine where and with whom it may or may not engage in municipal securities business. In addition, for disclosure purposes, the dealer must maintain information on executive officers' contributions and payments to political parties, as well as consultant hiring practices. Moreover, because of the ''directly and indirectly'' provision in rule G–37(d), as well as the no solicitation and no bundling provisions in section (c) of the rule, the dealer must ensure that those persons and entities subject to the rule are not causing the dealer to be in violation thereof. In this regard, the Board wishes to remind dealers that they are responsible for determining which of their employees, supervisors (*e.g.*, branch managers), and management personnel (*e.g.*, members of the dealer's executive or management committee or similarly situated officials) are ''municipal finance professionals.'' In addition to those persons and entities covered by the rule, the dealer must ensure that other persons and entities hired to assist in municipal securities activities (*e.g.*, consultants) are not being directed to make contributions, or otherwise being used as conduits, in violation of the rule. In reviewing a request for exemption, the NASD or the appropriate regulatory agency also will consider whether the dealer has taken all available steps to obtain a return of the contribution. The return of the contribution, while important, is only one of the factors to be considered, and is not dispositive of whether an exemption should be granted.

Finally, the NASD or appropriate regulatory agency will consider whether the dealer has taken remedial or preventive measures as may be appropriate under the circumstances. Thus, dealers should provide information on any changes to compliance procedures and/or personnel action taken to address the particular situation which resulted in the prohibition so that such problems do not recur. For additional guidance on the exemption provision, please refer to Q&A number 2 in the August 1994 issue of *MSRB Reports* (Vol. 14, No. 4).

The Board previously provided two examples in which exemptions may be appropriate. The first example described a situation in which a disgruntled municipal finance professional made a contribution purposely to injure the

dealer, its management or employees. The second example involved a municipal finance professional who was eligible to vote for a particular issuer official and who made a number of small contributions during an election cycle (*e.g.*, over four years) which, when consolidated, amounted to slightly over the $250 *de minimis* exemption (*e.g.*, $255).

The Board believes that the following situations are not sufficient to justify the granting of an exemption from a ban on business: (1) A contribution was made by a municipal finance professional which subjected the dealer to the two-year ban on business, but the municipal finance professional was not aware of rule G–37 or any of its particular provisions; (2) the dealer or a municipal finance professional did not know that the recipient of a particular contribution was an ''official of an issuer''; and (3) at the time the contribution was made, an associated person did not know that he was a ''municipal finance professional'' by virtue of his supervisory capacity, by being primarily engaged in municipal securities representative activities, or by virtue of any of the other activities listed in the rule's definition of municipal finance professional.

The Board is strongly of the view that exemptions should be granted only in limited circumstances. If a significant number of exemptions are granted by the regulatory agencies, then the Board may reexamine the propriety of the exemption provision.]

June 29, 1998 (Q&A #1 (partial withdrawal), 2 and 3)

1. Q: A person is associated with a dealer in a non-municipal finance professional capacity and makes a political contribution to an official of an issuer for whom such person is not entitled to vote. Less than two years after such person made the contribution, the dealer merges with another dealer and, solely as a result of the merger, that person becomes a municipal finance professional of the surviving dealer. Would the surviving dealer be prohibited from engaging in municipal securities business with that issuer?

A: Yes. Rule G–37 would prohibit the surviving dealer from engaging in municipal securities business with the issuer for two years from the date the contribution was made. Of course, the surviving dealer's prohibition on business would only begin when the person who made the contribution becomes a municipal finance professional of the surviving dealer.

The Board notes, however, that rule G–37 was not intended to prevent mergers in the municipal securities industry or, once a merger is consummated, to seriously hinder the surviving dealer's municipal securities business if the merger was not an attempt to circumvent the letter or spirit of rule G–37. [Thus, the Board believes that it would be appropriate for the NASD or the appropriate regulatory agency (*i.e.*, federal bank regulatory authorities) to grant conditional or unconditional exemptions from bans on municipal securities business arising from such mergers if the NASD or the appropriate regulatory agency determines that, pursuant to rule G–37(i), the exemption is consistent with the public interest, the protection of investors and the purposes of the rule, as well as any other factors set forth in the rule or any other factors deemed relevant by the NASD or the appropriate regulatory agency.]

[2. Q: The Board has previously provided two examples in which exemptions from a ban on municipal securities business may be appropriate under rule G–37(i). Are these the only situations in which the NASD or the appropriate regulatory agency may provide an exemption under rule G–37(i)?]

[A: No. The two examples noted in Q&A number 4 (June 15, 1995), *MSRB Reports,* Vol. 15, No. 2 (July 1995) at 3–4, *MSRB Manual* (CCH) & 3681, were not meant to be the only instances in which exemptions might appropriately be given. Because of the varying factual situations that arise with each exemptive request, the Board believes that the NASD and the appropriate regulatory agencies should review such other factual situations presented by dealers in exemptive requests pursuant to the requirements in rule G–37(i) and, based on the facts, either approve or reject the request. Rule G–37(i) allows the NASD and the appropriate regulatory agencies to grant exemptions from the ban on business ''conditionally or unconditionally'' and, if the NASD or the appropriate regulatory agency believes it would be appropriate to shorten the ban on business or limit its scope, it is authorized to do so as long as the requirements of rule G–37(i) are met.]

[3. Q: The Board has previously described three situations which it believes are not sufficient to justify the granting of an exemption from a ban on municipal securities business under rule G–37(i). Does this mean that the NASD or the appropriate regulatory agency may never provide an exemption under rule G–37(i) if any of these situations exist?]

[A: No. The Board's intent in describing these three scenarios in Q&A number 4 (June 15, 1995), *MSRB Reports,* Vol. 15, No. 2 (July 1995) at 3–4, *MSRB Manual* (CCH) & 3681, was to note that none of these situations was sufficient, in and of itself, to justify the granting of an exemption from a ban on municipal securities business. However, any such scenario in combination with other facts and circumstances deemed relevant by the NASD or the appropriate regulatory agency (including, but not limited to, the factors set forth in rule G–37(i)) could, in the judgment of the NASD or the appropriate regulatory agency, be sufficient to justify a conditional or unconditional exemption from the ban.

