

40A:2-38

LEGISLATIVE HISTORY CHECKLIST

(Bond sales--local--permit financial advisors to participate in competitive bidding)

NJSA 40A:2-38

LAWS 1981

CHAPTER 268

Bill No. S3025

Sponsor(s) Bedell and Foran

Date Introduced Jan. 22, 1981

Committee: Assembly Municipal Government

Senate County and Municipal Government

Amended during passage ~~Yes~~ No

Date of Passage: Assembly June 22, 1981

Senate May 14, 1981

Date of approval Aug. 24, 1981

Following statements are attached if available:

Sponsor statement Yes No

Committee Statement: Assembly Yes No

Senate Yes No

Fiscal Note ~~Yes~~ No

Veto Message ~~Yes~~ No

Message on signing ~~Yes~~ ~~No~~

Following were printed:

Reports ~~Yes~~ No

Hearings ~~Yes~~ No

Attached:

Rule G23 of the Federal/Municipal Securities Rulemaking Board.

SENATE, No. 3025

STATE OF NEW JERSEY

INTRODUCED JANUARY 22, 1981

By Senators BEDELL and FORAN

Referred to Committee on County and Municipal Government

AN ACT concerning the "Local Bond Law" and amending N. J. S.
40A:2-38.

1 BE IT ENACTED *by the Senate and General Assembly of the State*
2 *of New Jersey:*

1 1. N. J. S. 40A:2-38 is amended to read as follows:

2 40A:2-38. In the issuance or sale of obligations, it shall be
3 unlawful for the governing body or any member thereof or any
4 official:

5 a. To pay or agree to pay, directly or indirectly, any bonus,
6 commission, fee or other compensation or consideration for the
7 issuance or for the sale of obligations, and any amount so paid
8 may be recovered for the local unit;

9 b. To make any agreement with any purchaser or bidder, or his
10 representative, regarding the deposit or disposition or any moneys
11 received or to be received from such sale and every such agreement
12 shall be void;

13 c. To make any agreement pertaining to the sale of obligations
14 which contains provisions as to any other matter, and such sale
15 and any such agreement shall be void;

16 d. To make any agreement or "service contract" with respect to
17 publication of notice of sale and printing of bonds or notes, the
18 providing of a legal opinion or for any of such services, whether
19 or not accompanied by an offer to bid for or purchase obligations.
20 Any such agreement or contract shall be void, and any amount so
21 paid may be recovered for the local unit except, however, agree-
22 ments made directly with a newspaper, bond printer or an attorney
23 licensed to practice law in the State in which he has his office.

24 A municipal bond dealer, banker, or financial expert may be
25 engaged or employed as a financial advisor to provide financial
26 services in connection with the sale of obligations, including the
27 preparation of a bidding circular or prospectus~~], but no such~~].

**EXPLANATION—Matter enclosed in bold-faced brackets [thus] in the above bill
is not enacted and is intended to be omitted in the law.**

28 *The financial advisor may bid for obligations offered by the issuer*
29 *at public sale. The financial advisor shall not purchase any such*
30 *obligations at any [public or] private sale, but any such purchase*
31 *shall not affect the validity of the obligations and the local unit*
32 *shall recover any compensation and profit resulting therefrom to*
33 *such financial advisor.*

1 2. This act shall take effect immediately.

STATEMENT

N. J. S. 40A:2-38 now provides that financial advisors retained by municipalities and counties may not submit bids at public competitive bond sales for bonds issued by the municipality or county. This provision restricts the ability of municipalities and counties to select qualified financial advisors, since often those most qualified to provide these services are also customary bidders for the bonds of the municipality or county. There is no advantage to the present provision, since when bonds or notes are sold at competitive sale, sealed proposals from all bidders are opened at the same time and publicly read.

Rule G23 of the Federal/Municipal Securities Rulemaking Board permits financial advisors to bid at competitive sales with the consent of the issuer. This amendment would permit this practice to be followed in New Jersey and should result in the best possible bids being received by municipalities and counties when selling their bonds or notes.

No such financial advisor would be permitted to purchase bonds or notes in a private sale.

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S3025 (1981)

ASSEMBLY MUNICIPAL GOVERNMENT COMMITTEE

STATEMENT TO

SENATE, No. 3025

STATE OF NEW JERSEY

DATED: JUNE 15, 1981

The purpose of this bill is adequately explained in the Senate County and Municipal Government Committee's statement which is appended hereto:

Senate Bill No. 3025 would permit financial advisors (bond dealer, banker or financial expert) retained by a local government to assist on a bond sale, including preparing the bidding circular or prospectus to bid to purchase bonds or notes in a public sale. The financial advisor would not be permitted to purchase at private sale.

