

MSRB REPORTS

Volume 8, Number 1

Municipal Securities Rulemaking Board

January 1988

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Recommendations for Board Nominations Requested

The process has begun for selecting five new Board members to serve three-year terms beginning October 1, 1988. Two bank dealer, one public and two securities firm 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 those currently serving on the Board are published on pages 3 through 5 of this issue.

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Calendar

March 1	— Recommendations due for Board nominations
Pending	— G-12 and G-15 on delivery of interchangeable securities
	— G-32 on sole underwriting period
	— A-3 on nomination and election of new Board members



Route to:

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

Recommendations Requested for Board Nominations

The 1988 Nominating Committee requests recommendations of persons to be considered for five Board positions opening on October 1, 1988.

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:

- One public representative, two securities representatives 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, 1988** to:

W.J. Turner L. Cobden
 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, 1988

W.J. Turner L. Cobden, Senior Vice President and Manager
Smith Barney, Harris Upham & Company, Inc.
New York, New York

Terrence E. Comerford, Managing Director
PaineWebber Inc.
San Francisco, California

James B.G. Hearty, Managing Director
Bank of Boston
Boston, Massachusetts

G. Timothy Lane, Executive Vice President
Barnett Banks, Inc.
Jacksonville, Florida

Thomas H. Locker, Comptroller
Orange County
Orlando, Florida

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
Bankers Trust Company
New York, New York

David J. Master, Executive Vice President
Boettcher & Company, Inc.
Houston, Texas and Denver, Colorado

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

Recommendation Form

1. Individual Recommended: _____

Business Address: _____

Home Address: _____

Telephone Number: _____

Telephone Number: _____

Category: Bank 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: _____



Route to:

- Manager, Muni Dept.
- Underwriting
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- Public Finance
- Compliance
- Training
- Other _____

Letter to SEC on Information in the Municipal Securities Markets

December 17, 1987

Honorable David S. Ruder
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Adequacy of Information in the Municipal Securities Markets

Dear Chairman Ruder:

The Municipal Securities Rulemaking Board (Board) is the self-regulatory organization charged with primary rulemaking authority with respect to all brokers, dealers and municipal securities dealers (dealers) effecting transactions in municipal securities. Over the past several years the Board has been scrutinizing the adequacy of information in the municipal securities market. The Board has concluded that dealers and investors do not have adequate access to information about municipal securities and their issuers. As discussed below, municipal securities have grown more complex and information problems have engendered pricing, trading and processing inefficiencies in the municipal securities market which must be corrected. The Board is seeking the Commission's cooperation in obtaining improvements in the flow of information to the municipal securities marketplace. The Board also believes it is

necessary and appropriate to seek the thoughtful cooperation of all market participants and relevant enforcement organizations in this endeavor.

The Board's Authority Over Information About Municipal Securities

The Board was established under the Securities Acts Amendments of 1975 which added section 15B to the comprehensive scheme of federal regulation of the securities markets set forth in the Securities Exchange Act (Act).¹ The Board is composed of 15 members—five individuals representing securities firms, five individuals representing dealer banks and five individuals representing the public. At least one public member must represent issuers and one must represent investors.² The Board is vested with broad rulemaking authority applicable to all transactions in municipal securities effected by brokers, dealers and municipal securities dealers.³

Since its inception, the Board, through the adoption of its fair practice rules, has sought to ensure that municipal securities investors are apprised of all information material to their investment decisions.⁴ In particular, rule G-17 of the Board's rules of fair practice requires dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest or unfair practice. The Board has interpreted this rule to require a dealer to disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and prohibits a dealer from omitting any material facts which would render other statements misleading. In addition, rule G-19, on suitability, prohibits a municipal securities professional from recommending a transaction in municipal securities to a customer unless the professional has reasonable grounds for making the recommendation in light of information about the security

¹ Prior to adoption of the 1975 legislation, municipal securities were exempt from the federal securities laws except for the *post hoc* application of the antifraud provisions of those laws. Section 15B requires all municipal securities dealers, including dealer banks and securities firms dealing solely in municipal securities, which had not previously been regulated, to register with the Commission and subjects certain of these entities to financial responsibility and reporting requirements.