The Board also notes that none of the three situations previously cited as insufficient to justify an exemption involved a contribution made prior to an individual becoming a municipal finance professional. Thus, for example, where a non-*de minimis* contribution was made by a person who later becomes a municipal finance professional (whether by reason of a merger, as a newly hired associated person, as an existing associated person becoming involved in municipal securities activities, or otherwise), neither the NASD nor any appropriate regulatory agency is constrained from granting a conditional or unconditional exemption if, in its judgment, such exemption is consistent with rule G–37(i).]

II. Self-Regulatory Organization's Statement of the Purpose of and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the Proposed Rule Change and discussed any comments it received on the Proposed Rule Change. The text of these statements may be examined at the places specified in item IV below. The MSRB has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Rule G–37, on political contributions and prohibitions on municipal securities business, became effective on April 25, 1994. During the past eight years, the MSRB believes that the rule has been successful in halting pay-to-play practices in the municipal securities market. As part of the MSRB's

Long-Range Plan, the MSRB determined to conduct a review of the rule's requirements and seek comments on whether there are compliance concerns to address. Although the MSRB is sensitive to the burden imposed on brokers, dealers and municipal securities dealers (''dealers'') by the requirements of rule G–37 and is committed to reducing this burden whenever possible, the MSRB believes that the rule has provided substantial benefits to the industry and the investing public by reducing the direct connection between political contributions to issuer officials and the awarding of municipal securities business.

Background

Rule G–37 prohibits a dealer from engaging in municipal securities business [2] with an issuer within two years after certain contributions to an official of such issuer made by the dealer, any municipal finance professional (''MFP'') associated with such dealer (other than certain *de minimis* contributions) [3] or any political action committee (''PAC'') controlled by the dealer or any MFP. In addition, the rule requires dealers to disclose on Form G–37/G–38 certain contributions to issuer officials and payments to political parties of states and political subdivisions made by MFPs and certain other categories of contributors. Rule G–8, on books and records, requires dealers to create records of such contributions and payments. Finally, rule G–37(i) provides a procedure whereby dealers may request that NASD or the appropriate regulatory agency (*i.e.*, federal bank regulatory authorities) grant an exemption from rule G–37's two-year ban on municipal securities business with an issuer that resulted from political contributions made to officials of that issuer.

Review of Proposed Rule Change

Exemption Process and Withdrawal of Certain Rule G–37 Questions and Answers

As noted above, under rule G–37(i), a dealer that has triggered the rule's two-year ban on municipal securities business may seek an exemption from that ban from the appropriate regulatory agency.[4] The rule provides that the appropriate regulatory agency may exempt, ''conditionally or unconditionally,'' a dealer that is banned from engaging in municipal securities business with an issuer from such ban. The MSRB specifically intended that the regulatory agencies have flexibility in dealing with the various factual situations that may arise pursuant to exemption requests. For example, a regulatory agency could reduce the ban on business from two years to a lesser period of time. In determining whether to grant an exemption request, the appropriate regulatory agency is required to consider, among other factors, whether an exemption would be consistent with the public interest, the protection of investors and the purposes of rule G–37. The regulatory agency also is required to examine whether the dealer had appropriate procedures in place to ensure compliance with the rule, had no actual knowledge that the contribution was being made, has taken all steps to obtain a return of the contribution, and has taken any other appropriate remedial or preventive measures.

The Proposed Rule Change includes the addition of the following relevant factors to be considered by the appropriate regulatory agency in determining whether to grant an exemption (conditional or unconditional) from the two-year ban on business:

- The nature of remedial or preventive measures directed specifically toward the contributor and all employees of the dealer.
- Whether, at the time of the contribution, the contributor was an MFP or otherwise an employee of the dealer, or was seeking such employment.
- The timing and amount of the contribution.
- The nature of the election (*e.g.*, federal, state or local).
- The contributor's apparent intent or motive in making the contribution, as evidenced by the facts and circumstances surrounding such contribution.

The additional factors will help to clarify facts and circumstances relevant to exemptive requests and will facilitate the review of such requests by the appropriate regulatory agency. To further clarify and facilitate this process, the MSRB also is withdrawing certain rule G–37 Questions and Answers (''Qs and As'') previously published concerning when an exemption may or may not be appropriate. This action is necessary in order to clarify that the regulatory agencies have discretion in administering the exemption process. The Proposed Rule Change will assist the regulatory agencies in exercising their discretion in a manner that will fulfill the purposes of rule G–37.

Adoption of an Automatic Exemption Provision

The Proposed Rule Change provides for an automatic exemption from a dealer's ban on business in certain limited instances. This provision sets out procedures that would permit dealers to execute two such exemptions per 12-month period for contributions made by an MFP of $250 or less if the dealer discovers the contribution within four months of the date of such contribution and the contributor obtains a return of the contribution within 60 calendar days of the date of discovery of such contribution by the dealer. A dealer would not be permitted to execute more than one automatic exemption relating to contributions by the same MFP. The automatic exemption would not be available for contributions made by a dealer, a dealer-controlled PAC or MFP-controlled PAC. Finally, dealers would be required to report the exemption on Form G–37/G–38 and to maintain records of such exemptions pursuant to rule G–8, on books and records. A dealer would be banned from municipal securities business until the contribution was returned.

The MSRB believes that a limited automatic exemption provision will provide a measure of relief to the industry without compromising the purposes of rule G–37. In addition, it will relieve some of the regulatory agencies' burden of administering the exemption process by removing from this process certain routine cases involving small contributions. The MSRB notes that the time periods proposed are reasonable and will encourage dealers to discover contributions that could give rise to a ban on business in a timely manner (*e.g.*, in preparation for the filing of quarterly forms G–37/G–38) and to seek quick refunds of these contributions. The automatic exemption will, for example, allow dealers who wish to hire as an MFP someone who previously gave a small contribution to an issuer official to lift the ban on business with that issuer after meeting the requirements of the new provision.

[2] Municipal securities business is defined in rule G–37 to encompass certain activities of dealers in connection with primary offerings of municipal securities, such as acting as underwriter in a negotiated sale, as placement agent, or as financial advisor, consultant or remarking agent to an issuer in which the dealer was chosen on a negotiated basis.

