MSRB REPORTS

Volume 8, Number 5 | Municipal Securities Rulemaking Board | December 1988

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  The Board requests comments on a draft rule which would require a dealer, within 10 business days after receipt of an arbitration award against it, either to pay the award or, if the dealer is considering an appeal of the award, to deposit the amount of the award in an escrow account set up for this purpose by the dealer.

Calendar

January 20	— Comments due on payment or escrow of arbitration awards
March 1	— Recommendations due for Board nominations
Pending	— G-8 on suitability recordkeeping for institutional accounts
	— G-35 and A-16 changes to the Arbitration Code

Recommendations for Board Nominations Requested

The process has begun for selecting five new Board members to serve three-year terms beginning October 1, 1989. Two public, one securities firm and two bank dealer representatives must be elected. Industry members and the general public are invited to participate. The instructions and form for making a recommendation and the names of members currently serving on the Board are published on pages 3 through 5 of this issue.

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POSTMASTER send address changes to Municipal Securities Rulemaking Board, 1818 N Street, NW, Suite 800, Washington, DC 20036-2491. Telephone (202) 223-9347

From the Chairman

As a Board member, I am keenly aware that every time the Board meets it will be considering matters that will affect each municipal securities dealer across the country, including my bank. It truly brings home the meaning of "self-regulation." The other dealer members around the Board table feel much the same way as I do and, along with the public members, we share a common goal of having a market that has integrity, is efficient and is growing.

Yet, I am disappointed that we receive only a small number of comment letters on many proposed rules and other Board actions. All letters sent to the Board on rulemaking matters are sent to all Board members for their review. It is dismaying to come to a Board meeting to discuss a proposal that may alter industry practice and find that we have received less than 10 comment letters, many of those are written by the same dedicated people we have heard from in the past.

If you do not send a comment letter, you are relying upon the experiences and knowledge of Board and staff members. Sometimes we may be unaware of how a Board initiative may affect practices in a particular geographic region or in a particular segment of the market. We rely on your comments to keep us informed. Silence is considered to be agreement.

Your vigilance is critical for the future of the industry. We in the municipal securities industry face a period of significant change. Events of the past several years have convinced the Board that to achieve its goals it must take steps:

1. to provide market participants (investors, dealers, and issuers) with more information about the description of individual securities,
2. to provide market participants with more credit information about issuers,
3. to provide market participants with more information about the relative value of their securities,
4. to ensure that agents of issuers (transfer agents, paying agents, financial advisors, etc.) fulfill their responsibilities to the marketplace, and
5. to enhance the examination and enforcement of Board rules and the ethical standards of the industy.

The Board is prepared to take whatever actions are necessary (including seeking legislation) to accomplish these objectives. Steps taken in the last year include our request to the Securities and Exchange Commission (SEC) to establish a central repository for official statements and our publication of a report entitled "Automated Clearance and Settlement in the Municipal Securities Market," in which we called for legislation giving authority to the SEC to regulate transfer agents and paying agents.

Our comment letter to the SEC on its proposed rule 15c2-12 to require the review and production of official statements is a further step and is contained in this issue of *MSRB Reports*. I urge you to read it carefully and to write your own comments to the SEC. As we go forward, please continue to read *MSRB Reports* and do not hesitate to comment on the Board's proposals. WE NEED YOUR INPUT!

John W. Rowe
MSRB Chairman, 1988-1989

New Issue of *MSRB Manual*

The updated soft-cover edition of the *MSRB Manual*, dated October 1, 1988, now is available.

The *MSRB Manual*, published by Commerce Clearing House, includes the Securities Exchange Act of 1934, the Securities Investor Protection Act of 1970, Board rules and interpretations, pertinent regulations of other agencies and samples of forms.

Copies of the updated *Manual* may be obtained from the Board's offices by submitting a completed order form along with payment in full for the amount due. An order form is located on page 27 of this issue. The cost of the *Manual* is $5.00.

MSRB REPORTS

Volume 8, Number 5 December 1988

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [ ] Sales
- [ ] Operations
- [ ] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other _____

Recommendations Requested for Board Nominations

The 1989 Nominating Committee requests recommendations of persons to be considered for five Board positions opening on October 1, 1989.

Membership Requirements

The Board, established by Congress in 1975 to act as the primary rulemaking body for the municipal securities industry, consists of 15 members—five representatives of bank dealers, five representatives of securities firms and five public members. One public member must represent issuers and one investors. Public members may not be associated with a securities firm or bank dealer other than by reason of being under common control with, or directly controlling, any broker or dealer which is not a municipal securities broker or municipal securities dealer.

When making recommendations, keep these Board membership requirements in mind:

- Two public representatives, one securities firm representative and two bank dealer representatives must be elected this year to ensure equal representation in each category;
- Municipal securities brokers and municipal securities dealers of diverse size and type must be represented; and
- Wide geographic representation must be maintained.

Procedure for Recommending Candidates

1. Complete the form printed on page 5 or a photocopy of that form. (Additional forms may be obtained from the Board's offices.) The following information must be included on the form:
   - The name, business affiliation, business address and telephone number, home address and telephone number and category (bank dealer, securities firm or public representative) of the individual recommended. (Item 1)
   - The educational and professional background of the individual recommended. (Item 2)
   - The proposer's name, business address, telephone number and professional relationship (if any) to the individual recommended. (Item 3)
   - The affiliation (if any) of the individual with any broker, dealer or municipal securities dealer. (Item 4)
2. Determine in advance that the individual recommended is willing to serve on the Board.
3. Submit recommendations no later than **March 1, 1989** to:

Michael E. Dougherty
Chairman, Nominating Committee
Municipal Securities Rulemaking Board
1818 N Street, NW Suite 800
Washington, DC 20036-2491

Terms of Present Board Members

Terms Expire September 30, 1989

Michael E. Dougherty, President
Dougherty, Dawkins, Strand & Yost, Inc.
Minneapolis, Minnesota

W. Graham Lynch, Senior Vice President
Wachovia Bank & Trust Company, Inc.
Winston-Salem, North Carolina

Leslie Nelman, Vice President
Farmers Insurance Group
Los Angeles, California

Carroll M. Perkins, Associate General Manager
Salt River Project
Phoenix, Arizona

John W. Rowe, Executive Vice President
Centerre Bank, N.A.
St. Louis, Missouri

Terms Expire September 30, 1990

Eric N. Keber, Managing Director
BT Securities Corporation
New York, New York

David J. Master, President and Chief Executive Officer
Lovett Mitchell Webb & Garrison
Houston, Texas

Elizabeth A. Roistacher, Professor of Economics
Queens College
New York, New York

Thomas Sexton, Managing Director
First Boston Corporation
New York, New York

Richard S. West, President
American Syndicate Advisors
Boston, Massachusetts

Terms Expire September 30, 1991

John M. Gunyou, City Finance Officer
City of Minneapolis
Minneapolis, Minnesota

David E. Hartley, Senior Partner
Stone & Youngberg
San Francisco, California

R. Fenn Putman, Executive Vice President and Managing Director
Dean Witter Reynolds, Inc.
New York, New York

S. Ashton Stuckey, Executive Vice President
Southtrust Bank of Alabama
Birmingham, Alabama

Donald J. Stuhldreher, President
The Huntington Company, Investment Banking
Subsidiary of Huntington Bancshares, Inc.
Columbus, Ohio

Recommendation Form

1. Individual Recommended: _____

Business Address: _____

_____

_____

Telephone Number: _____

Home Address: _____

_____

_____

Telephone Number: _____

Category: ☐ Bank Dealer Representative ☐ Securities Firm Representative ☐ Public member

2. Educational and Professional Background

Professional: _____

_____

_____

Educational: _____

_____

_____

Associations: _____

_____

_____

3. Proposer: _____

_____

_____

4. Associated Person under Securities Exchange Act of 1934: _____

_____

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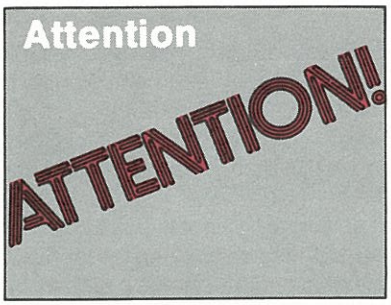

Route to:

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- [ ] Training
- [ ] Other _____

Letter to SEC on Its Proposed Rule 15c2-12

November 28, 1988

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Rule 15c2-12, File S7-20-88

Dear Mr. Katz:

The Municipal Securities Rulemaking Board ("Board") is the self-regulatory organization charged with regulating transactions in municipal securities effected by brokers, dealers and municipal securities dealers.[1] The Board appreciates this opportunity to comment on proposed rule 15c2-12 under the Securities Exchange Act ("Act") and on responsibilities of underwriters as discussed in Securities Exchange Act Release No. 26100 (September 22, 1988) ("Release").