² Board members serve staggered three-year terms.

³ The areas of rulemaking specified in section 15B(b)(2) are: professional qualification; prohibition of fraud and unfair practices; form and content of quotations; arbitration; scope and frequency of compliance inspections; recordkeeping; defining separately identifiable department of a bank; fees; selection of Board members; foster coordination among persons engaged in clearance and settlement, and facilitate a free and open market. Pursuant to section 19(b) of the Act, the Board has adopted rules in all of these areas.

⁴ It is important to note that the Board has authority only to write rules. It has no inspection or enforcement authority. 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.

available from the issuer or otherwise and believes that the transaction is suitable for the particular customer. With regard to confirmation disclosure, rule G-15(a) requires that a dealer provide a customer with a confirmation evidencing their municipal securities transaction which includes a standard (legal) securities description as well as certain other important items of information about the securities, such as whether the securities are prerefunded, issued at an original issue discount, taxable or subject to the alternative minimum tax.⁵ These requirements apply to all municipal securities transactions in the primary and secondary markets.⁶

Board Authority to Require Dissemination of Issuer Disclosure Documents

One of the Board's most important fair practice rules is rule G-32 on disclosures in connection with new issues. The rule requires a dealer selling new issue municipal securities to a customer to deliver by settlement of the transaction a copy of the final official statement, if one is prepared by or on behalf of the issuer.⁷ The offering statement is the sole official source of information about a municipal security. While other summary sources of information are available about municipal securities,⁸ the official statement is the only document that contains a complete description of the securities, which rarely changes over the life of the issue,⁹ as well as a "snapshot in time" of the issuer and its credit.¹⁰

As noted above, rule G-32 applies only if an issuer voluntarily prepares an official statement.¹¹ This reflects the fact that municipal securities issuers are not regulated, except under the antifraud provisions of the federal securities laws. Unlike the corporate securities market in which issuers generally are prohibited from selling new issue securities except by a prospectus, section 15B(d) of the Act, the "Tower Amendment," expressly prohibits the Board from requiring issuers to prepare offering material or to distribute such documents to dealers or

purchasers of their securities. Section 15B(d) has two broad prohibitions against issuer regulation. Paragraph (1) provides:

Neither the Commission nor the Board is authorized under this title, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.

This paragraph expressly protects issuers from being required, directly or indirectly through the underwriters, to file disclosure documents with the Board or the Commission as a condition of bringing an issue to market.

Paragraph (2) provides:

The Board is not authorized under this title to require any issuer of municipal securities, directly or indirectly through a municipal securities broker or municipal securities dealer or otherwise, to furnish to the Board or to a purchaser or prospective purchaser of such securities any application, report, document, or information with respect to such issuer: *provided, however*, that the Board may require municipal securities brokers and municipal securities dealers to furnish to the Board or purchasers or prospective purchasers of municipal securities applications, reports, documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer. Nothing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this title.

This paragraph prohibits the Board, but not the Commission, from requiring an issuer to provide any information to it or to a purchaser of the issuer's securities. The Board expressly is permitted to require dealers to provide information about the issuer that generally is available from a source other than the

⁵ It should be stressed that since the confirmation is received by a customer after the investment decision is made and the transaction occurs, its delivery does not excuse a dealer from the obligation to disclose material information about a security to a customer prior to executing the transaction. Rule G-12(c) specifies similar confirmation requirements for inter-dealer transactions.

⁶ The Board also has discussed the potential for creating new automated systems to provide current market information on municipal securities. In March 1985, the Board published a notice reviewing the history of automated systems for the dissemination of quotations and trade reporting on municipal securities and soliciting industry comment on the development and use of such systems. In January 1986, the Board published a summary of the comments received. The commentators generally expressed interest in these issues and in hearing the views of other industry members, but questioned whether such systems could be utilized in the municipal securities market. The Board continues to be hopeful that such systems can be devised for municipal securities in the near future. *MSRB Reports*, vol. 6, no. 1, pp. 21-22 (January 1986).