[3] Contributions made by an issuer for whom the MFP is entitled to vote will not cause the MFP's dealer to be prohibited from engaging in municipal securities business with issuer if the contributions, in total, are not in excess of $250 by such MFP to each official of such issuer, per election.

[4] The appropriate regulatory agencies include NASD for securities firms and the federal bank regulators for bank dealers.

Also, a dealer could lift the ban on business if an MFP contributes to an issuer official for whom he or she is not entitled to vote without knowing that his or her firm does business with that issuer. The MSRB determined to limit the number of exemptions, as well as the dollar amount involved, to ensure that the automatic exemption provision could only be used in limited circumstances and not as an avenue for circumvention of the rule.

Definition of Municipal Finance Professional

MFPs Primarily Engaged in Municipal Securities Representative Activities

The Proposed Rule Change amends the definition of MFP so that associated persons ''primarily engaged'' in municipal securities representative activities based on their retail sales of municipal securities are excluded from the definition. While there may be limited instances in which retail sales persons make contributions to obtain municipal securities business for dealers, the MSRB believes that these instances do not outweigh the compliance burden of determining which of these persons are included in the rule. In addition, any retail sales representative who solicits municipal securities business would remain covered under the rule as an MFP.

Look Back and Look Forward Provisions

Since rule G–37 prohibits a dealer from engaging in municipal securities business within two years of certain contributions made by MFPs, a dealer must perform a two-year ''look back'' of its MFPs'' contributions in order to make a determination on whether it is subject to any prohibitions on municipal securities business. Dealers have informed the MSRB that this look back has precluded them from hiring individuals who had made contributions, even though the contributions (which may have been relatively small) were made at a time when the individuals had no reason to be familiar with rule G–37. In addition, some dealers have noted how the look back has affected individuals with regard to in-firm transfers and promotions.

Once an individual is designated as an MFP by a dealer, he or she retains this designation for two years after the last activity or position which gave rise to the designation. This ''look forward'' provision has created compliance problems for some dealers in trying to track the contributions of individuals who have left their MFP positions and transferred to other areas in the firms.

The Proposed Rule Change produces the following results:

- *MFPs primarily engaged in municipal securities representative activities:* The two-year look back is retained, and the look forward is reduced to one year.
- *Solicitor MFPs:* The two-year look back is retained, but limited only to contributions to officials of the issuer solicited, and the look forward is reduced to one year.
- *Supervisor and management-level MFPs:* The look back is reduced to six months and the look forward is reduced to one year.

Thus, the two-year look back is retained for those MFPs who are primarily engaged in municipal securities representative activities and for those who solicit municipal securities business while the two year look forward is reduced to one year for these individuals. For supervisory and management-level MFPs, the look back is reduced to six months and the look forward is reduced to one year.[5] The MSRB believes that supervisors and management-level MFPs should remain subject to the rule while they hold their supervisory positions; however, the potential link between obtaining municipal securities business and contributions made by an individual prior to becoming an MFP solely by reason of taking on a new supervisory or management position is tenuous and therefore the shorter timeframes are appropriate. The MSRB notes that most supervisors in the municipal securities department will still be covered by the two-year look back because such individuals are ''primarily engaged'' in municipal securities representative activities.

In addition, many dealers over the years have raised concerns about bringing non-MFPs to meetings with issuers to solicit municipal securities business (*e.g.*, an individual with expertise in asset-backed securities may be asked to attend a meeting with an issuer that is considering a securitization of tobacco settlement revenue or delinquent tax receipts) because the prior contributions of these individuals could result in a ban on business, even if made to issuers other than those solicited. Dealers believe that such a result is unreasonable given that the contribution by the solicitor MFP to another issuer's official would have no impact on the underwriter selection process of the issuer that he or she is soliciting. Accordingly, the Proposed Rule Change limits the look back for solicitor MFPs (*i.e.*, persons not primarily engaged in municipal securities representative activities) only to contributions to officials of the issuer solicited. Once these solicitors become MFPs, all of their subsequent contributions to any issuer official still will be covered by the rule.

2. Statutory Basis

The MSRB believes the Proposed Rule Change is consistent with section 15B(b)(2)(C) of the Securities Exchange Act of 1934 (''Act''), which provides that the Board's rules shall:

> be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade * * * to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest.

The MSRB believes that the Proposed Rule Change is consistent with the Act in that it will facilitate dealer compliance with rule G–37, thereby further protecting investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The MSRB does not believe that the Proposed Rule Change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, since it would apply equally to all brokers, dealers and municipal securities dealers.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

On April 2, 2002, the MSRB proposed for comment draft amendments relating to the exemption provision and the definition of municipal finance professional as contained in Rule G–37 (the ''Notice''). The MSRB received nine comment letters from the following:

John M. Hartenstein (''Mr. Hartenstein''),
Investment Company Institute (''ICI'')
MassMutual Financial Group (''MassMutual'')
Morgan Stanley & Co. Incorporated (''Morgan Stanley'')
National Association of State Treasurers (''NAST'')
Seasongood & Mayer, LLC (''Seasongood'')
T. Rowe Price Group, Inc. (''T. Rowe Price'')
The Bond Market Association (''TBMA'')
Wilmer, Cutler & Pickering (''Wilmer'') (commenting on behalf of the

[5] The Proposed Rule Change also amends rule G–8(a)(xvi) to reduce the look back to six months for contributions made by non-MFP executive officers.

Democratic National Committee (''DNC'') and the Republican National Committee (''RNC'')).

Many commentators expressed their support for one or more of the proposals and provided suggestions for additional changes.

The Exemption Provision

Additional Relevant Factors To Be Added; Certain Qs & As To Be Withdrawn

The MSRB proposed the addition of the following relevant factors to be considered by the appropriate regulatory agency in determining whether to grant an exemption (conditional or unconditional) from the two-year ban on business:

- The nature of remedial or preventive measures directed specifically toward the contributor and all employees of the dealer.
- Whether, at the time of the contribution, the contributor was an MFP or otherwise an employee of the dealer, or was seeking such employment.
- The timing and amount of the contribution.
- The nature of the election (*e.g.*, federal, state or local).
- The contributor's apparent intent or motive in making the contribution, as evidenced by the facts and circumstances surrounding such contribution.