Over the past several years the Board has scrutinized the adequacy of information in the municipal securities market. The Board concluded in December 1987 that investors and dealers do not have adequate access to information about municipal securities and their issuers. The Board, in setting its long-term and short-term goals, resolved to improve access to and dissemination of information about municipal securities, their issuers, and their prices for primary and secondary market participants. At that time, the Board formally asked the Commission to use its authority to improve the flow of information to the municipal securities market by, among other things, facilitating the establishment of a mandatory central repository for official statements and certain refunding documents.[2]

As a general matter, the proposed rule is responsive to a number of the Board's concerns about the adequacy of information in the municipal securities market. The Board believes proposed rule 15c2-12, if adopted, will improve the dissemination and quality of issuer disclosure documents in the municipal securities market. In addition, the Board continues to support the establishment of a mandatory electronic repository for official statements and other issuer disclosure documents. As discussed below, the Board believes the goals of proposed rule 15c2-12 would be best served if issuers were responsible for providing copies of their disclosure documents to a central repository.

Underwriter Responsibilities

The Release reiterates the duty of underwriters to have a reasonable basis for reoffering new issue securities to the public and to exercise reasonable care in evaluating the accuracy of statements in issuer disclosure documents ("reasonable basis responsibilities").[3] The Board has long recognized that underwriters, in introducing new municipal securities into the stream of commerce, must satisfy the antifraud requirements of the federal securities laws. The same principles are embodied in the Board's Fair Practice Rules. Rule G-19, on suitability, prohibits a dealer from recommending a security unless, among other things, after making a "reasonable inquiry" the dealer "has reasonable grounds based upon information available from the issuer of the security or otherwise for recommending a purchase, sale or other transaction in the security; . . ." In addition, rule G-17, on fair dealing, requires a dealer to deal fairly with all persons and prohibits a dealer from engaging in any deceptive, dishonest or unfair practice. The Board has interpreted its fair dealing rule to require a dealer to be knowledgeable about the securities it buys and sells and to disclose all material information about a transaction to a customer at or before effecting the transaction.

The Board believes that the discussion of underwriters' reasonable basis responsibilities contained in the Release has been useful in reviewing the responsibilities dealers must discharge to the market. The Release also provides much needed guidance with respect to standards of care underwriters must

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[1] *See* Section 15B(b) of the Securities Exchange Act.

[2] Letter from James B.G. Hearty, Chairman of MSRB, to David S. Ruder, Chairman of SEC (December 17, 1987) ("December letter").

[3] The Commission states:

> By participating in an offering, an underwriter makes an implied recommendation about the securities. Because the underwriter holds itself out as a securities professional, and especially in light of its position vis-a-vis the issuer, this recommendation itself implies that the underwriter has a reasonable basis for belief in the truthfulness and completeness of the key representations made in any disclosure documents used in the offerings. Release, pp. 44-45.

satisfy.[4] Significantly, the Commission recognizes that the circumstances affecting a dealer's discharge of its reasonable basis responsibilities differ between competitive and negotiated sales.[5]

In discharging their duties under current law, the Board notes that underwriters, absent actual knowledge or obvious inaccuracies, must rely on the official disclosure documents of issuers. Although the revised *Disclosure Guidelines for State and Local Government Securities* ("GFOA *Guidelines*")[6] do an excellent job of discussing the content of official statements, the level of voluntary compliance by issuers with the *Guidelines* varies.[7] The Board expects, however, that if adopted, proposed rule 15c2-12 will improve the dissemination of official statements and hopes that the market will become more aware of and less tolerant toward official statements that do not conform to the GFOA's standards. If not, it may be necessary for the Commission to consider whether substantive disclosure requirements would be appropriate.

Proposed Rule 15c2-12

Proposed rule 15c2-12 is designed to prevent fraud by establishing standards for the procurement and dissemination by underwriters of issuer disclosure documents, thus enhancing the accuracy and timeliness of disclosure to investors in larger offerings of municipal securities. The rule, in establishing certain procedural and substantive requirements directly on dealers and indirectly on issuers, presents a realistic step toward ensuring that critical information about new issue municipal securities is available in the market at or before the time trading begins in the issue. It also seeks to ensure that important descriptive information about an issue will be accessible over the life of the issue. Reaching these goals is critical in ensuring efficient pricing and trading of municipal securities and in promoting investor confidence in the municipal securities markets, particularly in light of the complex nature of municipal securities today. Over the past several years the Board, in discharging its regulatory responsibilities, has discussed a number of issues that are relevant to the proposed rule. It respectfully offers its comments and suggestions on the proposed requirements for the Commission's consideration.

Application of Rule. Proposed rule 15c2-12(a) states that the rule will apply to any dealer acting as an underwriter. The Release and Commission staff comments suggest that a syndicate (or selling group) member need not duplicate the efforts of the manager and that a syndicate may delegate some of the responsibilities that would be established by rule 15c2-12 to the manager.[8] This suggestion has engendered confusion as to which duties can be allocated to the syndicate manager and whether underwriter liabilities would be affected. The Board requests further clarification in this area. In addition, if allocations of responsibilities are permitted under the rule, the rule should state explicitly that participating underwriters or selling group members may not divest themselves of their responsibility to review the official statement and must have a reasonable basis for recommending the issue to customers. Moreover, it is essential that any allocation of responsibility should be expressly stated and clearly assumed by the managing underwriter in the agreement among underwriters.

Proposed rule 15c2-12 would apply to underwriters of issues that have an aggregate offering price in excess of $10 million. As the Commission is aware, the official statement is the sole official source of information about an issue of municipal securities. Review of a "nearly final" official statement is an essential predicate to a dealer considering whether to purchase a new issue as underwriter. Moreover, if an issuer authorizes the preparation of an official statement, Board rule G-32 requires, among other things, that a dealer that sells the new issue municipal security to a customer deliver a final official statement to the customer by settlement of the transaction. The Board is concerned that placing the threshold for application of rule 15c2-12 at $10 million could have a negative impact on obtaining and disseminating official statements for issues under $10 million, even when an issuer voluntarily prepares one. Industry representatives have advised that most issues of municipal securities that have an aggregate par value of $1 million or more are accompanied by final or nearly final official statements. Since most issuers already bear the expense of producing official statements, they should find the costs of complying with the rule to be minimal. However, any issuers that are issuing larger issues without providing descriptive and financial information typically found in an official statement will entail certain compliance costs.

The Board recommends that the proposed rule 15c2-12 apply in its entirety to all issues of at least $1 million aggregate par value. This would bring under the rule an estimated 99 percent of the total dollar amount of municipal securities issued, comprising 79 percent of the total number of issues. While lowering the threshold amount could increase issuance costs for some issues, the Board believes that any such costs or other burdens are completely outweighed by the benefits that would

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[4] The Release helps to provide a framework for comparing the negligence and scienter standards that must be demonstrated by the Commission and private litigants respectively under rule 10b-5 of the Act with the strict liability of underwriters of corporate securities under the Securities Act and the limited defense of due diligence available to underwriters under section 11 of that Act.

[5] Release, pp. 53-54.

[6] The revised GFOA *Guidelines* published by the Government Finance Officers Association in 1988 address the substance of offering documents, continuing disclosure responsibilities of issuers and procedural matters concerning issuer disclosure.

[7] *See, e.g.*, Ferris, "Municipal Market Considers Disclosure," *The Bond Buyer*, October 22, 1987, pp. 14-15. Moreover, with respect to accounting standards, the Board understands that many sophisticated municipal issuers have chosen to follow Financial Accounting Standards Board ("FASB") standards, rather than the more "onerous" Government Accounting Standards Board ("GASB") standards that have been formulated specifically for municipalities.

[8] Release, p. 33 fn. 53. *See also* Release, p. 54 fn. 87; "Syndicates Can Assign Disclosure Responsibilities," *The Bond Buyer*, October 4, 1988, p. 1.

be derived from the increased availability of disclosure documents to municipal securities market participants.[9]

Review of Official Statement Prior to Sale. Proposed rule 15c2-12(b) would require underwriters to receive and review a nearly final official statement prior to bidding on or purchasing a new issue. An official statement would be nearly final if it is complete except for certain specified information which normally is not available until the date of sale ("reoffering information").[10]

As the Commission recognized, this would effectively prohibit dealers from bidding on or purchasing issues that meet the aggregate price requirement but that are not accompanied by official statements. However, since issuers generally prepare a final or nearly final official statement for issues over $1 million, the Board believes that any changes in current practices largely would be procedural: issuers and underwriters would have to adhere to a less flexible time-table for the preparation and review of official statements.[11] The Board believes that it is both possible and practical to prepare a nearly final official statement at least two days prior to the date of sale.[12] Moreover, the requirement would facilitate an underwriter's discharge of his reasonable basis responsibilities and ensure that securities are described accurately at the time they are introduced into the stream of commerce.[13] These effects would be beneficial to the efficiency of the municipal securities market and the protection of investors.

Delivery of Preliminary Official Statements. Proposed rule 15c2-12(c) would require an underwriter to send a preliminary official statement, if one is prepared, to any person promptly upon request. The Release states that the purpose of this requirement is to ensure that information on a new issue is provided to a potential investor early enough for it to be of use in his investment decision.