⁷ If no official statement is prepared, a dealer must provide a written statement to that effect. In a negotiated sale of new issue securities, a dealer also must deliver certain written information about the underwriting arrangements.

⁸ Information services include electronic data bases containing descriptive information, underwriting and initial market information and underwriting information databases. These sources may not contain complete descriptive information and/or may not be available until the security is trading in the secondary market.

⁹ A major exception is when an issue has been advance refunded. In such an instance the official statement will indicate that the issuer has reserved the right to advance refund and one must refer to the refunding and escrow documents for a complete description of the terms and conditions of the refunding.

¹⁰ This "issuer" information quickly may become outdated. However, issuers of all rated issues must prepare annual financial statements as a condition of maintaining a rating by the major rating agencies.

¹¹ As the municipal securities market has grown, market participants have required the preparation of official statements. Today, the Board understands that most issues of municipal securities over \$1 million par value are accompanied by official statements, the contents of which generally comport with the Government Finance Officers Association's (GFOA) *Disclosure Guidelines for State and Local Government Securities*. The GFOA recently adopted revisions to its suggested guidelines for issuers which, if followed, would improve the content of official statements. The *Guidelines* also recommend that issuers make official statements available over the life of the issue. In commenting on the proposed revisions, the Board noted its concern with the voluntary nature of the *Guidelines*.

issuer.

As a result of the Tower Amendment, rule G-32 is carefully drawn to require a dealer selling new issue municipal securities to a customer to deliver by settlement of the transaction a copy of the final official statement only if one is prepared by or on behalf of the issuer.

Need for Improving Information in the Municipal Securities Market

Since 1975, when the Board was created, the municipal securities market has changed dramatically. In 1975 the volume of municipal securities was \$29.3 billion par value; municipal securities were relatively simple instruments, only a few standard call features existed and defaults were rare. Since then the volume of municipal securities has grown to a high of \$222.2 billion par value in 1985,¹² and the variety and complexity of bonds have increased greatly. New types of municipal securities have been developed including warrants, leases, zero coupon bonds and puts, and there has been a proliferation of revenue bonds. More important, a typical issue may include a number of complex extraordinary and other call features, put options and variable and/or convertible interest rates.

The complexities of municipal securities make it essential that professionals and investors have access to complete and timely descriptive information about municipal securities and the issuers.¹³ Although the Board's disclosure requirements have kept pace with developments in municipal securities, it is concerned that the flow of information to the market has not. Notwithstanding its rule G-32, the Board is aware that official statements often are not disseminated to purchasers of new issue municipal securities and may not be available to dealers when they begin selling municipal securities. Since the Board has no inspection or enforcement authority, the Board does not have adequate information explaining why official statements are not available to customers by the time the securities are received and the transactions completed. The Board is concerned, however, that the completion, printing and delivery of official statements may be a low priority for issuers and dealers

involved in the underwriting.¹⁴ In 1984-85, the Board spent considerable effort revising rule G-32 to obtain better compliance without sacrificing the important regulatory objective of timely dissemination of official statements. Since then, the Board has publicized the revised rule and has called for better compliance and stricter enforcement.¹⁵ If these efforts do not improve the dissemination of official statements, the Board believes there may be a need for greater authority to require that official statements be available prior to the time trading begins in a new issue.

In the secondary market, dealers often do not retain official statements and may not have quick access to official statements to review complete descriptive information for issues they are trading.¹⁶ Since summary sources do not contain complete descriptive information, some dealers trade municipal securities or sell municipal securities to customers without knowledge of important features of the securities. This has resulted in pricing and trading inefficiencies and customer protection concerns. One of the most common issues raised in customer arbitrations brought under the Board's rules is whether call features adequately were disclosed to a customer at the time of trade.¹⁷

Establishment of a Mandatory Repository

The Board believes that the problems discussed above could be resolved within the current statutory framework by the creation of a mandatory repository of official statements and certain refunding documents.¹⁸ As an ideal, the Board believes that a requirement to supply these documents to the repository should be placed on issuers, since the official statement is an issuer's document and since the issuer ultimately has control over its preparation. In addition, to facilitate access to and dissemination of information contained in official statements, the documents should be provided in computer-readable (digital) form promptly after the issuer satisfies applicable state and federal regulations pertaining to the sale or award of a new issue of municipal securities.¹⁹ The repository should have the capacity to make the information available to all interested

¹² In 1986 the volume of municipal securities was \$147.3 billion par value.