The MSRB also proposed withdrawing certain Qs and As previously published concerning when an exemption may or may not be appropriate, noting that this action is necessary to clarify that the regulatory agencies have discretion in administering the exemption process.

Morgan Stanley and T. Rowe Price expressed support for the additional relevant factors and the withdrawal of certain Qs and As. Morgan Stanley believes that the MSRB ''must go further to facilitate the NASD's equitable administration of the exemption process by adding an additional factor that expressly requires the NASD to consider the proportionality of the penalty to the violation.'' They argue that the MSRB ''must emphasize to the NASD that it has at its disposal and must utilize the option of granting conditional exemptions to fashion remedies that are more proportional to the egregiousness of the violation.''

Seasongood believes that the opportunity for exemptive relief should be available only to those dealers who discover problematic contributions prior to a third party discovering them. Seasongood argues that this approach ''will encourage firms to be forthright in dealing with violations and will more effectively punish firms who either are not vigilant in monitoring G–37 compliance or who willfully violate the rule.''

MSRB Response. The two-year ban arose from the MSRB's view of the necessity of avoiding even the appearance of a conflict of interest by an issuer in awarding negotiated municipal securities business to a dealer that made contributions (or an MFP who made non-*de minimis* contributions) to issuer officials. In reviewing exemptive requests, the appropriate regulatory agencies examine the facts and circumstances surrounding each such request and, in addition to the relevant factors set forth in the rule, may examine *any other* factor they wish, including the size of the contribution and the potential business lost. The draft amendments add to the list of factors the timing and amount of the contribution, as well as the contributor's apparent intent or motive in making the contribution. The MSRB does not believe it is appropriate to add to the list of relevant factors the amount of business lost because then it could be argued that a contribution of any size should not result in a ban on business in a large issuing state. The MSRB believes such a result would go against the purposes of rule G–37.

In addition, rule G–37(i) states that the regulatory agencies may exempt, ''conditionally or unconditionally,'' a dealer that is banned from engaging in municipal securities business with an issuer from such ban. The regulatory agencies may, if they deem it appropriate, reduce a ban on business to less than two years, and, in fact, have done so on certain occasions. Thus, the rule, as amended, already provides the regulatory agencies the ability to limit the extent of the ban on business in situations where, based on the specific facts and circumstances, a reduced penalty would be appropriate. Because the MSRB has no inspection or enforcement authority, it must defer to the regulatory agencies' judgment on these matters. Thus, the MSRB does not believe it is appropriate for it to *mandate* that the regulatory agencies grant conditional exemptions in appropriate cases, as suggested by Morgan Stanley.

The MSRB disagrees with Seasongood's suggestion that exemptions should only be available to those dealers who discover problematic contributions prior to someone else discovering them and reporting them to the authorities or the media. The MSRB believes that most dealers discover their own problematic contributions and then apply to the NASD for exemptive relief in appropriate cases. While self-discovery of problematic contributions is a factor, it should not be a conclusive one against the dealer. A failure to self-discover does not mean that a dealer has willfully violated the rule.

Adoption of an Automatic Exemption Provision

The Notice requested comments on incorporating an automatic exemption provision into Rule G–37. The draft amendments provided for an automatic exemption from a dealer's ban on business in certain limited instances. The provision sets out procedures that would permit dealers to execute two such exemptions per 12-month period for contributions made by an MFP of $250 or less if: (1) The dealer discovers the contribution within four months of the date of such contribution; (2) the contributor makes a written request for a return of the contribution within 30 calendar days of the dealer's discovery; and (3) the contributor obtains a refund within 30 calendar days of the written request. A dealer would not be permitted to execute more than one automatic exemption relating to contributions by the same MFP. The automatic exemption would not be available for contributions made by a dealer, a dealer-controlled PAC or an MFP-controlled PAC. Finally, dealers would be required to report the exemption on Form G–37/G–38 and to maintain records of such exemptions pursuant to rule G–8, on books and records. A dealer would be banned from municipal securities business until the contribution was returned.

TBMA supports the concept of an automatic exemption but believes ''that a somewhat broader exemptive provision is warranted.'' They recommend increasing the allowable dollar amount to $1,000, arguing that ''contributions that are promptly identified and refunded in full would not reasonably influence the underwriter selection process'' regardless of the amount. Morgan Stanley also recommends that the amount be increased to $1,000, arguing that ''the fact that a refund must be obtained in a prompt manner eliminates any perceived risk of pay-to-play.''

The draft amendments required a dealer to make a written request for a refund within 30 days of discovering the contribution, and obtain the refund within 30 days of such request. TBMA recommends adding a measure of flexibility to the automatic exemption provision by combining these two time periods so that dealers would be

required to obtain a refund within 60 days of discovering the contribution.

In its Notice, the MSRB noted that, in addition to the automatic exemption, dealers may continue to seek exemptions from the appropriate regulatory agency through the regular exemption process. TBMA argues that ''it is likely that waivers will continue to be granted infrequently, and the process will continue to be time-consuming. Further, the mere existence of an automatic exemption may lessen the likelihood of obtaining a discretionary waiver in circumstances in which contributions are quickly discovered and refunded but do not meet all the requirements of the automatic exemption.''

T. Rowe Price and Wilmer support the draft amendments in this area, but believe it is unfair to base the availability of the automatic exemption on a requirement that is outside the contributor's control, *i.e.,* obtaining a refund. T. Rowe Price recommends eliminating this requirement. ICI suggests that the requirement be changed to require that the contributor make a ''good faith effort'' within 30 calendar days of the dealer's discovery to obtain a return of the contribution, including making a written request for such return. T. Rowe Price also recommends that the Board eliminate the requirement that a dealer discover the contribution in a timely manner (*i.e.,* within four months).

Seasongood believes that an automatic exemption should be available only if the dealer itself discovers the rule violation (as opposed to another dealer discovering it and reporting it to the authorities or the media). They also argue that the automatic exemption should not be available if the contribution is returned after the election for which it was given, otherwise the candidate would derive the benefit of using the funds when they were needed most.

MSRB Response. The MSRB determined to adhere to the $250 contribution limit for automatic exemptions since the provision is intended to apply to routine cases involving small contributions. With regard to the requirements that contributors make a written refund request within 30 days of discovery of the contribution and obtain a refund within 30 days thereafter, the MSRB adopted TBMA's suggestion that these two time periods be combined. Thus, the Proposed Rule Change requires the contributor to obtain a return of the contribution within 60 calendar days of the date of discovery of such contribution by the dealer.