There is some confusion how paragraph (c) would apply to underwriters in a competitive offering. Since the identities of the underwriters are not known until the date of award, it is unclear who should be delivering the preliminary official statement, or when this duty would begin or end.[14]

As noted in the Release, preliminary official statements usually are used as sales documents and supplied voluntarily to potential purchasers by dealers. While the Board is not opposed to sending preliminary official statements, it questions whether their delivery should be required. Prior to 1985, Board rule G-32 required dealers selling new issue securities to deliver a final official statement with the confirmation of the transaction. If the final version was not available, dealers were required to deliver the preliminary version.[15] In fact, final official statements rarely were available in time to send with confirmations. As a result, dealers were required to send a preliminary official statement and a final version to their new issue customers. In 1984, a number of dealers, in commenting on draft amendments to rule G-32, suggested that the mailing and administrative expenses associated with sending both preliminary and final official statements to each investor was burdensome and noted that after the date of sale there often is little incentive to complete and disseminate final official statements.[16]

The Board found it necessary to balance the benefits of a customer receiving both documents against the compliance costs to dealers. It concluded that it was appropriate to require dealers to send only one document; since only the final official statement has complete information about a new issue, the Board amended rule G-32 to require dealers to deliver the final official statement to new issue customers by settlement of the transaction.[17] Thus, while the rule does not require delivery of preliminary official statements, it does not prohibit their distribu-

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[9] The Board notes that rule G-32, on delivery of official statements, exempts municipal commercial paper. The Board provided this exemption because periodic disclosure documents generally are provided by issuers of municipal commercial paper to all investors.

[10] Page 68 of the Release states that a nearly final official statement should be "complete except for the offering price, interest rate, selling compensation, amount of proceeds, delivery dates, other terms of securities depending on such factors, and the identity of the underwriter." As discussed below, a preliminary official statement may not be nearly final, as defined in paragraph (b).

[11] In discussions over the past eight months, bond counsel have advised the Board that nearly final official statements currently are prepared by or before the date of sale or award. In the Board's comment letter to the GFOA on the GFOA *Guidelines*, the Board emphasized that the production of official statements prior to the date of sale is desirable for negotiated and competitive issues. Letter from H. Keith Brunnemer, Jr., Chairman of MSRB, to Andre Blum, Chairman of GFOA Task Force on Municipal Disclosure, August 7, 1987, pp. 4-5.

[12] Bond counsel and issuers have indicated that the requirement generally will not interfere with the ability of issuers to bring issues to market quickly. *See, e.g.*, "SEC Official Says New Disclosure Proposals Do Not Stop 'Wire Deals,'" *The Bond Buyer*, October 3, 1988, p. 1 (Remarks of Donald Robinson, Bond Counsel; Edward Arnendariz, Metropolitan Transportation Authority, New York City; Margaret Van Cook, New York City). The Board believes that in instances in which issues previously have been sold "without papers," issuers generally have advance notice and can have official statements prepared for this possibility.

[13] As noted in its December letter, the Board generally is concerned that the flow of information to the municipal market is not adequate and that official statements are not available prior to the time that trading begins in a new issue. In addition, the Board notes that, in 1987, roughly 84 percent of all customer complaints and 49 percent of inter-dealer complaints arbitrated through the Board's arbitration program alleged that inadequate information was provided concerning the securities.

[14] For example, how would a dealer know if it should provide preliminary official statements? Would the requirement begin as soon as the issuer prepares a preliminary official statement, or when dealers agree to form a potential syndicate or selling group? If a dealer failed to respond to requests for preliminary statements, would the dealer then be prohibited from later deciding to bid on the issue?

[15] The official statement delivery requirements of rule G-32 only apply when preparation of an official statement is authorized by the issuer.

[16] These comments are summarized in the Board's 1985 filing of amendments to rule G-32. SR-MSRB-85-11, filed March 11, 1985, p. 13.

[17] It also exercised its limited jurisdiction to ensure that the final version is available soon after the date of sale. The rule requires any broker, dealer or municipal securities dealer that serves as a financial advisor or underwriter on an issue and that is responsible for preparing an official statement on behalf of the issuer to ensure that the official statement is made available in final form promptly after the date of sale or award. If the broker, dealer or municipal securities dealer is responsible for printing the official statement, the copies must be ready no later than two days before delivery of the issue by the syndicate manager to syndicate members.

tion as a selling tool by the dealer community.[18]

When a dealer provides a preliminary official statement to a customer, there is no guarantee that the issue will not be subject to material changes or that changes to financial information will not occur by the date of sale. The earlier the preliminary official statement is circulated, the more likely such changes will occur. Moreover, it is not uncommon for a preliminary official statement to be materially incomplete in a number of respects. Thus, while it may be permissible to utilize preliminary official statements as a selling tool, it may not be appropriate to deem them to be disclosure documents whose delivery should be mandated. Accordingly, the Board believes that rule 15c2-12 should not require delivery of a preliminary official statement, particularly in instances in which the preliminary official statement is not "nearly final." It believes that one complete official document should be delivered to a new issue customer by settlement of the transaction irrespective of whether a preliminary version was delivered. The Board also believes that paragraph (c) expressly should prohibit the sending of preliminary official statements after the date of sale or award, to ensure that the final version is disseminated whenever possible.

Finally, if the Commission determines to adopt a requirement to deliver preliminary official statements, the Board notes that proposed rule 15c2-12(c) would require any dealer participating in an underwriting to provide a preliminary official statement to any person requesting one, including dealers and others who are not customers or potential customers of the dealer. This requirement is very broad and the Board questions whether the benefits derived from requiring dissemination of preliminary official statements outweigh the costs to underwriters.

Delivery by Issuers of Final Official Statements. Proposed rule 15c2-12(d) would require underwriters to contract with the issuer or an agent of the issuer to obtain copies of a final official statement within two business days after the date of sale of the issue. This paragraph is intended to facilitate prompt distribution of official statements and ensure their availability in the secondary market. The Board believes that issuers of municipal securities should share responsibility for ensuring that their disclosure documents are available to investors. As the Board noted in its December letter, the completion, printing and delivery of official statements sometimes is a low priority for issuers and underwriters and thus, official statements often are not disseminated to new issue investors as required by rule G-32.[19] Requiring that issuers expressly agree to deliver official statements within a specified number of business days after the date of sale should ensure that issuers prepare disclosure documents in a timely manner, which will facilitate greatly dissemination of official statements in the municipal securities market.

The draft rule would permit a dealer to contract with an issuer's agent to obtain an official statement. The Board believes that any contractual obligations specifically should flow between the issuer and underwriter rather than between an issuer's agent and the underwriter. Moreover, these obligations should be part of the sale documents. It also would be clearer if the rule provided that underwriters must enter into a contract under which issuers agree "to deliver" official statements within the time period specified by the rule.

Moreover, any such contract should specify the exact number of copies the issuer agrees to provide rather than use vague terms.[20] This will enable a managing underwriter to know whether it needs to obtain additional official statements to meet its rule G-32 duty to provide one copy to each of its customers and to provide a purchasing dealer, upon request, with one official statement for each $100,000 of securities purchased.[21]

With respect to the two business day requirement, the Board is concerned that up to five days (or longer) may be required to complete and print final official statements, particularly for smaller issues. The Board urges the Commission to discuss with issuers and dealers any federal, state and local requirements that may affect the timing of official statement production, as well as practical problems in complying with this aspect of the rule.

Delivery by Underwriters of Official Statements. Proposed rule 15c2-12(e) would require the underwriter for an issue to provide an official statement in a timely manner to any person upon request. The Release states that "timely manner" would mean, for the first month after an offering, that the official statement would be mailed out within two business days of the request. Requests made after this would be answered within a "reasonable time."

The Board strongly supports the continued availability of official statements, which is the goal of paragraph (e). However, for purposes of the primary market, the proposal's "on request" contingency would undermine Board requirements that investors of new issue securities automatically be provided with a final official statement. The Board strongly believes that primary market investors should automatically receive a final official statement and not have to request one. In addition, the Board strongly believes that no investor in the primary market should have to pay for a copy of the final official statement and that dealers should be entitled to one or more copies of the official statement, as provided by rule G-32, without charge.

The impact of paragraph (e) would be greatest in the secondary market where official statements are not routinely provided to investors and often are unavailable.[22] Rather than delegating to the underwriters responsibility to deliver an official statement to any person for the life of an issue, it appears that this ongoing

[18] If a final official statement is not prepared by the issuer, rule G-32 requires that the preliminary official statement, if any, be sent, along with a notice that no final official statement is being prepared.

[19] The Board noted that the production of the final official statement is not a precondition to the issuance of municipal securities and that this might be the reason for the lack of emphasis in this area.

[20] The number of official statements the issuer will provide for a specific issue is best left to negotiation between the issuer and underwriter.

[21] The rule also requires the managing underwriter to provide purchasing dealers with instructions on how to order additional copies of the official statement from the printer. The Board has stated that it is appropriate for dealers to obtain additional official statements at their own cost.

