

MEMO# 13483

May 7, 2001

MSRB INTERPRETIVE GUIDANCE ON APPLICATION OF CERTAIN RULES TO ELECTRONIC PRIMARY OFFERINGS AND TRADING SYSTEMS AND ELECTRONIC RECORDKEEPING

[13483] May 7, 2001 TO: FIXED-INCOME ADVISORY COMMITTEE No. 6-01 RE: MSRB INTERPRETIVE GUIDANCE ON APPLICATION OF CERTAIN RULES TO ELECTRONIC PRIMARY OFFERINGS AND TRADING SYSTEMS AND ELECTRONIC RECORDKEEPING The Municipal Securities Rulemaking Board ("MSRB") has filed with the Securities and Exchange Commission a proposed rule change consisting of interpretations on the application of various MSRB rules to (1) electronic primary offerings through auction procedures, (2) specific electronic trading systems, and (3) electronic recordkeeping.¹ The Notice addresses some, but not all, of the issues raised in the MSRB's request for comment, issued last September, on its draft interpretive guidance on dealer responsibilities in connection with electronic and traditional municipal securities transactions.² According to the attached Notice, the proposed rule changes are effective immediately. I. Application of MSRB Rules to New Issues Offerings Through Auction Procedures The Notice provides interpretive guidance on the application of MSRB Rules G-32 and G-36 to electronic securities offerings. Specifically, the Notice discusses how the role of brokers, dealers, and municipal securities dealers (collectively "dealers") in the primary market has changed in recent years given the increasing use by issuers of an electronic "auction" process for securities offerings, which permits the taking of bids from both dealers and investors directly. The Notice explains that this process has enabled issuers to engage dealers to serve as "dealer-intermediaries," such as auction agent, settlement agent, or some other intermediary role, to effectuate the transfer of the securities from the issuer to the winning bidders and for certain other purposes connected with the auction process. The Notice clarifies that such dealer-intermediaries have the same responsibilities relating to distribution of official 1 Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the MSRB Providing Guidance on Specific Electronic Primary Offering and Trading Systems and Electronic Recordkeeping, dated April 16, 2001 ("Notice") 2 See Memorandum to Fixed Income Advisory Committee No. 9-00, dated October 24, 2000. As you may recall, the MSRB's draft guidance contained the controversial sophisticated market professional proposal. That proposal, and certain other aspects of the draft guidance, including the MSRB's views on compliance issues arising under MSRB Rule G-13 (quotation) and Rules G-17, G-18, and G-19 (fair practice), are not included in the current proposal, but will be addressed in a subsequent release that is expected to be issued in the near future. 2statements and other

documents as do dealers selling new issue municipal securities under Rule G-32 and, in some circumstances, as underwriters under Rules G-32 and G-36. II. Application of MSRB Rules to Specific Electronic Trading Systems The Notice provides interpretive guidance on the application of MSRB Rules G-8, G-12, and G-14 to transactions effected on a proposed electronic trading system, such as one with features that, among other things, (1) limit trading to dealers, (2) create purchase and sale contracts, (3) impose rules governing contract formation and the bid/offer process, (4) allow transaction clearing without system operator involvement, and (5) require dealers trading on the system to clear and settle transactions directly with each other. The Notice clarifies that under this type of system, the dealer operating the system is effecting agency transactions for dealer clients; the system operator has no role in clearing the transaction and takes no principal positions in the securities being traded. The Notice points out, however, that because the system operator is participating in the transactions at key points of contract formation, such as by providing anonymity to buyers and sellers and setting system rules, all MSRB rules generally applicable to inter-dealer transactions would apply, except to the extent that such rules explicitly, or by context, are limited to principal transactions. The Notice also discusses inter-dealer transaction reporting obligations under MSRB Rule G-14, and clarifies that in an electronic trading system where the dealer operating the system is not involved in clearing and settling the transaction (i.e., where the buyer and seller clear and settle transactions directly as principals with each other and report any such transactions directly to the National Securities Clearing Corporation), then it would not be necessary for the system operator separately to report the transactions to the MSRB. III. Application of MSRB Rules to Electronic Recordkeeping The Notice provides interpretive guidance on the application of MSRB Rules G-8 (books and records) and G-9 (preservation of records) to electronic recordkeeping. Specifically, the Notice confirms that the use of electronic records to create and maintain required books and records is permitted, provided any such recordkeeping method reflects clear and accurate information, provides an adequate audit trail, and facilitates ready retrieval, inspection, and production of the record maintained.

Barry E. Simmons Associate Counsel Attachment Attachment (in .pdf format)