¹³ For example, an investor who is not well informed about an issue may lose his expected investment return when extraordinary or other call features are exercised.

¹⁴ Perhaps this is because the preparation of such a document cannot be a precondition to the issuance of municipal securities.

¹⁵ See, e.g., *MSRB Reports*, vol. 7, no. 2, pp. 7-14 (March 1987). In March 1987, the Board sent letters to the National Association of Securities Dealers, Inc., the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation, calling for stricter enforcement of the rule. While some enforcement efforts have begun, the Board generally has not seen increased compliance with rule G-32.

¹⁶ While *The Bond Buyer* sponsors a repository of official statements, it does not include all official statements. The documents are available in microfiche form and paper copies may be requested. In addition, in its recent revision to its *Disclosure Guidelines*, the GFOA recommended that issuers make official statements available for the life of issues. These sources, however, do not allow quick access to the documents for use by dealers during the trading day.

¹⁷ In September 1986 and May 1987 the Board proposed draft amendments to rule G-15 to require dealers to deliver to customers, upon request, certain written descriptive information about securities sold in the secondary market. The Board suggested that, given the complexity of municipal securities, secondary market customers should be provided with complete written information upon request. *MSRB Reports*, vol. 6, no. 4, pp. 3-4 (September 1986); *MSRB Reports*, vol. 7, no. 3, pp. 3-5 (June 1987). The commentators generally agree that investors should have access to written descriptive information about municipal securities in the secondary market. They point out, however, that often the issuer's official statement is the only source of complete descriptive information about a security and suggest that they would have compliance problems because of the difficulty and cost of obtaining official statements in the secondary market. The Board has not taken final action on the draft amendments.

¹⁸ It does not appear feasible to obtain official statements prepared prior to the establishment of an official repository. Therefore, the benefits that will accrue will be prospective and may not improve access to information for outstanding issues of municipal securities.

¹⁹ For example, the Board understands that some jurisdictions require subsequent ratification of a sale or award by the issuing body.

Requiring that the official statement be supplied on or after the date of sale would avoid the presale filing prohibition of section 15B(d)(1) of the Act.

persons, for a fee, shortly after receipt of the information.²⁰

A mandatory repository should alleviate information problems for municipal securities participants. In the primary market, as noted above, issuers preparing official statements would be required to complete the final official statement promptly after the date of sale or award.²¹ This should result in fewer delays in printing official statements so that they can be made available to dealers to deliver to primary market customers by settlement of transactions as required by rule G-32.²² In addition, a dealer executing transactions in a new issue could access an official statement on an in-house computer screen to review descriptive information necessary to price the securities or to explain or describe the security to a customer. Although the system may permit users to generate copies of documents on in-house printers, its primary value would be its electronic access. The Board does not intend that the repository would be used by syndicate members and other dealers to obtain paper copies of the official statements to deliver to customers in the primary market.

Even greater benefits from a repository would accrue in the secondary market. Dealers trading in an issue would be able to view on their computer screens pages from an official statement at the precise time they need the information. This instantaneous access would make it possible for dealers to review complete information about the municipal securities they trade and thereby make the disclosures required by Board rules.²³ Moreover, copies of an official statement, or portions thereof, could be readily obtained when necessary.²⁴ Finally, information vendors would have a reliable source of all official statements and these sources of information would be more complete and more timely than now is possible.