The MSRB did not adopt the recommendations of T. Rowe Price and Wilmer regarding the elimination of the requirement to actually obtain a refund or ICI's suggestion to make a ''good faith effort'' to obtain a refund. While it is true that the return of the contribution is not within the dealer's control, the automatic exemption provision should be limited to those circumstances where there is no appearance of a conflict of interest. In those circumstances where the contribution is not returned within the appropriate time frame, the MSRB believes that NASD or bank regulator review is needed through the regular exemption process. Therefore, a refund must be obtained in order to execute an automatic exemption.

Additionally, the MSRB believes that requiring dealers to discover offending contributions within four months of such contributions represents a reasonable time period that will encourage dealers to develop and institute good compliance procedures. The MSRB disagrees with T. Rowe Price's suggestion that this requirement be eliminated. The time periods proposed are fair and reasonable; so long as a dealer discovers, and obtains a refund of, the offending contribution within those time periods (and otherwise complies with the provision's requirements) the dealer should be permitted to avail itself of an automatic exemption.

Finally, the MSRB disagrees with Seasongood's suggestions that the automatic exemption should only be available to those dealers who discover the problematic contributions before someone else does and reports the information to the authorities or the media, and only if the contribution is returned before the election for which it was intended. As noted above, the MSRB believes that most dealers discover and report their own bans on business and then apply to NASD or bank regulator for exemptive relief. Moreover, the requirement that dealers discover the offending contributions within four months acts as a significant incentive for dealers to discover their own potential bans on business. The MSRB also did not adopt Seasongood's suggestion that dealers be required to obtain a refund prior to the election for which it was intended. Given the relatively small dollar amounts involved, the Board was not persuaded that this issue represented a significant problem or otherwise merited regulatory action.

Definition of Municipal Finance Professional

MFPs Primarily Engaged in Municipal Securities Representative Activities

The draft amendments provide for amending the definition of MFP to exempt retail sales representatives. While there may be limited instances in which retail sales persons make contributions to obtain municipal securities business for dealers, the MSRB proposed the draft amendments because of its belief that these instances do not outweigh the compliance burden of determining which of these persons are included in the rule. In addition, any retail sales person who solicits municipal securities business would be covered under the rule as an MFP.

T. Rowe Price states that it strongly supports the proposal. It notes that it is in agreement ''with the Board's belief that if the retail salesperson is not soliciting municipal securities business, the connection between the retail salesperson's contributions and any awarding of municipal securities business is very tenuous.'' T. Rowe Price notes that, for its firm, ''where the registered representatives who deal with investors and potential investors in Section 529 Plan securities do not receive commission-based compensation and do not have their own client base * * * there is no connection between any contributions they may make and the awarding of a long-term contract by a state for the program management of its Section 529 Plan.'' It states that the ''proposal brings much needed clarity to the area without diluting the effectiveness of Rule G–37.''

Seasongood is opposed to the proposal. It states that firms are ''seeking municipal underwriting business by touting the size and effectiveness of their retail sales force. As evidenced by the significant increase in issuers having a separate 'retail order period' prior to the regular order period, firms utilize their sales forces to generate underwriting fees from tax-exempt financings. Specifically, the takedown component, which is usually the largest part of an underwriter's fee, is being earned by the firm and the salesperson.'' Seasongood believes that the proposal will make it more difficult for a firm's competitor to uncover violations in helping to enforce compliance with the rule.

MSRB Response. The MSRB determined to exempt retail sales representatives from the definition of MFP. If a retail sales person is not soliciting municipal securities business, the appearance of a conflict of interest is negligible because there is little

reason to believe that the contribution was intended to be, or taken to be, an attempt to gain influence in the awarding of municipal securities business. A retail sales person who solicits municipal securities business will still be covered under the rule as an MFP. The Commission staff asked that the MSRB make a technical language revision to the definition of MFP concerning retail sales persons to clarify that the exemption from the definition applies to sales activities with individual (not institutional) investors. The MSRB has done so.

Look Back and Look Forward Provisions

In the Notice, the MSRB requested comments on draft amendments concerning the look back and look forward provisions that would produce the following results:

- *MFPs primarily engaged in municipal securities representative activities:* Retain the two-year look back. Reduce the look forward to one year.
- *Solicitor MFPs:* Retain the two-year look back, but limit it only to contributions to officials of the issuer solicited. Reduce the look forward to one year.
- *Supervisor and management-level MFPs:* Eliminate the look back and look forward.

T. Rowe Price supports the proposals concerning both the look back and look forward provisions.

TBMA supports only the proposals for eliminating the look back and look forward provisions for supervisor and management-level MFPs. TBMA questions ''whether the look back and overhang requirements, as applied to other persons, are justified.'' With respect to the look forward provision, TBMA states that ''the MSRB has not identified *any* circumstances in which it is likely that a contribution by a former MFP for up to one year *after* losing that status is being made for the purpose of attracting municipal business.'' If the MSRB continues to apply look forward and look back provisions for MFPs primarily engaged in municipal securities representative activities and solicitor MFPs, TBMA states that a six-month period ''is more than sufficient to remedy possible abuses.'' TBMA notes that ''a six-month period is more consistent with the requirements of Rule G–38,'' on consultants, and that dealers ''have designed their compliance systems to track such contributions over these time periods.''

Seasongood states that the look forward provision should remain at two years and it should continue to apply to supervisor and management-level MFPs. With respect to the proposal to limit the two-year look back for solicitor MFPs to contributions to officials of the issuer solicited, Seasongood notes that it ''could not disagree more strongly.'' Seasongood states that the proposal ''would eviscerate the definition of solicitation by allowing anyone to participate in a presentation calculated to appeal to issuer officials for municipal securities business without repercussions. This definition has been the lynchpin in preventing the ''pay to play'' games G–37 was designed to stop. If a firm soliciting municipal business can bring individuals to the presentation who are allowed to contribute to campaigns without being banned from their business, the MSRB will be opening a huge hole in the overall effectiveness of G–37 and the ability of competitors to discern when a violation has occurred.''