[22] As the Commission is aware, in June 1987, the Board exposed a draft amendment to rule G-15 that would have required a dealer to provide a secondary market customer, upon request made within one year of the transaction, with a copy of the official statement for the issue purchased. The dealer would have 30 days to provide the official statement. The Board has not acted on the draft amendment, pending the development of an official statement repository.

duty properly is that of the issuer. Once a distribution is completed, an underwriter's responsibilities effectively end.[23] By contrast, an issuer has continued responsibility for its securities. Indeed, the Board suggested and the GFOA amended the GFOA *Guidelines* to state that an issuer should make the official statement available to any person upon request, at cost.[24]

The Board notes that some of the administrative burdens of proposed paragraph (e) could be eased if a mandatory repository were established. If so, an official statement for a secondary market issue could be supplied relatively easily and within a few days of a request. Moreover, if a repository were in place, it would be appropriate to require a dealer, rather than the underwriter, to provide the official statement to its customer, on request. In such an instance, the Board believes that it may be appropriate for dealers to pass on the actual costs of obtaining and mailing the official statement for a secondary market security, as long as this is explained to the party making the request.[25]

Enforcement Concerns. Under the Act, the Board has responsibility to adopt rules pertaining to transactions in municipal securities effected by brokers, dealers and municipal securities dealers; enforcement and inspection authority for its rules has been delegated to other entities.[26] The Board, however, has a legitimate and ongoing interest in the enforcement of its rules and devotes considerable resources toward maintaining a dialogue with the enforcement agencies to ensure compliance by all municipal securities dealers.[27] In adopting a rule, the Board considers, among other things, whether dealers reasonably can comply with the requirement as well as how the enforcement agencies will inspect for compliance. The Board notes that proposed rule 15c2-12 would condition a dealer's participation as an underwriter of municipal securities on its performance of certain duties during and after the distribution.[28] Violations of these conditions would not be discovered until long after the securities were sold to the public, when the dealer is subjected to a periodic compliance examination.[29] The Board respectfully suggests that the requirements that arise after the underwriting be stated as affirmative obligations of a dealer, for example of a dealer that acted as underwriter, to clarify these ongoing responsibilities.

In addition, it may be difficult to inspect for compliance with proposed rule 15c2-12. When the Board amended its rule G-32 in 1985, it concluded that it was necessary also to require dealers to keep records of requests for and deliveries of official statements.[30] Given the extensive delivery responsibilities for preliminary and final official statements the rule would impose, it would be appropriate for the Commission to consider some recordkeeping requirements to accompany the rule. Moreover, recordkeeping would be helpful to underwriters who must contact investors who received preliminary official statements that were subject to material revisions.[31]

Finally, the Board notes that there is no enforcement mechanism in place if an issuer does not live up to its contractual obligation to deliver final official statements within two business days after the date of sale. Given the sensitive nature of the issuer-underwriter relationship, it may be impractical to expect an underwriter to seek contract remedies against an issuer if it does not deliver official statements as agreed. In order to evaluate the effectiveness of this provision, the Commission may wish to require underwriters to record when final official statements are delivered by issuers.

Official Statement Repository

The Board is pleased that the Commission has requested comments on the establishment of a mandatory repository for official statements. The Board's December letter emphasized the critical need to ensure access to and promote dissemination of official statements; it did not address the content or adequacy of official statements.

As noted above, and in the Board's December letter, a repository would provide a reliable source of information for secondary market issues and promote the prompt completion and dissemination of official statements in the primary market. These goals require that the repository be mandatory, so that it includes all official statements,[32] and that the official statements be supplied to the repository as soon as possible after the date of sale or award.[33] Because the official statement is the issuer's document and the issuer ultimately is responsible for its content and the timing of its production, the Board believes that the

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[23] A dealer's obligations under rule G-32, for example, apply only to those transactions executed during the underwriting period. Under Board rule G-11(a)(ix) an underwriting period ends when the issuer delivers the securities to the syndicate or the syndicate no longer retains an unsold balance, whichever last occurs.

[24] GFOA *Guidelines*, p. 92.

[25] The Board also suggested that such direct costs might be passed on to customers in proposing its draft amendment on secondary market official statement delivery. The existence of a repository offering the official statements at reasonable cost should ensure that these costs do not chill access to the repository by investors.

[26] The Congress has designated the National Association of Securities Dealers, Inc. as the enforcement authority for securities firms; the Office of the Comptroller of the Currency for national banks; the Federal Reserve Board for banks of the Federal Reserve System, and the Federal Deposit Insurance Corporation for state banks that are not members of the Federal Reserve System.

[27] When the Board learns of general compliance problems, it forwards that information to the enforcement agencies. Over the past year, for example, the Board has asked the enforcement agencies to emphasize compliance with the Board's automated clearance rules and rule G-32. *See, e.g.*, "New Issue Disclosure Requirements," *MSRB Reports*, Vol. 7, No. 2 (March 1987) pp. 7-9.

[28] Proposed rule 15c2-12(c) would require an underwriter to provide preliminary official statements to potential bidders and customers, and (d) would require an underwriter to provide copies of the final official statement after the distribution is completed.

[29] Board rule G-16 requires that dealers be examined at least once every 24 months.

[30] Rule G-8(a)(xiii).

[31] *See* Release, p. 30 fn. 49.

[32] The Board suggested that the requirement for deposit in the repository should extend to all issues for which official statements are prepared.

[33] The Board, therefore, does not believe that summary data should be provided to the repository. Vendors of summary information, however, would be able to access the official statements from the repository and thus the repository would improve the accuracy of summary information.

responsibility to provide the official statement should rest with the issuer.[34] The Board suggests that the contract provisions of paragraph (d) be amended to require that the issuer also agree that it or its agent will provide a copy of its final official statement to a central repository at the same time it is delivered to the underwriter.

The Board remains convinced that the volume and size of official statements in the repository, and the desirability of later collecting updated issuer information in the repository, requires a form of electronic storage of the data. In this regard, the Board has examined the technology currently available for this purpose and shared this information with other industry groups interested in the repository. The Board notes that relatively new technology exists that could provide electronic storage, yet allow issuers to submit documents in hard copy form.[35] It also would permit information to be transmitted from the repository over telephone lines to inquirers.

Should the Commission wish to pursue the establishment of a central repository, the Board stands ready to serve a leadership role in coordinating and facilitating its development. The Board continues to believe that this project requires the thoughtful cooperation of all market participants and will attempt to coordinate additional research into the technical aspects of an electronic repository.

* * *

The Board appreciates the opportunity to comment on proposed rule 15c2-12 and on underwriters' responsibilities to the municipal securities market. As the Commission considers the Board's and others' comments on proposed rule 15c2-12, the Board would be happy to provide further input as necessary to assist the Commission's final determinations with respect to the rule. If the Commission adopts rule 15c2-12, the Board will review its rules, particularly rule G-32, to determine whether conforming changes are necessary or appropriate. Should the Commission have any questions on the Board's letter, please contact Angela Desmond, the Board's General Counsel.

Sincerely,

John W. Rowe
Chairman

[34] As noted in the Board's December letter, the Board believes that the Commission has the authority to require this under section 10(b) of the Exchange Act. The Board also stated that, while it preferred the establishment of a repository within the current regulatory framework, it is committed to supporting legislation to establish one if such action is determined to be necessary or appropriate.

[35] This technology, called "imaging," easily allows the image appearing on a hard copy page to be scanned and stored on optical disks. The image later can be retrieved for hard copy printing. Such a system appears to be feasible and the Board now is examining the cost and technical considerations relevant to its use.

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Payment or Escrow of Arbitration Awards: Rule G-35

Comments Requested

The Board requests comments on a draft rule which would require a dealer, within 10 business days after receipt of an arbitration award against it, either to pay the award or, if the dealer is considering an appeal of the award, to deposit the amount of the award in an escrow account set up for this purpose by the dealer.

Rule G-35, the Board's Arbitration Code, and rule G-17, on fair dealing, require dealers to pay arbitration awards promptly unless a timely motion to vacate the award has been made according to applicable law.[1] If a dealer goes out of business or declares bankruptcy prior to paying an arbitration award, the prevailing party must compete with general creditors for payment of the award. Such situations are inconsistent with the Board's statutory mandate to protect investors and undermine the goals of the Board's arbitration program: to make available quick and inexpensive means of resolving disputes involving municipal securities dealers.

Requirements of the Draft Rule

The Board is considering adopting a rule that would require a dealer, within 10 business days after receipt of an arbitration award against it, either to pay the award or, if the dealer is considering an appeal of the award, to deposit the amount of the award in an escrow account set up for this purpose by the dealer. If the dealer is considering an appeal, the amount of the award would be deposited with a bank (the "escrow agent") in an interest-bearing escrow account pursuant to an escrow agreement, subject to instructions consistent with the requirements of the draft rule. If an appeal is not filed by the relevant state or federal law deadline (the "appeal date"), or is filed but later withdrawn by the dealer prior to the entry of a final court order on the appeal, the escrow agreement would provide that the deposited funds, and interest, would be delivered by the escrow agent to the prevailing party. If a final court order is obtained, the escrow agreement must provide for the delivery of the deposited funds, plus interest, pursuant to the court order. Any costs incurred in the escrow account would be borne by the dealer.

In order to ensure that dealers comply with the draft rule, if the dealer deposits the amount of the award with an escrow agent, the dealer would be required to notify the prevailing party in writing of that fact, along with the name and address of the escrow agent and the appeal date. If the prevailing party does not receive payment of the award or notice of deposit of the funds within the 10-business-day period, the prevailing party could contact the appropriate enforcement agency. The enforcement agency then could bring an immediate action against a dealer for failing to comply with the rule, rather than waiting for the statutory appeal period to run.