Currently, N. J. S. 40A:2-38 of the "Local Bond Law" prohibits these financial advisors from purchasing bonds or notes at public or private sale. According to the sponsor, this "restricts the ability of municipalities and counties to select qualified financial advisors, since often those most qualified to provide these services are also customary bidders for the bonds of the municipality or county. There is no advantage to the present provision, since when bonds or notes are sold at competitive sale, sealed proposals from all bidders are opened at the same time and publicly read."

The sponsor points out that Rule G-23 of the Federal/Municipal Securities Rulemaking Board permits financial advisors to bid at competitive sales with the consent of the issuer. The bill would bring New Jersey local governments under that rule, rather than the more restrictive provisions of current State law.

The original purpose of the existing restriction on financial advisors was to "prevent the possibility of a charge that a bidder has inside information on a particular obligation to be offered for sale."

The League of Municipalities approves the bill because it would "permit financial advisors, on behalf of municipalities, to bid at competitive sales for higher rates on municipal bonds and notes."

SENATE COUNTY AND MUNICIPAL
GOVERNMENT COMMITTEE

STATEMENT TO

SENATE, No. 3025

STATE OF NEW JERSEY

DATED: APRIL 23, 1981

Senate Bill No. 3025 would permit financial advisors (bond dealer, banker or financial expert) retained by a local government to assist on a bond sale, including preparing the bidding circular or prospectus, to bid to purchase bonds or notes in a public sale. The financial advisor would not be permitted to purchase at private sale.

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FROM THE OFFICE OF THE GOVERNOR

FOR IMMEDIATE RELEASE

FOR FURTHER INFORMATION

AUGUST 24, 1981

KATHRYN FORSYTH/DAVID DEMAIO

Governor Brendan Byrne today signed the following bills into law:

S-3025, sponsored by Senator Eugene Bedell (D-Monmouth), amends the Local Bond Law to permit a municipality's financial advisor to bid for its bonds at a public sale.

Under prior law, a town's financial advisor could not bid on bonds being offered by that municipality either at a public or private sale. This bill retains that prohibition for private sales, but permits the advisor to bid for the bonds at public sales.

S-3085, sponsored by Senator Frank Graves, Jr. (D-Passaic), permits the courts to postpone, suspend or revoke the driving privileges of a person who uses a motor vehicle in the course of committing a crime, a disorderly persons offense or a delinquent act.

This type of punishment would replace or be in addition to the dispositions currently available to the courts. Any suspension may not exceed two years.

S-3264, sponsored by Senator Steven Perskie (D-Atlantic), permits all honorably discharged veterans to receive special vendors' licenses.

Prior law restricted issuance to veterans who served in time of war or during war-like conditions. The county clerks issue the licenses.

S-1272, sponsored by Senator John Skevin (D-Bergen), permits a policeman to hold a titular office or leadership position in a fraternal, veterans or religious organization which has a club liquor license.

Under prior law, a policeman could not hold such a liquor license and therefore could not be head of a licensed club.

ACS for 1243, sponsored by Senator Matthew Feldman (D-Bergen), clarifies the responsibility for the conduct of municipal police forces by providing for a line of authority with respect to the police function in municipalities and by providing for the duties and responsibilities of police chiefs in those instances where that position is established by ordinance by the municipal governing body. ~~_____~~

¶ 3606

Control Relationships

Rule G-22. (a) *Control Relationship.* For purposes of this rule, a control relationship with respect to a municipal security shall be deemed to exist if a broker, dealer, or municipal securities dealer (or a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) controls, is controlled by, or is under common control with the issuer of the security or a person other than the issuer who is obligated, directly or indirectly, with respect to debt service on the security.

(b) *Discretionary Accounts.* No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for the discretionary account of a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to such security unless such transaction has been specifically authorized by such customer.

(c) *Disclosure.* No broker, dealer, or municipal securities dealer shall effect a transaction in a municipal security with or for a customer if such broker, dealer, or municipal securities dealer has a control relationship with respect to the security unless, before entering into a contract with or for the customer for the purchase, sale, or exchange of such security, the broker, dealer, or municipal securities dealer discloses to the customer the nature of the control relationship, and if such disclosure is not made in writing, such disclosure must be supplemented by the sending of written disclosure concerning the control relationship at or before the completion of the transaction.