MSRB Response. The MSRB determined to adopt the draft amendments to revise the look back and look forward provisions for MFPs primarily engaged in municipal securities representative activities and for solicitor MFPs. The MSRB believes it is important to retain the longer time frames for those MFPs more directly involved in obtaining municipal securities business. Once an associated person of a dealer solicits municipal securities business, the new look back requirement would be limited to officials of the issuer solicited. All contributions by this solicitor MFP to any issuer official would be covered going forward.

The SEC staff asked that the MSRB revise the proposal for supervisor and management-level MFPs as contained in the draft amendments. The SEC staff asked that the look back be revised to six months (instead of eliminated) and the look forward be reduced to one year (instead of eliminated). The MSRB has revised the requirements per the SEC staff's suggestions.

De Minimis Contributions

Maintain the ''Entitled to Vote'' Requirement

Contributions made by an MFP to officials of an issuer for whom the MFP is entitled to vote will not cause the MFP's dealer to be prohibited from engaging in municipal securities business with the issuer if the contributions, in total, are not in excess of $250 by such MFP to each official of such issuer, per election. Wilmer believes that the *de minimis* exception should be available to any MFP, not just those entitled to vote for the particular candidate, arguing that ''[t]here are compelling reasons that a contributor who lives in one jurisdiction might want to support a candidate in a different jurisdiction. When a voter lives in a different jurisdiction from where the voter works, the voter might feel effected as much or more by the election of county or city officials in the work jurisdiction than at home.'' Similarly, NAST believes that the Board should eliminate the ''entitled to vote'' requirement, noting that ''the determination of whether a contribution is so small as to be *de minimis* should not depend on where the contributor lives.''

MSRB Response. The MSRB determined to maintain this requirement. Eliminating the requirement would allow national firms with numerous MFPs to make many contributions to an issuer official. This would create at least the appearance of a conflict of interest since the MFPs would have no direct interest in the issuer's jurisdiction.

Maintain the $250 *De Minimis* Amount

NAST ''strongly believes'' that the *de minimis* amount should be raised to $1,000 to correspond to current federal limits, arguing that:

First, Congress determined that $1,000 per election is a sufficiently low amount that it does not raise conflict of interest or favoritism concerns. Inflation and the increasing amount of contributions required to compete in local, state, and national elections in many jurisdictions have diminished even further the potential impact of an individual appropriate to prevent corruption or the perception of corruption in connection with contributions in the amount of $1,000 or less.* * * Second, increasing the *de minimis* contribution exemption to correspond with the federal contribution limit would significantly reduce the likelihood that a contributor might inadvertently trigger a two-year ban on business under rule G–37.* * * Finally, raising the *de minimis* exemption to the current FECA level would eliminate the disproportionate impact of rule G–37 on contributions to issuer officials who are candidates for federal office.

MSRB Response. First, the MSRB determined that $250 continues to be an appropriate limit. Second, the inclusion of ''the nature of the election'' in the list of relevant factors should assist NASD and bank regulators in deciding whether to grant an exemptive request (conditionally or unconditionally) in view of the contribution amount and the federal contribution limits. Finally, the SEC's 1994 rule G–37 Approval Order rejected the argument of a

disproportionate impact on issuer officials who are candidates for federal office.

Other Issues

Eliminate the Two-Year Ban on Business

Morgan Stanley is concerned that NASD, in administering exemptive requests, does not take into account ''the proportionality of the penalty to the perceived violation. * * *'' They note that ''the two-year ban applies regardless of the nature of, or intent in making, the contribution. Thus, a $1 million contribution triggers the same ban as a $5 contribution * * * [and the] so-called 'death penalty' applies equally to minor infractions and blatant attempts to engage in 'pay-to-play'.'' Morgan Stanley also states that the protracted nature of the current exemption process ''is particularly problematic when a broker-dealer has committed significant resources in connection with a municipal securities deal and is suddenly subject to a ban because it discovers an inadvertent contribution by an MFP with no relationship to that particular deal.'' While they agree with the Board's proposal to amend the exemption process, Morgan Stanley believes that ''simply changing the exemption standards does not go far enough to remedy the problem.* * * It is imperative that the Rule incorporate a mechanism designed to avoid disproportionate and clearly inequitable results.'' Therefore, Morgan Stanley urges the Board to consider eliminating the two-year ban on business and replacing it ''with a fair and equitable enforcement process in which the NASD has the mandate to consider issues of proportionality and impose sanctions that are consistent with the facts and circumstances of each case.'' They state that, under this approach, offending contributions would not automatically trigger the two-year ban but instead would require the NASD ''to craft a penalty that is proportional to the egregiousness of the violation.''

MSRB Response. The MSRB determined not to eliminate the two-year ban on business that results when a dealer or MFP (or their controlled PACs) makes a contribution to an issuer official. In formulating rule G–37, the MSRB initially proposed a rule that would focus on the intent of the giver and be enforced like other MSRB rules through the normal inspection and review process of the enforcement agencies. Many commentators noted that such a rule would not halt pay-to-play practices because determining the intent of the giver would be impossible. Thus, the MSRB determined to make the ban on business an automatic result of certain contributions to issuer officials. In this way, the MSRB believed that pay-to-play practices would be halted, but MFPs still could contribute to those they were entitled to vote for, and could continue to volunteer their services to those elections. The ban is a way to ensure fair competition by avoiding conflicts of interest or the appearance of such a conflict.

Morgan Stanley complains that the two-year ban should be eliminated because it does not take into account the proportionality of the contribution to the business lost. Morgan Stanley also gives examples of MFPs making small contributions that resulted in bans on business but were not granted exemptions by NASD. As noted in rule G–37(i), the regulatory agencies have the ability to review a number of factors in making its decision on exemption requests and has the ability to make conditional or unconditional exemptions. Certain of the conditions noted include what procedures the firm had in place at the time of the contribution and the actions of the MFP. After reviewing these and other facts, in a number of cases exemptions were not given. In other cases, the ban was lifted, either in whole or in part. A review of the totality of the factors apparently led NASD to these results. If one of the factors had been the proportionality of the contribution to the business lost, one could argue that a contribution of any size should not result in a ban on business in a large issuing state. The MSRB believes that the addition of such a factor would push the process to be too lenient in contravention of the purposes of rule G–37.