Discussion and Request for Comment

The Board believes that the draft rule will promote the prompt payment of arbitration awards while permitting dealers to pursue legitimate appeals of arbitration awards. The Board understands that, if a dealer enters bankruptcy within 90 days after depositing an arbitration award, the bankruptcy trustee may recover the funds.[2] The Board notes, however, that an arbitration award deposited in an escrow account prior to the 90 days before the filing of bankruptcy probably would be a legal transfer under the Bankruptcy Code and would not be recovered by the bankruptcy trustee.[3] Moreover, even if the funds deposited within 90 days of bankruptcy are attached by the

Comments on the matters discussed in this notice should be submitted no later than January 20, 1989, and may be directed to Diane G. Klinke, Deputy General Counsel. Written Comments will be available for public inspection.

[1] The Federal Arbitration Act requires that an application to vacate an arbitration award be made within three months after the award is filed or delivered. The states that have adopted arbitration statutes allow between 30 to 90 days to file an application to vacate an arbitration award. *See* Notice of Interpretation Requiring Dealers to Submit to Arbitration as a Matter of Fair Dealing (March 6, 1987), *MSRB Manual* para. 3581 at 4860-1.

[2] Under Section 547 of the U.S. Bankruptcy Code (11 U.S.C. 547) certain transfers of the property of the debtor, within 90 days of the filing of bankruptcy, are "void" transfers which the trustee may recover.

[3] In limited instances in which a party in bankruptcy makes payments specifically to reduce the funds available to its creditors, a trustee may void payments up to a year prior to the filing of bankruptcy. Section 548 of the U.S. Bankruptcy Code.

bankruptcy trustee, these assets would have been preserved for the estate and available for general creditors, including successful parties to arbitrations.

The Board requests comment on the draft rule from interested persons. The Board seeks comment whether the rule should apply to all arbitration awards against dealers or only to public customer awards against dealers. Information is requested on the ability of dealers to pay an arbitration award within 10 business days or to deposit the funds in an escrow account. The Board seeks comment on the costs involved in obtaining the services of a bank as an escrow agent and in preparing an escrow agreement. In addition, the Board requests comment on the draft rule's distribution of the interest earned on such accounts.

November 16, 1988

Text of Draft Rule

Rule G-35. Arbitration

Section 31 *Awards*

(a) through (d) No change.

(e) Upon receipt by a broker, dealer or municipal securities dealer ("dealer") of a monetary award rendered against it, the dealer, within 10 business days, shall:

(1) deliver the amount of the award to the prevailing party (subject to any action required of the prevailing party by the award as a precedent to payment), or

(2)(i) if the dealer is considering an appeal of the award, deposit the amount of the award with a bank (the "escrow agent") in an interest-bearing escrow account pursuant to an escrow agreement which includes certain provisions described below. Any costs incurred in this escrow account shall be borne by the dealer.

(ii) Immediately upon deposit by the dealer of the amount of the award, the dealer must notify the prevailing party in writing of the deposit of the arbitration award, the name and address of the escrow agent, and the final date an appeal may be filed according to relevant state or federal law ("appeal date"). If an appeal is not filed by the appeal date, or filed but later withdrawn by the dealer prior to the entry of a final court order, the escrow agreement must provide that the escrow agent will deliver the amount of the award, plus the interest earned in the escrow account, to the prevailing party within two business days after the appeal date or the withdrawal date. If an appeal is filed, the amount of the award and the interest earned in the escrow account shall be held by the escrow agent until the entry of a final court order on the appeal. Within 10 business days of the entry of the final court order, the escrow agreement must provide that the escrow agent will deliver the amount of the award and the interest earned in the escrow account in accordance with the court's order.

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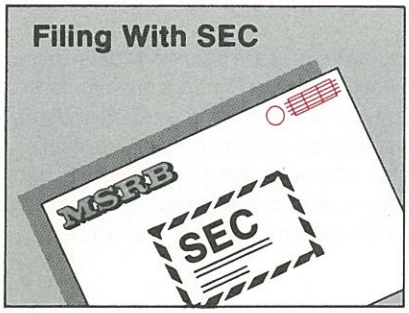

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Arbitration Changes, Policies and Interpretations: Rules G-35 and A-16

Amendments Filed

The proposed amendments would

- **require dealers to make certain disclosures to customers regarding predispute arbitration agreements;**
- **define "public arbitrator;" and**
- **conform the Board's Arbitration Code and arbitration fees to recent amendments to the Uniform Arbitration Code developed by the Securities Industry Conference on Arbitration.**

On November 23, 1988, the Board filed with the Securities and Exchange Commission (Commission) amendments to rule G-35, the Board's Arbitration Code, and rule A-16 on arbitration fees and deposits. The proposed amendments relate to predispute arbitration agreements and the definition of public arbitrator. They also conform the provisions of the Board's Arbitration Code and arbitration fees to recent amendments to the Uniform Arbitration Code developed by the Securities Industry Conference on Arbitration which is composed of representatives of the Board, nine other self-regulatory organizations, four public members, and the Securities Industry Association.[1] The proposed amendment regarding predispute arbitration agreements will be effective three months after Commission approval in order to allow dealers to revise their customer account agreements to include the required disclosures. The remaining amendments will become effective upon approval by the Commission. In addition, the Board has filed certain policies and procedures it follows in the arbitration program.[2] These procedures are outlined below and became effective upon filing with the Commission.

Predispute Arbitration Agreements

Predispute arbitration agreements usually provide that any dispute arising between the dealer and its customer will be resolved in binding arbitration. They typically are contained in the account agreement signed by a customer when he opens a new account. Some dealers will not open an account unless the customer signs an arbitration clause. In response to the Commission's concerns about dealers conditioning access to their services on the execution of mandatory arbitration clauses and the extent to which dealers currently explain the meaning of these clauses to customers, as well as the comments received by the Board on its recent notice on this topic,[3] the Board has adopted new Section 36 to rule G-35 on predispute arbitration agreements.

The proposed amendment requires predispute arbitration clauses to be highlighted and preceded by specific highlighted language which explains that arbitration is final and binding on the parties; that the parties are waiving their right to seek remedies in court; that discovery in arbitration is limited; that the award need not contain factual findings and legal reasoning; that appeals of awards are strictly limited; and that the arbitration panel will include a minority of persons who were or are affiliated with a dealer.

In addition, the proposed amendment requires the customer agreement to include a statement immediately preceding the signature line that the agreement contains an arbitration clause. Also, it requires dealers to provide a copy of the arbitration agreement to the customer who must acknowledge receipt on the account agreement or on a separate document.[4] The proposed amendment would apply only to new agreements signed by an existing or new customer of a dealer after the effective date of the rule.

The proposed amendment is designed to ensure that customers understand arbitration and are able to make an informed

Questions about this notice may be directed to Diane G. Klinke, Deputy General Counsel.

[1] SEC File No. SR-MSRB-88-5. Comments filed with the Commission should refer to the file number.
[2] SEC File No. SR-MSRB-88-6.
[3] *See MSRB Reports*, Vol. 8, No. 4 (August, 1988), pp. 3-4.
[4] The proposed amendment also mandates that the arbitration clause itself must not include any condition which limits or contradicts the rules of any self-regulatory organization, or limits the ability of any party to file any claim in arbitration, or limits the ability of the arbitrators to make any award.

decision whether to agree to arbitrate all future disputes and to do business with the dealer asking them to agree to this clause. If, in the future, more dealers begin requiring predispute arbitration agreements and customers have no choice but to sign such agreements if they wish to purchase municipal securities, the Board may consider whether further action is warranted.

Definition of Public Arbitrator and Other Amendments

In response to the Commission's September 1987 suggestion that a more complete definition of public arbitrator be developed to ensure that such arbitrators do not have any affiliation with the securities industry, the Board has adopted new section 12(c) to rule G-35. Section 12(c) prohibits persons currently employed in the securities industry, or employed during the last three years, from acting as public arbitrators. The proposed amendment retains industry members retired for more than three years as public arbitrators, but the Board will grant a challenge for cause to any customer who is concerned about the possible bias of such arbitrators.[5]

The proposed amendments remove from the public arbitrator pool attorneys who spent more than 20 percent of their work effort within the previous two years as municipal securities underwriter's counsel or representing dealers in securities-related litigation or arbitration matters involving public customers. Securities lawyers, accountants, and other professionals who devote "substantial" work effort (30 percent or more of work effort) to other municipal securities dealer activities will continue to act as public arbitrators; however, under Section 8(c), customers will be granted a challenge for cause if they are concerned about any possible bias.[6]

The remaining amendments are intended to improve the efficiency of the arbitration process; to extend the benefits of simplified arbitration procedures to controversies not involving more than $10,000; to provide additional information concerning arbitrators' backgrounds to parties to arbitration proceedings; to codify the affirmative disclosure obligations of arbitrators; to improve pre-hearing discovery processes; to require that a verbatim record of proceedings be kept; and to provide for the publication of arbitration awards.