The Board reiterates that the repository must be mandatory if it will succeed in obtaining all official statements. Therefore the Board believes that the repository should be created under governmental auspices. The Board also believes it would be preferable to establish the repository under the current statutory scheme if possible. It appears that such action may be possible pursuant to the Commission's broad rulemaking authority

under the antifraud provisions of section 10(b) of the Act. The information the Board has received indicating that dealers generally do not have sufficient access to information about securities they are selling to customers raises significant questions about the adequacy of disclosure to the public as mandated by rule 10b-5 under the Act. More effective access to the official statements would alleviate this concern without any undue regulatory intrusion on issuers.²⁵

The Commission's rulemaking authority under section 10(b) is not diminished by the Tower Amendment. Although the Board is prohibited from directly or indirectly requiring issuers to provide information to the Board or to customers, no similar restrictions apply to the Commission. Moreover, section 15B(d)(2) expressly states "[n]othing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this title." Thus, it appears that the Commission, under section 10(b) of the Act, may have authority to require issuers to provide official statements to a central repository.

The Board believes that improved access to official statements is critical to the efficiency of the municipal securities market and the protection of investors. This is an issue which requires the thoughtful participation of all market participants. The Board welcomes the opportunity to meet with the Commission to discuss in more detail the possible development of a mandatory official statement repository. The Board is prepared to cooperate with the Commission and to serve a leadership role in facilitating such a project. While the Board prefers that a mandatory repository be established within the current regulatory framework, it is committed to supporting legislation to establish one if such action is determined to be necessary or appropriate. The Board also is committed to exercising its full rulemaking authority by taking whatever additional actions are necessary to bring improvements in this area.

Sincerely,

James B.G. Hearty
Chairman

²⁰ The Board would expect information vendors to access the information received by such a repository in the new issue market.

²¹ Generally, certain features of an issue, including coupon rates, prices and maturity dates, are not set until the date of sale.

²² The typical length of time from the date of sale or award until settlement or delivery of a new issue ranges from two weeks to one month.

²³ The Board's concern at this time is improving access to descriptive information about municipal securities. It recognizes, however, the potential for the repository to collect updated issuer information throughout the life of an issue.

²⁴ As noted earlier, the Board's efforts to require dealers to provide complete written call information to customers upon request revealed that most dealers do not have access to portions of official statements and are reluctant to incur the expense of obtaining the whole document even when it is available.

²⁵ As noted earlier, official statements now are being prepared for most municipal securities issues.

ATTENTION!

Route to:

- Manager, Muni Dept.
- Underwriting
- Trading
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- Public Finance
- Compliance
- Training
- Other _____

Priority of Orders for New Issue Securities: Rule G-17

Interpretation

The Board advises dealers that the principles of fair dealing require that customer orders for new issue securities should receive priority over similar dealer orders.

The Board is concerned about reports that senior syndicate managers may not always be mindful of principles of fair dealing in allocations of new issue securities. In particular, the Board believes that the principles of fair dealing require that customer orders should receive priority over similar dealer or certain dealer-related account¹ orders, to the extent that this is feasible and consistent with the orderly distribution of new issue securities.

Rule G-11(e) requires syndicates to establish priority provisions and, if such priority provisions may be changed, to specify the procedure for making changes. The rule also permits a syndicate to allow the senior manager, on a case-by-case basis, to allocate securities in a manner other than in accordance with the priority provisions if the senior manager determines in its discretion that it is in the best interests of the

syndicate. Senior managers must furnish this information, in writing, to the syndicate members. Syndicate members must promptly furnish this information, in writing, to others upon request. This requirement was adopted to allow prospective purchasers to frame their orders to the syndicate in a manner that would enhance their ability to obtain securities since the syndicate's allocation procedures would be known.

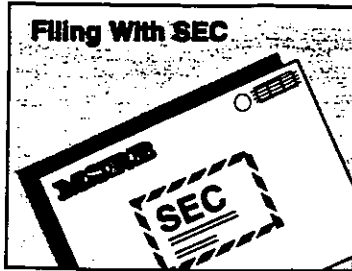
The Board understands that senior managers must balance a number of competing interests in allocating new issue securities. In addition, a senior manager must be able quickly to determine when it is appropriate to allocate away from the priority provisions and must be prepared to justify its actions to the syndicate and perhaps to the issuer. While it does not appear necessary or appropriate at this time to restrict the ability of syndicates to permit managers to allocate securities in a manner different from the priority provisions, the Board believes senior managers should ensure that all allocations, even those away from the priority provisions, are fair and reasonable and consistent with principles of fair dealing under rule G-17.² Thus, in the Board's view, customer orders should have priority over similar dealer orders or certain dealer-related account orders to the extent that this is feasible and consistent with the orderly distribution of new issue securities. Moreover, the Board suggests that syndicate members alert their customers to the priority provisions adopted by the syndicate so that their customers are able to place their orders in a manner that increases the possibility of being allocated securities.