¶ 3611

Activities of Financial Advisors

Rule G-23. (a) *Purpose.* The purpose and intent of this rule is to establish ethical standards and disclosure requirements for brokers, dealers, and municipal securities dealers who act as financial advisors to issuers of municipal securities.

(b) *Financial Advisory Relationship.* For purposes of this rule, a financial advisory relationship shall be deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such issue or issues, for a fee or other compensation or in expectation of such compensation for the rendering of such services. Notwithstanding the foregoing, a financial advisory relationship shall not be deemed to exist when, in the course of acting as an underwriter, a municipal securities dealer renders advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.

(c) *Basis of Compensation.* Each financial advisory relationship shall be evidenced by a writing entered into prior to, upon or promptly after the inception of the financial advisory relationship (or promptly after the creation or selection of the issuer if the issuer does not exist or has not been determined at the time the relationship commences). Such writing shall set forth the basis of compensation for the financial advisory services to be rendered, including provisions relating to the deposit of funds or the utilization of fiduciary or agency services offered by such broker, dealer, or municipal securities dealer or by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer

in connection with the rendering of such financial advisory services. The requirement for a writing shall become effective on June 4, 1980.

(d) *Underwriting Activities.* No broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or arrange for such acquisition or participation by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer, unless

(i) if such issue is to be sold by the issuer on a negotiated basis,

(A) the financial advisory relationship with respect to such issue has been terminated in writing and at or after such termination the issuer has expressly consented in writing to such acquisition or participation in the purchase of the securities on a negotiated basis;

(B) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination that there may be a conflict of interest in changing from the capacity of financial advisor to purchaser of the securities with respect to which the financial advisory relationship exists and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; and

(C) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the broker, dealer, or municipal securities dealer with respect to such issue in addition to the compensation referred to in section (c) of this rule, and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; or

(ii) if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

The limitations and requirements set forth in this section (d) shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a financial advisory relationship. The use of the term "indirectly" in this section (d) shall not preclude a broker, dealer, or municipal securities dealer who has a financial advisory relationship with respect to a new issue of municipal securities from purchasing such securities from an underwriter, either for its own trading account or for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule. Each broker, dealer, and municipal securities dealer subject to the provisions of this section (d) shall maintain a copy of the written disclosures, acknowledgements and consents required by this section in a separate file and in accordance with the provisions of rule G-9.

(e) *Disclosure to Customers.* If a broker, dealer, or municipal securities dealer acquires new issue municipal securities or participates in a syndicate or other account that acquires new issue municipal securities in accordance with section (d) of this rule, such broker, dealer, or municipal securities

dealer shall disclose the existence of the financial advisory relationship in writing to each customer who purchases such securities from such broker, dealer, or municipal securities dealer, at or before the completion of the transaction with the customer.

(i) *Applicability of State or Local Law.* Nothing contained in this rule shall be deemed to supersede any more restrictive provision of state or local law applicable to the activities of financial advisors.

(g) *Effective Date of Rule.* Except as otherwise provided in this rule, the provisions of this rule shall take effect on April 5, 1980.

.10 **Financial advisory relationship.**—I refer to your letter of December 4, 1980 and a subsequent conversation regarding the application of rule G-23(d) to the participation by your client, a municipal securities dealer, in the underwriting of securities to be issued by the County referred to in your letter (the "County").

Rule G-23(d) provides in pertinent part that no municipal securities dealer "that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal . . . from the issuer all or any portion of such issue . . ." unless the dealer complies with certain specified provisions of the rule. You indicate that your client has a financial advisory agreement with the County which provides that your client will furnish financial advisory services from time to time at the County's request. You state, however, that your client was not requested to furnish financial advisory services with respect to the particular issue of securities which the County now proposes to sell and was selected by the County after responding to an advertisement for underwriters. You request our concurrence in your opinion that a financial advisory relationship with respect to the proposed new issue does not exist.