Policies and Procedures

The Board has developed a number of policy guidelines which it employs in the administration of its arbitration program. These guidelines include dealing with requests for extensions of time for filing pleadings, how situs for a hearing is determined, what are not proper subject matters for Board arbitrations, how requests for subpoenas must be handled, the amount of arbitrator honoraria, the consolidation of certain claims, objections to pleadings, requests for attorneys' fees and punitive damages, the Board's arbitration award publication policy and a three-year sunset period for certain public arbitrators.

November 23, 1988

Text of Proposed Amendments*

Rule G-35. Arbitration

Sections 1 through 4 No change.

Section 5. *Initiation of Proceedings*

(a) No change.

(b)(1) No change.

(2)(i) A respondent, responding claimant, cross claimant or third party respondent who pleads only a general denial as an answer may, upon ~~written~~ objection by ~~the adversary~~ a party ~~to the Director of Arbitration before the hearing~~, in the discretion of the arbitrators, be barred from presenting any facts or defenses at the time of hearing.

(ii) through (f) No change.

Sections 6 and 7 No change.

Section 8. *Composition and Appointment of Panels*

(a) No change.

(b) *Notice of Appointment ~~Objections~~*. The Director of Arbitration shall inform the parties to the proceeding of the names and ~~business affiliations~~ employment histories for the past ten years of the persons appointed to the panel as well as information disclosed pursuant to Section 13 at least eight business days prior to the date fixed for the initial hearing session. A party may make further inquiry of the Director of Arbitration concerning the background of any arbitrator.

(c) *Objections*

(i) In any arbitration proceeding, each party shall have the right to one peremptory challenge. In arbitration proceedings where there are multiple claimants, respondents and/or third-party respondents, the claimants shall have one peremptory challenge, the respondents shall have one peremptory challenge and the third-party respondents shall have one peremptory challenge, unless the Director of Arbitration determines that

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[5] Section 8(c) of rule G-35, on the Composition and Appointment of Arbitration Panels, grants each party the right to one peremptory challenge of a member of the arbitration panel. This allows a party to demand that an arbitrator be removed without being required to explain or justify such removal to the Director of Arbitration. Parties also are given unlimited challenges for cause. In such instances, the party explains to the Director of Arbitration its concern about the ability of an arbitrator to determine the case fairly based, for example, on the background of the arbitrator. The Director of Arbitration then would decide whether such concerns are justified and thus whether to allow the challenge for cause and replace the arbitrator. In the case of a retired industry member, if a customer challenged such arbitrator for cause, under Section 8(c), the Director of Arbitration would be required to allow such challenge and to replace the arbitrator.

[6] Currently, spouses and members of the households of industry members may be included in the public arbitrator pool as long as the connection to industry members is disclosed. The proposed amendments exclude any such person.

While the public arbitrator pool is being replenished, the Board will permit persons currently serving as public arbitrators, who would not qualify as public arbitrators under the new criteria, to continue to serve for up to three years as long as the arbitrators' affiliations are disclosed to the parties and are grounds for challenges for cause by customers. This three-year sunset period for such current public arbitrators is included in the Board's Arbitration Policies and Interpretations.

* Underlining indicates new language; strikethrough indicates deletions.

the interests of justice would best be served by awarding additional peremptory challenges. Each party shall also have the right to request that the Arbitration Committee remove other members of the panel which the Arbitration Committee shall be empowered to do in its sole discretion. Unless extended by the Director of Arbitration, a party wishing to exercise a peremptory challenge or to request that the Arbitration Committee remove members of the panel must do so by notifying the Director of Arbitration in writing within five business days of notification of the identity of the persons named to the panel. There shall be unlimited challenges for cause.

(ii) Each party who is a person other than a broker, dealer, municipal securities dealer, government securities broker or government securities dealer, shall be granted a challenge for cause to a public arbitrator, as defined in Section 12(c), who: (i) has been retired from a broker, dealer, municipal securities dealer, government securities broker or government securities dealer for over three years, or (ii) is an attorney, accountant or other professional who devoted 30 percent or more of his professional work effort within the last two years to the municipal securities activities of clients who are brokers, dealers or municipal securities dealers.

Sections 9 through 11 No change.

Section 12. *Designation of Number of Arbitrators and Definitions of Industry and Public Arbitrators*

(a) *Controversies Involving Persons Other Than Brokers, Dealers ~~Municipal Securities Brokers~~ or Municipal Securities Dealers*

~~(1)~~ Except as otherwise provided in this Arbitration Code, in all arbitration matters in which a person other than a ~~municipal securities~~ broker, dealer or municipal securities dealer is involved and where the matter in controversy ~~does not~~ exceeds the amount of ~~$500,000~~ $10,000, or where the matter in controversy does not involve or disclose a money claim or the amount of damages cannot be readily ascertained at the time of commencement of the proceeding, the Director of Arbitration shall appoint an arbitration panel which shall consist of no less than three nor more than five arbitrators, at least a majority of whom shall ~~not be associated with a broker, dealer or municipal securities dealer~~ be public arbitrators as defined in paragraph (c), below, unless such person requests a panel consisting of a majority of industry arbitrators ~~associated with a broker, dealer or municipal securities dealer~~ as defined in paragraph (c), below.

~~(2) In all arbitration matters in which a person other than a municipal securities broker or municipal securities dealer is involved, and where the amount in controversy exceeds $500,000, the Director of Arbitration shall appoint an arbitration panel which shall consist of five arbitrators, unless the parties agree in writing to a panel of three arbitrators, at least three of whom shall not be associated with any broker, dealer or municipal securities dealer unless such person requests a panel consisting of a majority of arbitrators associated with a broker, dealer or municipal securities dealer.~~

(b) *Intra-Industry Controversies*

Except as otherwise provided in this Arbitration Code, in all arbitration matters between or among ~~municipal securities~~ brokers, dealers, and municipal securities dealers, or persons associated with ~~municipal securities~~ brokers, dealers, and municipal securities dealers, a panel shall consist of no less than three nor more than five industry arbitrators, as defined in paragraph (c), below, as determined by the Director of Arbitration~~, all of which shall be associated with a broker, dealer, or municipal securities dealer~~.

(c) *Definitions of Industry and Public Arbitrators*

(1) An industry arbitrator:

(i) is a person associated with a broker, dealer, municipal securities dealer, government securities broker or government securities dealer, or

(ii) is a person who has been associated with a broker, dealer, municipal securities dealer, government securities broker or government securities dealer within the past three years, or

(iii) is an attorney who devoted 20 percent of more of his professional work effort within the last two years in either or both of the following areas: (A) as counsel to a broker, dealer or municipal securities dealer acting as the underwriter of an issue of municipal securities, or (B) as counsel to a broker, dealer, municipal securities dealer, government securities broker or government securities dealer in securities-related litigation or arbitration proceedings against a person other than a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer.

(2) A public arbitrator is a person other than an industry arbitrator.

(3) A person will not be classified either as a public or industry arbitrator if he or she has a spouse or other member of the household who is a person associated with a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer.

Section 13. *Required Disclosure by Arbitrators*

(a) Each arbitrator shall be required to disclose to the Director of Arbitration any circumstances which might preclude such arbitrator from rendering an objective and impartial determination upon any matter submitted to arbitration. Each arbitrator shall disclose:

(1) Any direct or indirect financial or personal interest in the outcome of the arbitration;

(2) Any existing or past financial, business, professional, family or social relationships which are likely to affect impartiality or which might reasonably create an appearance of partiality or bias. Persons requested to serve as arbitrators should disclose any such relationships which they personally have with any party or its counsel, or with any individual whom they have been told will be a witness. They also should disclose any such relationship involving members of their families or their current employers, partners or business associates.

(b) Persons who are requested to accept appointment as arbitrators should make a reasonable effort to inform themselves of any interests or relationships described in Paragraph (a) above.

(c) The obligation to disclose interests or relationships described in Paragraph (a) above is a continuing duty which requires a person who accepts appointment as an arbitrator to disclose, at any stage of the arbitration, any such interests or relationships which arise, or which are recalled or discovered.

(d) Prior to the commencement of the first hearing session, the Director of Arbitration may remove an arbitrator who dis-

closes such information. The Director of Arbitration also shall inform the parties of any information disclosed pursuant to this section if the arbitrator who disclosed the information is not removed.

Section 14. *Disqualification or Other Disability of Arbitrators*

(a) In the event that any arbitrator, after appointment and prior to the first hearing session, should become disqualified, resign, die, refuse or be unable to perform or discharge his duties, the Director of Arbitration shall appoint a new member to the panel to replace such arbitrator.

(b) In the event that any arbitrator, after the commencement of the first hearing session but prior to the rendition of an award should become disqualified, resign, die, refuse or be unable to perform or discharge his duties as an arbitrator, ~~the Director of Arbitration, upon such proof as the Director of Arbitration deems satisfactory shall, where permitted by law, either (a) appoint a new member to the panel to replace such arbitrator, obtaining the consent of the parties if necessary under applicable law, or (b) with the consent or waiver of the parties, direct that the arbitration proceed without the substitution of a new arbitrator.~~ the remaining arbitrator(s) may continue with the hearing and determination of the controversy, unless such continuation is objected to by any party within five days of notification of such disqualification. Upon objection, the Director of Arbitration shall appoint a new member to the panel to fill any vacancy.