MSRB Interpretation of December 22, 1987, by Diane G. Klinke, Deputy General Counsel.

¹ A dealer-related account includes a municipal securities investment portfolio, arbitrage account or secondary trading account of a syndicate member, a municipal securities investment trust sponsored by a syndicate member, or an accumulation account established in connection with such a municipal securities investment trust.

² Rule G-17 provides that:

[I]n the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice.

**Route to:**

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

Nomination and Election of New Board Members: Rule A-3

Amendments Filed

The amendments would reconstitute the Board's Nominating Committee and grant it more responsibility.

On December 23, 1987, the Board filed with the Securities and Exchange Commission proposed amendments to rule A-3 on the nomination and election of new Board members. The amendments would reconstitute the Board's Nominating Committee and grant it more responsibility. The amendments also would delete the ability of 20 percent of municipal securities dealers to nominate an additional candidate for each industry position to be filled. The Board believes that these revisions will retain the Board's primary goals in its selection of new Board members: providing equal representation on the Board by bank dealers, securities firms, and public members within the framework of staggered terms of office; assuring broad diversity in the background of Board members; establishing a workable democratic procedure for the nomination and election of Board members; and tailoring a suitably deliberative framework for the election process. The amendments will not become effective until approved by the Commission. Persons wishing to comment on the amendments should comment directly to the Commission.¹

Membership of the Nominating Committee

Under rule A-3(c)(ii), the Nominating Committee currently consists of five senior class members of the Board and six persons who are not members of the Board consisting of two representatives each of securities firms, bank dealers and the public. The proposed amendments provide that the Nominating Committee will consist of six Board members and three persons who are not members of the Board. Of the six Board members, two each will represent securities firms, bank dealers and the public. The Board has concluded that it is appropriate

to provide some continuity from year-to-year of Board member representatives on the Nominating Committee. Therefore, the six Board members may be chosen from any of the three member classes. Of the three non-Board members, one each will represent securities firms, bank dealers and the public, respectively.

Nominations Procedure

Under current rule A-3(c)(iv), the Nominating Committee nominates three persons for each of the Board positions to be filled. The Board elects one of the three nominees. The proposed amendments provide that the Nominating Committee will submit only one nominee for each available Board position. Under this approach, the Board will communicate with the Nominating Committee the qualifications of individuals the Committee should consider and later may review the list of all possible nominees. When the Committee determines its slate of nominees, it will contact these individuals and ask them if they wish to serve on the Board, subject to the Board's approval. If they agree, their names will be presented to the Board. The Board will accept or reject the slate of nominees. It is anticipated that the Board will vote to accept the nominees. In the event a nominee is rejected, however, the Nominating Committee must hold a meeting to choose another nominee. The Board believes that this non-competitive election process will ensure that highly qualified individuals are nominated to become members of the Board.

Industry Nomination Process

Under current rule A-3(c)(vi), (vii) and (viii), 20 percent of municipal securities dealers may nominate an additional candidate for each of the industry positions to be filled. When the Board adopted this procedure it indicated that it was intended as a "safety valve" in the event there was substantial industry disagreement with the candidates nominated by the Board. In

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

¹ SEC File No. SR-MSRB-87-15. Comments filed with the Commission should refer to the file number.

the ten years the rule has been in effect, there have been no industry candidates nominated in this fashion. Moreover, as a practical matter, it appears that this procedure would be difficult to implement. The Board believes that its nomination and election process has resulted in industry candidates that are able and representative of municipal securities dealers and, as a result, this alternative nomination procedure would be deleted from the rule.

December 23, 1987

Text of Proposed Amendments*

Rule A-3. Membership on the Board

(a) through (b) No change.