For purposes of the rule, a financial advisory relationship is deemed to exist when a "municipal securities dealer renders or enters into an agreement to render financial advisory or consultant services to or on behalf of an issuer with respect to a new issue or issues of municipal securities . . ." (emphasis added). Therefore, where a dealer has entered into a blanket agreement to render financial advisory services, a financial advisory relationship with respect to a particular issue of securities may be presumed to exist despite the fact that the municipal securities dealer does not furnish any financial advice concerning such issue. Whether or not your client has a financial advisory relationship with respect

to the proposed new issue referred to in your letter is a factual question which we are not in a position to resolve. Therefore, we are unable to concur in your opinion.—*MSRB interpretation of January 5, 1981 by Richard B. Nesson, General Counsel.*

.11 **Financial advisory relationship.**—This is in response to your letter of February 27, 1981, asking whether a dealer bank which is retained by the Board of Water Governors of a water utility owned by City X to provide advice regarding the structure, timing, and terms of a new issue of mortgage revenue bonds to be issued by City X has entered into a financial advisory agreement for purposes of rule G-23. You note that the bonds would be sold at a competitive underwriting and payable from the revenues of the water utility.

Under rule G-23, a financial advisory relationship is deemed to exist when a broker, dealer, or municipal securities dealer renders or enters into an agreement to render financial advisory services *to or on behalf of an issuer* with respect to a new issue or issues of municipal securities. Based solely upon the facts contained in your letter, it appears that the Board of Water Commissioners is a political subdivision of City X. It further appears that the Board of Water Governors entered into the financial advisory agreement for the specific purpose of obtaining advice regarding the new issue of bonds on behalf of the City. Thus, the fact that City X, rather than the Board of Water Governors, actually will issue the bonds would not itself support a conclusion that the financial advisory agreement is not subject to the provisions of rule G-23.—*MSRB interpretation of March 13, 1981 by Angela Desmond, Deputy General Counsel.*

.20 **Unrestricted consent.**—This is in response to your April 7, 1981, letter asking whether, consistent with rule G-23(d)(ii), a municipal securities dealer acting as a

financial advisor to an issuer may obtain from the issuer prospective approval to participate in any and all new issues the issuer may sell on a competitive basis at some future date.

Rule G-23(d)(ii) provides that a municipal securities dealer which is acting as a financial advisor may not acquire or participate in the distribution of a new issue unless

if such issue is to be sold by the issuer at competitive bid the issuer has consented in writing to such acquisition or participation.

The rule is designed to minimize the "prima facie" conflict of interest that exists when a municipal securities professional acts as both financial advisor and under-

writer with respect to the same issue. Rule G-23(d) speaks in terms of "a new issue" and the implication is that consent should be obtained on an issue-by-issue basis.

The Board believes that such a reading of the rule is consistent with the rule's rationale—that an issuer should have an opportunity to consider whether, under the particular circumstances of an offering, the financial advisor's potential conflict of interest is sufficient to warrant not consenting to its participation in the sale. The Board has concluded that an unrestricted consent would not afford an issuer such an opportunity and, accordingly, has determined that such a consent would not satisfy the requirements of rule G-23(d)(ii).
—MSRB interpretation of July 30, 1981 by Angela Desmond, Deputy General Counsel.

¶ 3616 Use of Ownership Information Obtained in Fiduciary or Agency Capacity

Rule G-24. No broker, dealer, or municipal securities dealer having access to confidential, non-public information concerning the ownership of municipal securities that was obtained by such broker, dealer, or municipal securities dealer (or by a bank or other person of which the broker, dealer, or municipal securities dealer is a department or division) in the course of acting in a fiduciary or agency capacity for an issuer of municipal securities or for another broker, dealer, or municipal securities dealer, including but not limited to acting as a paying agent, transfer agent, registrar, or indenture trustee for an issuer or as clearing agent, safekeeping agent, or correspondent of another broker, dealer, or municipal securities dealer, shall use such information for the purpose of soliciting purchases, sales, or exchanges of municipal securities or otherwise make use of such information for financial gain except with the consent of such issuer or such broker, dealer, or municipal securities dealer or the person on whose behalf the information was given.

¶ 3621 Improper Use of Assets

Rule G-25. (a) *Improper Use.* No broker, dealer, or municipal securities dealer shall make improper use of municipal securities or funds held on behalf of another person.

(b) *Guaranties.* No broker, dealer, or municipal securities dealer shall guarantee or offer to guarantee a customer against loss in

(i) an account carried or introduced by such broker, dealer, or municipal securities dealer in which municipal securities are held or for which municipal securities are purchased, sold or exchanged or

(ii) a transaction in municipal securities with or for a customer. Bona fide put options and repurchase agreements issued in the ordinary course of business shall not be deemed to be guaranties against loss.

(c) *Sharing Account.* No broker, dealer, or municipal securities dealer shall share, directly or indirectly, in the profits or losses of