(c) If a replacement arbitrator is named, the Director of Arbitration shall inform the parties as soon as possible of the name and employment history for the past ten years of the replacement arbitrator, as well as information disclosed pursuant to section 13. A party may make further inquiry of the Director of Arbitration concerning the replacement arbitrator's background and, within the time remaining prior to the next hearing session or the five business day period provided by Section 8, whichever is shorter, may exercise its right to challenge the replacement arbitrator as provided in Section 8.

Sections 15 through 21 No change.

Section 22. *Discovery*

(a) *Requests for Documents and Information*

The parties shall cooperate to the fullest extent practicable in the voluntary exchange of information to expedite the arbitration. Any request for documents or other information should be specific, relate to the matter in controversy, and afford the party to whom the request is made a reasonable period of time to respond without interfering with the time set for the hearing.

(b) *Document Production and Information Exchange*

(1) Any party may serve a written request for information or documents ("information request") upon another party twenty (20) business days or more after service of the Statement of Claim by the Director of Arbitration or upon service of the Answer by the Director of Arbitration, whichever is earlier. The requesting party shall serve the written information request on all parties and file a copy with the Director of Arbitration. The parties shall endeavor to resolve disputes regarding an information request prior to serving any objection to the request. Such efforts shall be set forth in the objection .

(2) Any objection to an information request, in part or in whole, shall be served in writing by the objecting party on all parties and filed with the Director of Arbitration within fifteen (15) calendar days from the date of service. Any response to objections to an information request shall be served on all parties and filed with the Director of Arbitration within ten (10) calendar days of receipt of the objection.

(3) Unless an objection is filed or a greater time is allowed by the requesting party, information requests shall be satisfied within thirty (30) calendar days from the date of service.

(4) Upon the written request of a party whose information request is unsatisfied, the matter may be referred by the Director of Arbitration, with the consent of a majority of the arbitration panel, to a selected arbitrator under paragraph (d) of this section.

(c) *Pre-hearing Exchange*

At least ten (10) calendar days prior to the first scheduled hearing date, all parties shall serve on each other copies of documents in their possession and shall identify witnesses they intend to present at the hearing. The arbitrators may exclude from the arbitration any documents not exchanged or witnesses not identified. This paragraph does not require service of copies of documents or identification of witness which parties may use for cross-examination or rebuttal.

(d) *Prehearing Conferences*

Upon the request of an arbitrator or at the discretion of the Director of Arbitration, a prehearing conference shall be scheduled. The Director of Arbitration shall set the time and place of a prehearing conference and appoint a person to preside. The prehearing conference may be held by telephone conference call. The presiding person shall seek to achieve agreement among the parties on any issue which relates to the prehearing process or to the hearing, including but not limited to exchange of information, exchange or production of documents, identification of witnesses, identification and exchange of hearing documents, stipulation of facts, identification and briefing of contested issues, and any other matters which will expedite the arbitration proceedings. Any issues raised at the prehearing conference that are not resolved may be referred to a single member of the arbitration panel by the Director of Arbitration for decision as described in subsection (e).

(e) *Decisions by Selected Arbitrator*

With the consent of a majority of the panel of arbitrators, the Director of Arbitration may appoint a single member of the Arbitration Panel to decide all unresolved issues referred to under this section and Section 23. Such arbitrator shall be authorized to act on behalf of the panel to issue subpoenas, direct appearances of witnesses and production of documents, set deadlines for compliance, and issue any other decision which will expedite the arbitration proceedings. Decisions under this paragraph shall be made upon the papers submitted by the parties, unless the arbitrator calls a hearing. The arbitrator may elect to refer any issue under this paragraph to the full panel.

Section 22 Renumbered Section 23(b).

Section 23. *Subpoena Process and Power to Direct Appearances*

(a) The arbitrators and any counsel of record to a proceeding shall have the power of subpoena process as is now or may hereafter be provided by law. All parties shall be given a copy of the subpoena upon its issuance. ~~However,~~ The parties shall produce witnesses and documents to the fullest extent possible

without resort to the issuance of subpoena process.

~~(b) Prior to the first hearing session, the parties shall cooperate in the voluntary exchange of such documents and information as will serve to expedite the arbitration. If the parties agree, they may also submit additional documents to the Director of Arbitration for forwarding to the arbitrators.~~

(b) The arbitrators shall be empowered, without resort to subpoena process, to direct the appearance of any person employed by or associated with a ~~municipal securities~~ broker, dealer or municipal securities dealer and the production of any records in the possession or control of such person or any ~~municipal securities~~ broker, dealer or municipal securities dealer. Unless the arbitrators direct otherwise, the party requesting the appearance of a person or the production of documents under this section shall bear all reasonable costs incurred in connection with the appearance of such person or the production of documents.

Sections 24 through 26 No change.

Section 27. *Record of Proceedings*

~~Unless requested by the arbitrators or a party or parties to a dispute, no record of an arbitration proceeding shall be kept. If a record is kept, it shall be a verbatim record.~~ A verbatim record by stenographic reporter or tape recording of all arbitration hearings shall be kept. If a party or parties to a dispute elect to have the record transcribed, the cost of such transcription shall be borne by the party or parties making the request unless the arbitrators direct otherwise. The arbitrators may also direct that the record be transcribed.

Sections 28 through 30 No change.

Section 31. *Awards*

(a) through (d) No change.

(e) The award shall contain: (1) the names of the parties; (2) a summary by the arbitrators of the issues in controversy, the damages and/or other relief requested, the damages and/or other relief awarded, and a statement of any other issues resolved; and (3) the names of the arbitrators and the signatures of those arbitrators concurring in the award.

(f) Awards shall be made publicly available in accordance with the policies of the Board.

Sections 32 and 33 No change.

Section 34. *Simplified Arbitration for Small Claims Relating to Transactions with Customers*

(a) Any claim, dispute or controversy, arising between a customer and a ~~municipal securities~~ broker, dealer or municipal securities dealer, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding ~~$5,000~~ $10,000 (exclusive of attendant costs and interest), shall upon demand of the customer or by written consent of the parties be arbitrated as hereinafter provided.

(b) No change.

(c) The claimant shall pay the sum of $15 if the amount in controversy is $1,000 or less, $25 if the amount is more than $1,000 but $2,500 or less, ~~or~~ $100 if the amount in controversy is more than $2,500 but does not exceed $5,000, or $200 if the amount in controversy is more than $5000 but does not exceed $10,000 upon filing of the Submission Agreement. The final disposition of this sum shall be determined by the arbitrator.

(d) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent one copy of the Submission Agreement and Statement of Claim. The respondent shall within 20 calendar days from receipt of service file with the Director of Arbitration one executed copy of the Submission Agreement and one copy of an answer, together with supporting documents. The answer shall designate all available defenses to the claim and may set forth any related counterclaim and/or related third-party claim the respondent may have against the claimant or any other person. The term "related counterclaim" for the purposes of this provision means a counterclaim related to a customer's account or accounts with a ~~municipal securities~~ broker, dealer or municipal securities dealer. If the respondent has interposed a third-party claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of the third-party claim together with a copy of the Submission Agreement on such third party who shall respond in the manner herein provided for response to the claim. If the respondent files a related counterclaim exceeding ~~$5,000~~ $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of arbitrators, the size and composition of which shall be determined in accordance with section 12 hereof, or, he may dismiss the counterclaim and/or third-party claim without prejudice to the counterclaimant and/or third-party claimant pursuing the counterclaim or third-party claim in a separate proceeding.

(e) through (l) No change.

Section 35. *Simplified Arbitration for Small Claims Relating to Intra-Industry Transactions.*

(a) Any claim, dispute or controversy between or among ~~municipal securities~~ brokers, dealers and municipal securities dealers which involves a dollar amount not exceeding ~~$5,000~~ $10,000 (exclusive of attendant costs and interest), shall be arbitrated as hereinafter provided.

(b) and (c) No change.

(d) If the respondent or respondents interpose a third-party claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of the third-party claim, together with a copy of the Submission Agreement, on such third party who shall respond in the manner provided for response to the statement of claim. If the respondent or respondents file a related counterclaim exceeding ~~$5,000~~ $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of arbitrators, the size and composition of which shall be determined in accordance with section 12 hereof, or, he may dismiss the counterclaim or third-party claim without prejudice to the counterclaimant or third-party claimant in a separate proceeding.

(e) through (j) No change.

Section 36. *Predispute Arbitration Agreements with Customers*

(1) Any predispute arbitration clause shall be highlighted and shall be immediately preceded by the following disclosure language which shall also be highlighted:

(a) Arbitration is final and binding on the parties.

(b) The parties are waiving their right to seek remedies in court, including the right to a jury trial.

(c) Pre-arbitration discovery is generally more limited than and different from court proceedings.

(d) The arbitrators' award is not required to include factual

findings or legal reasoning and any party's right to appeal or to seek modification of rulings by the arbitrators is strictly limited.

(e) The panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry.

(2) Immediately preceding the signature line, there shall be a statement that the agreement contains a predispute arbitration clause.

(3) A copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(4) No agreement shall include any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award.

(5) The requirements of this section shall apply only to new agreements signed by an existing or new customer of a dealer after [insert delayed effective date].

Rule A-16. Arbitration Fees and Deposits

(1) through (3) No change.