(c) *Nomination and Election of Members.*

(i) No change.

(ii) ~~Prior to April 15 of each year,~~ The Board will appoint a Nominating Committee composed of ~~eleven~~ nine members. The membership of the Nominating Committee shall consist of ~~the five members of the six~~ Board ~~whose terms expire during each year~~ members and ~~six~~ three persons who are not members of the Board. Of the six Board members, two of whom shall be associated with and representative of bank dealers, two of whom shall be associated with and representative of municipal securities brokers, dealers, and municipal securities dealers other than bank dealers, and two of whom shall not be associated with any broker, dealer, or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling any broker or dealer which is not a municipal securities broker or municipal securities dealer). Of the three non-Board members, one shall be associated with and representative of bank dealers, one shall be associated with and representative of brokers, dealers, and municipal securities dealers other than bank dealers, and one shall not be associated with any broker, dealer, or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling any broker or dealer which is not a municipal securities broker or municipal securities dealer). The chairman of the Nominating Committee shall be designated by the Board. In appointing persons to serve on the Nominating Committee, the Board shall take into consideration such factors to be considered include as the need to achieve broad geographic representation on such Committee, as well as diversity in the size and type of municipal securities brokers, dealers and municipal securities dealers represented on such Committee.

(iii) ~~No later than May 15 of each year,~~ The Nominating Committee shall publish a notice in a financial journal having general national circulation among members of the municipal securities industry soliciting ~~public recommendations for nominations for the positions on the Board to be filled in such year.~~ Such The notice shall require that recommendations be accompanied by a statement of the position for which the person is recommended, the background and qualifications for member-

ship on the Board of the person recommended and information concerning such person's association with any broker, dealer, or municipal securities dealer. The Nominating Committee shall accept recommendations pursuant to such notice for a period of at least 30 days. Any interested member of the public, whether or not associated with a ~~municipal securities broker, dealer,~~ or municipal securities dealer, may submit recommendations to the Nominating Committee. The names of all persons recommended to the Nominating Committee shall be made available to the public upon request.

(iv) ~~Not later than July 15 of each year,~~ The Nominating Committee shall nominate ~~three~~ one persons for each of the Board positions to be filled and shall submit ~~such nominations~~ the nominees to the Board for approval. In making such nominations, the Nominating Committee shall take into consideration such factors as the need to maintain broad geographic representation on the Board, as well as diversity in the size and type of ~~municipal securities brokers, dealers,~~ and municipal securities dealers represented. Each nomination shall be accompanied by a statement indicating the position for which such person is nominated, the nominee's qualifications to serve as a member of the Board, and information concerning the nominee's association with any broker, dealer, or municipal securities dealer. The names of the nominees will be confidential.

(v) The Board shall ~~not later than August 1 of each year, select from accept or reject each slate of three nominees submitted by the Nominating Committee, the name of one candidate for each of~~ in the event that the Board positions to be filled, taking into consideration such factors as the need to maintain broad geographic representation on the Board, as well as diversity in the size and type of municipal securities brokers and municipal securities dealers represented. The Board shall announce the names of the candidates which it has selected. The public representatives so named shall be considered duly elected, subject to the requirements of subparagraph (ix) below rejects a nominee, the Nominating Committee will propose another nominee for Board consideration.

(vi) ~~In naming the bank and broker-dealer representative candidates as provided in subparagraph (v) above, the Board shall announce the broad criteria applied to their selection in terms of geographic representation and size and type of municipal securities broker and municipal securities dealer to be represented. An additional candidate for each position of bank representative and broker-dealer representative to be filled may be nominated by 20 percent or more of the municipal securities brokers and municipal securities dealers that have paid the annual fee prescribed by rule A-14 of the Board for the fiscal year in which the election is conducted (hereafter referred to as "registered" municipal securities brokers and municipal securities dealers), if notice in writing signed by the required number of municipal securities brokers and municipal securities dealers is filed with the Board within 30 days of the date of the announcement by the Board of its selection of candidates. Any additional candidate nominated as provided in this subparagraph must meet the criteria of geography, and size and type of municipal~~

* Underlining indicates new language; strike-through indicates deletions.