Contributions by Bank PACs and Bank Holding Company PACs

The MSRB's Web site contains links to information provided to the Federal Election Commission (''FEC''), the Internal Revenue Service (''IRS'') and state election offices.

Wilmer supports the Board's decision to continue excluding from rule G–37 contributions by bank PACs and BHC PACs. On the other hand, Morgan Stanley states that ''bank affiliated dealers have the ability to circumvent the spirit of the Rule through contributions made by their bank affiliate or its PAC * * *. [T]his unintended loophole undermines the effectiveness of the Rule and places traditional broker-dealer firms at a competitive disadvantage.'' Morgan Stanley therefore recommends that the Board require disclosure on Form G–37 of contributions to issuer officials by dealer affiliated banks, bank PACs and BHC PACs. They believe that this ''would bring much needed transparency to this area * * * [which] would serve to discourage attempts to circumvent the spirit of the Rule through the use of bank affiliates.

Seasongood believes that sufficient disclosure of bank PAC contributions does not currently exist under federal law. They state that certain Web sites (*e.g., http://www.fec.gov/finance__reports*) ''are not user-friendly * * * which prevents someone from gleaning the information necessary to determine what PAC gave money to who.'' Moreover, the ''information available is old and difficult to analyze.'' Seasongood believes that the MSRB should be the single repository for information relating to political contributions and municipal securities business.

MSRB Response. The MSRB determined not to require disclosure on Form G–37/G–38 of contributions to issuer officials from dealer-affiliated banks, bank PACs and BHC PACs. As noted above, the MSRB has published links on its website to information provided by the FEC, IRS and state election offices. Banks and their PACs contribute to state and local officials for many reasons that have nothing to do with acquiring municipal securities business. Requiring affiliated dealers to report these contributions to the MSRB would raise a potentially unfair implication that the contribution was intended to influence the official to exercise his or her discretion in favor of granting an affiliate municipal securities business, when in fact the contribution may have been made to further the bank's legitimate political activity and there may be no connection between the contribution and the affiliated dealer's business.

Moreover, to the extent that dealer-affiliated bank PACs are controlled by the dealer, or by an MFP of the dealer (even if the MFP is an employee of the bank), rule G–37 already obligates the dealer to report contributions made by the bank PAC. In a recent administrative proceeding, the SEC, in only its second rule G–37 enforcement action, held that contributions by a bank PAC, controlled by bank-employed MFPs, resulted in bans on business by the affiliated dealer.[6] When the dealer engaged in banned business, it violated rule G–37.

Finally, there already is substantial public reporting of PAC contributions. The FEC requires all corporate affiliated

[6] *See In the Matter of Fifth Third Securities, Inc.,* Exchange Act Release No. 46087, June 18, 2002.

PACs that are not established exclusively for state and local (*i.e.*, nonfederal) activity to register and report receipts and expenditures to the FEC. These reports are available for free and online from the FEC's Web site. The FEC's Web site provides the ability to view actual financial reports filed by PACs from 1993 to the present. These reports usually reflect contributions to federal campaigns. In addition, some reports reflect state and local campaign activity. The FEC website also provides researchers with the ability to electronically search the records for contributions to PACs by individuals, contributions made or received by a specific committee using various criteria, and contributions received by a specific campaign using a candidate's name, state, or party affiliation. While the information on the FEC website may be of limited use to persons searching for state and local contributions, the FEC website also links to state records offices that receive campaign finance reports and make them publicly available. These state records offices provide a wealth of information about contributions to state and local officials by corporations and their affiliated PACs. In addition, section 527 of the Internal Revenue Code, which provides tax-exempt status for political organizations, including PACs and federal, state and local committees, requires that political organizations that receive $25,000 or more in gross receipts and wish to be tax exempt under section 527 to file certain informational forms. Currently, it is possible to find additional information about bank PACs on the IRS Web site.

Constitutional Issues

NAST reiterates constitutional issues that the organization raised in 1993 when rule G–37 was first proposed. Specifically, NAST questions whether the rule violates the First Amendment because it is underinclusive or overinclusive, and ''whether the rule is justified by a compelling governmental interest and whether it is narrowly tailored to achieve the goal.'' [7] NAST also raises again issues of federalism stating that, ''[w]hile the scope and subject matter of the rule is the regulation of municipal securities dealers (and related professionals), it is also clear that the rule has a direct impact on state and local political speech and the conducting of state and local elections.'' NAST goes on to say that ''extending the proposed rule to federal officials would remove the present inequity of having a federal rule which limits the fundraising ability of state and local officials running for national office, while leaving incumbent federal officials free to take political contributions and gifts from the securities industry.''

MSRB Response. All of the constitutional issues raised by the NAST comment letter were addressed and rejected in both the SEC's 1994 rule G–37 Approval Order and the United States District Court of Appeals for the District of Columbia Circuit decision in *Blount v. Securities and Exchange Commission*.[8] In *Blount,* a unanimous panel of the District of Columbia Circuit found that rule G–37 was constitutional under a strict scrutiny analysis by finding that the rule was narrowly tailored to serve a compelling governmental interest.[9] The court found the purposes of the rule of protecting investors from fraud and protecting underwriters from unfair, corrupt practices to be substantial and compelling. The court also held that rule G–37 self-evidently advanced that interest, noting that,

> Underwriter's campaign contributions *self-evidently* create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the government entity. (Emphasis added)

The court further concluded that ''the link between eliminating pay-to play practices'' and the goals of ''perfecting the mechanism of a free and open market'' were also ''self-evident.''