(4) Any matter submitted and thereafter settled or withdrawn prior to the commencement of the first session shall entitle the parties to a refund of all but ~~$25~~ $50 of the amount deposited. This section shall not apply to claims filed under Section 34 of Rule G-35, the Arbitration Code.

(5) and (6) No change.

* * *

Arbitration Policies and Interpretations

(a) *Extensions of Time for Filing Pleadings*

Pursuant to Rule G-35, Section 5(e), "[t]he time period to file a pleading, . . . may be extended for such further periods as may be granted by the Director of Arbitration." Extensions of time for filing pleadings may be granted only upon receipt of written, specific and compelling reasons.

(b) *Designation of Situs for the Hearing*

Pursuant to Rule G-35, Section 16, the Director of Arbitration shall determine the place for the initial hearing. Once all pleadings to a dispute have been submitted, the Director of Arbitration may give the parties an opportunity to request, in writing, the city or cities each believes is the appropriate location for the hearing and the reasons for this request. Such requests must be filed with the Director of Arbitration no later than 10 business days from receipt of the correspondence permitting them. Written requests may not be elicited if all the parties are located in or near the same major city.

In arbitrations involving public customers, it is the Board's policy, other than in exceptional circumstances, to hold the hearings in the major city, in which the Board has arbitrators, nearest to the public customer.

(c) *Proper Subject Matter for Arbitration*

Pursuant to Rule G-35, Section 7, the Arbitration Committee has determined that employer-employee disputes and antitrust claims are not proper subject matters for the Board's arbitration program.

(d) *Subpoena Process*

Pursuant to Rule G-35, Section 23(a), "[t]he arbitrators . . . shall have the power of subpoena as is . . . provided by law." If a party requests that the arbitrator(s) subpoena documents or witnesses, it is the responsibility of the party requesting such a subpoena to provide a draft subpoena, in the appropriate form, with its request. Such request must clearly explain the materiality of the information. Under Section 22 (renumbered Section 23(b) in this filing), the costs of production shall be borne by the party requesting the information. It is within the discretion of the arbitrator(s) whether or not to grant all or part of a subpoena request.

(e) *Arbitrator Honoraria*

The Board pays each arbitrator $100 per hearing session as an honorarium. A hearing session, for purposes of the honorarium, is defined as any part of or a whole day. An arbitrator who decides a case solely on the pleadings also receives a $100 honorarium.

(f) *Consolidation*

Pursuant to Rule G-35, Section 5(f)(2), the Director of Arbitration is authorized to determine preliminarily whether or not to consolidate two or more disputes for hearing and award purposes. Pursuant to Section 5(f)(3), all final determinations regarding consolidation, however, are to be made by the arbitration panel.

In instances in which an arbitration panel is requested to make a determination regarding consolidation, a panel will be designated to decide, based solely on the pleadings and requests, whether the disputes should be consolidated. If the arbitration panel decides the disputes should be consolidated, the consolidated hearing will be scheduled before that arbitration panel. If the arbitration panel decides the disputes should not be consolidated, that arbitration panel will be dissolved and new arbitration panels will be designated to decide the disputes separately.

(g) *Objections to Pleadings*

Pursuant to Rule G-35, Section 5(b)(2)(iii), a respondent who fails to file an answer within the prescribed length of time may be barred by the arbitrators from making a presentation at the hearing. If a claimant files a written objection to an answer because it is filed late, the pleadings, objection and any response to the objection will be forwarded to the arbitrators, without a copy of the late-filed answer, for the arbitrators' determination whether or not to permit the answer into the record. If the arbitrators determine that the answer should be permitted, a copy of the answer will be forwarded to them by the Director of Arbitration.

In addition, if a party files a written objection to any document filed by another party, the pleadings, objection and response will be forwarded to the arbitrators, without a copy of the document being objected to, for the arbitrators' determination whether or not to permit such document into the record.

(h) *Requests for Attorneys' Fees and Punitive Damages*

If a party requests that the arbitrators award it attorneys' fees, it must file a memorandum showing that such an award is permissible pursuant to applicable law, explaining the reasons why the party believes it is entitled to such an award and

itemizing the attorneys' fees incurred. The other parties to the dispute may file responses to such a memorandum.

If a party requests that the arbitrators award it punitive damages, it must file a memorandum showing that such an award is permissible pursuant to applicable law and explaining the reasons why the party believes it is entitled to such an award. The other parties to the dispute may file responses to such a memorandum. An arbitrator may ask the parties to brief this issue for its consideration, even if not requested by the parties.

The arbitrators will expressly grant or deny such requests in their awards.

(i) *Publication of Awards*

Pursuant to rule G-35, Section 31(f), awards shall be made available for public inspection at the Board's offices except for: (1) the names of parties who are public customers unless the customer agrees to the disclosure of his identity; and (2) the names of the arbitrators. If a party wishes to review prior awards rendered by the arbitrators assigned to the party's current case, such awards will be made available to that party.

(j) *Sunset for Certain Public Arbitrators*

Until [date three years from approval of rule change], the Director of Arbitration shall grant each party who is a public customer a challenge for cause to a public arbitrator who served as a public arbitrator prior to [date of approval of rule change] but would not be able to serve as a public arbitrator pursuant to the definitions of industry and public arbitrators in Section 12(c) of rule G-35.

MSRB REPORTS

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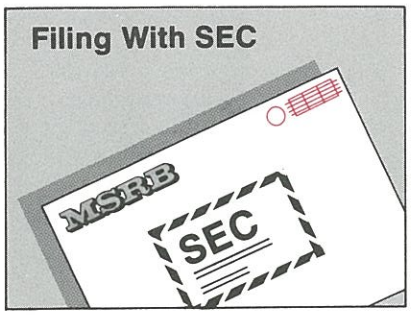

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Suitability Recordkeeping for Institutional Accounts: Rule G-8

Amendment Filed

The technical amendment would require dealers to maintain records of suitability information for institutional accounts.

On November 9, 1988, the Board filed with the Securities and Exchange Commission a technical amendment to rule G-8(a)(xi), on recordkeeping of customer account information, that requires the recordkeeping of suitability information for institutional accounts. The amendment will not become effective until approved by the Commission. Persons wishing to comment on the amendment should comment directly to the Commission.[1]

Rule G-19(b) provides that, before making a recommendation to a customer, a securities professional must determine that the securities are a suitable investment for that customer. The rule specifies that a suitability determination shall be based upon, among other things, information furnished by the customer relating to its "financial background, tax status and investment objectives and any other similar information." In 1987, the Board adopted and the SEC approved an amendment to rule G-8(a)(xi) to require the recordkeeping of suitability information for customer accounts required to be obtained by rule G-19. The Board noted that the amendment would provide additional protection by facilitating a dealer's discharge of its suitability responsibilities and would assist municipal securities principals and regulatory examiners in reviewing transactions for compliance with rule G-19.

Because of a cross-referencing problem in the rule, rule G-8(a) currently does not require dealers to keep suitability records for institutional accounts,[2] yet dealers are required to comply with rule G-19 when making recommendations to institutional customers. The amendment to rule G-8(a)(xi) will correct this cross-referencing problem and require the recordkeeping of suitability information for institutional accounts.

November 9, 1988

Text of Proposed Amendment*

Rule G-8. Books and Records to be Made by Municipal Securities Brokers and Municipal Securities Dealers

(a) No change.

(i) through (x) No change.

(xi) *Customer Account Information.* A record for each customer, other than an institutional account, setting forth the following information to the extent applicable to such customer:

(A) through (K) No change.

For purposes of this subparagraph, the terms "general securities representative" and "general securities principal" shall mean such persons as so defined by the rules of a national securities exchange or registered securities association. For purposes of this subparagraph, the term "institutional account" shall mean the account of an investment company as defined in section 3(a) of the Investment Company Act of 1940, a bank, an insurance company, or any other institutional type account. Anything in this subparagraph to the contrary notwithstanding, every municipal securities broker and municipal securities dealer shall maintain a record of the information required by items (A), (C), (F), (H), (I) and (K) of this subparagraph with respect to each customer which is an institutional account.

(xii) through (xiv) No change.

(b) through (g) No change.

Questions about the amendment may be directed to Ronald W. Smith, Legal Assistant.

[1] SEC File No. SR-MSRB-88-4. Comments filed with the Commission should refer to the file number.

[2] Rule G-8(a)(xi) states that "institutional account" means "the account of an investment company as defined in section 3(a) of the Investment Company Act of 1940, a bank, an insurance company, or any other institutional type account."

* Underlining indicates new language.

Publications List

Manuals and Rule Texts

MSRB Manual
Soft-cover edition containing the text of MSRB rules, interpretive notices and letters, samples of forms, texts of the Securities Exchange Act of 1934 and of the Securities Investor Protection Act of 1970, as amended, and other applicable rules and regulations affecting the industry. Reprinted semi-annually.
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Glossary of Municipal Securities Terms
Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.
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Professional Qualification Handbook
A guide to the requirements for qualification as a municipal securities representative, principal, sales principal and financial and operations principal, with questions and answers on each category. Includes sections on examination procedures, waivers, disqualification and lapse of qualification, the text of MSRB qualification rules and a glossary of terms.
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Arbitration Information and Rules
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