Finally, the court held that the rule was ''narrowly tailored'' to serve these compelling governmental interests.[10] Accordingly, the court concluded that the rule met the strict scrutiny test, noting that the rule is closely drawn and thus avoids unnecessary abridgement of First Amendment rights.[11]

NAST's federalism concerns were also addressed and rejected in the SEC's 1994 rule G–37 Approval Order. Specifically, the Commission stated that ''the proposed rule change is a necessary and appropriate measure to prevent fraudulent and manipulative acts and practices and the appearance of fraud and manipulation in the municipal securities market by eliminating 'pay-to-play'' arranged underwritings.' The Commission also noted that:

> The Commission believes that it is not necessary to extend the proposal to include contributions to candidates for federal office. The proposal addresses abusive political contributions to officials of issuers who may influence the selection of municipal securities underwriters. Because federal office holders do not influence the underwriter selection process, the Commission believes it would not be appropriate to include federal candidates under the rule's requirements. By the same token, the Commission also believes that any resulting hardship to candidates for federal office who are currently local officials is not a reason for eliminating these requirements.[12]

Ballot Referenda

One commentator, Mr. Hartenstein, raised the issue of contributions to ballot measure campaigns. He states that contributions to ballot measure campaigns are an inappropriate influence ''in the selection of investment banks and other municipal market participants for the consulting work that is generated by successful local bond measures.'' He notes that, ''[t]his influence is not unlike the pernicious effects that the rule is intended to curb.'' Mr. Hartenstein states that, ''in the ballot measure context, investment banking firms may freely make money contributions in order to directly influence the appointed and elected public officials who decide which firms to hire for the public agency's bond business, without

[7] NAST continues, ''[a]s an example of a potential First Amendment problem, NAST submits that the rule remains vulnerable to attack as being underinclusive in that it does not reach all the municipal securities professionals who participate in municipal securities transactions and who have a comparable incentive and opportunity to engage in unethical and anti-competitive behavior.''

[8] In 1994, William Blount, the then Chairman of the Alabama Democratic Party and a municipal securities dealer, brought an action against the SEC alleging that rule G–37 was unconstitutional. *Blount v. SEC,* 61 F. 3d 938 (D.C. Cir, 1995), *cert. denied,* 116 S. Ct. 1351 (1996).

[9] In 1996, the Supreme Court denied Blount's petition for a writ of *certiorari* to review the Court of Appeal's decision.

[10] The court observed that the dealer is barred from engaging in business with the particular issuer for only two years after making the contribution, and from soliciting contributions only during the time it is engaged in or seeking business with the issuer associated with the donee. It noted further that municipal finance professionals are still able to contribute up to $250 per election to each official for whom they are entitled to vote, without triggering the business bar. Finally it observed that, as interpreted by the SEC, ''the municipal finance professionals are not in any way restricted from engaging in the vast majority of political activities, including making direct expenditures for the expression of their views, giving speeches, soliciting votes, writing books, or appearing at fundraising events.''

[11] The court also specifically rejected *Blount's* claims that rule G–37 is fatally underinclusive, noting that ''a rule is struck for underinclusiveness only if it cannot 'fairly be said to advance any genuinely substantial governmental interest.' ''

[12] The United States District Court of Appeals for the District of Columbia Circuit in *Blount* also summarily rejected as meritless petitioner's claim that rule G–37 had an effect on states' own election processes and, as such, usurps the states' power to control their own elections.

any fear of sanctions under the rule. This clear flouting of the spirit of the rule should be stopped, and it can be stopped if the rule is amended to extend to ballot and bond measure elections.''

Mr. Hartenstein states that contributions to bond measure campaigns ''can result in higher bond interest and bond issuance costs, and higher taxes, than if municipal finance professionals were selected without regard to the amount they will contribute to campaigns.'' He notes that it is ''in the public interest to limit or prohibit contributions to local school bond election campaigns by interested private companies and individuals. This is an important corollary to the fundamental problem that rule G–37 is designed to address.''

MSRB Response. The MSRB is reviewing this issue to determine whether any further action in this area is advisable.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such Proposed Rule Change, or

(B) Institute proceedings to determine whether the Proposed Rule Change should be disapproved.

IV. Solicitation of Comments

Interested people are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule is consistent with the Exchange Act. People making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0608. Copies of the submissions, all subsequent amendments, all written statements with respect to the Proposed Rule Change that are filed with the Commission, and all written communications relating to the Proposed Rule Change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the Board's principal offices. All submissions should refer to File No. SR–MSRB–2002–12 and should be submitted by April 29, 2003.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03–8447 Filed 4–7–03; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47608; File No. SR–NASD–2003–43]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc., To Modify Computer-to-Computer Interface Fees for NASD Members

April 1, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and rule 19b–4 thereunder,[2] notice is hereby given that on March 20, 2003 the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in items I, II, and III below, which Items have been prepared by Nasdaq. Nasdaq has designated this proposal as one establishing or changing a due, fee or other charge imposed by the self-regulatory organization under section 19(b)(3)(A)(ii) of the Act[3] and rule 19b–4(f)(2) thereunder,[4] which renders the rule immediately effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to amend NASD rule 7010 to modify the fees paid by NASD members for bandwidth enhancements of Computer-to-Computer Interface (''CTCI'') lines.[5] Nasdaq will implement this rule change on April 1, 2003.

The text of the proposed rule change is below. New text is in *italics.* Deleted text is in [brackets].

* * * * *

7000. Charges for Services and Equipment

A. Rule 7010. System Services

(a)–(e) No change.

(f) Nasdaq Workstation™ Service

(1) No change.

[(3)] *(2)* The following charges shall apply for each CTCI subscriber[*]:

Options	Price
Option 1: Dual 56kb lines (one for redundancy) and single hub and router.	$1275/month.
Option 2: Dual 56kb lines (one for redundancy), dual hubs (one for redundancy), and dual routers (one for redundancy).	$1600/month.
Option 3: Dual T1 lines (one for redundancy), dual hubs (one for redundancy), and dual routers (one for redundancy). Includes base bandwidth of 128kb.	$8000/month.
Option 1, 2, or 3 with Message Queue software enhancement	Fee for Option 1, 2, or 3 (including any Bandwidth Enhancement Fee) plus 20%.
Disaster Recovery Option:	
Single 56kb line with single hub and router. (For remote disaster recovery sites only.)	$975/month.
Bandwidth Enhancement Fee (for T1 subscribers only)	$[4000]*600*/month per 64kb increase above 128kb T1 base[.].

[13] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 78s(b)(3)(A)(ii).

[4] 17 CFR 240.19b–4(f)(2).

[5] Nasdaq also submitted a proposed rule change to make an identical modification to the bandwidth enhancement fee paid by non-members. *See* Securities Exchange Act Release No. 47607 (April 1, 2003) (order granting Accelerated Approval to SR–NASD–2003–46).