~~securities broker or municipal securities dealer designated by the Board for the position to be filled.~~

~~(vii) If no additional candidate or candidates are nominated as provided in subparagraph (vi) above for a position to be filled, the candidate selected by the Board for such position shall be considered duly elected.~~

~~(viii) If any additional candidate or candidates are nominated for a position to be filled as provided in subparagraph (vi) above, the Board shall send to each registered municipal securities broker and municipal securities dealer, a ballot setting forth the names of each candidate for the contested position or positions. Such ballot shall indicate the date by which ballots must be returned to the Board, but such date may not be less than 20 nor more than 30 days from the end of the nominating period provided in subparagraph (vi). All ballots shall be opened by such representative of the Board as the chairman of the Board shall designate, and in the presence of a representative of each candidate if such representation is requested in writing by a candidate. The candidate for each contested position receiving the largest number of votes cast~~

~~(each registered municipal securities broker and municipal securities dealer having one vote for each contested position) shall be considered duly elected. In all elections under this subparagraph, voting shall be by confidential mail ballot.~~

~~(*) (vi) The public representatives on the Board will, prior to their assumption of office, be subject to approval by the Commission to assure that no one of them is associated with any broker, dealer or municipal securities dealer (other than by reason of being under common control with, or indirectly controlling, any broker or dealer which is not a municipal securities broker or municipal securities dealer) and that at least one of the public representatives of the Board is representative of investors in municipal securities and at least one is representative of issuers of municipal securities.~~

~~(*) (vii) Upon completion of the procedures for nomination and election of new Board members as set forth above, the Board will announce the names of the new members not later than October 1 of each year.~~

~~(d) through (f) No change.~~

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.
October 1, 1987 \$5.00

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.
1985 \$1.50

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.
July 1986 5 copies per year no charge
Each additional copy \$1.50

Manual on Close-Out Procedures

A discussion of the close-out procedures of rule G-12(h)(i) in a question and answer format. Includes the text of rule G-12(h)(i) with each sentence indexed to particular questions, and a glossary of terms.
January 1, 1985 \$3.00

Arbitration Information and Rules

Pamphlet reprinting SICA's *Arbitration Procedures and How to Proceed with the Arbitration of a Small Claim*, the text of rules G-35 and A-16, a glossary of terms and list of sponsoring organizations.
1986 no charge

Instructions for Beginning an Arbitration

Step-by-step instructions and forms necessary for filing an arbitration claim.
1986 no charge

Reporter and Newsletter

MSRB Reports

The MSRB's reporter and newsletter to the municipal securities industry. Includes notices of rule amendments filed with and/or approved by the SEC, notices of interpretations of MSRB rules, requests for comments from the industry and the public and news items.
Bi/tri-monthly no charge

Examination Study Outlines

A series of guides outlining subject matter areas a candidate seeking professional qualification is expected to know. Each outline includes a list of reference materials and sample questions.

Study Outline: Municipal Securities Representative Qualification Examination

Outline for Test Series 52.
November 1987 no charge

Study Outline: Municipal Securities Principal Qualification Examination

Outline for Test Series 53.
April 1987 no charge

Study Outline: Municipal Securities Financial and Operations Principal Qualification Examination

Outline for Test Series 54.
1987 no charge

Brochures

MSRB Information for Municipal Securities Investors

Investor brochure describing Board rulemaking authority, the rules protecting the investor, arbitration and communication with the industry and investors. Use of this brochure satisfies the requirements of rule G-10.
1 to 500 copies no charge
Over 500 copies \$.01 per copy

MSRB Information

Brochure describing Board structure and responsibility, the rulemaking process, and communications with the industry.
1 to 500 copies no charge
Over 500 copies \$.05 per copy

Publications Order Form

Description	Price	Quantity	Amount Due
MSRB Manual (soft-cover edition)	\$5.00		
Glossary of Municipal Securities Terms	\$1.50		
Professional Qualification Handbook	5 copies per year no charge Each additional copy \$1.50		
Manual on Close-Out Procedures	\$3.00		
Arbitration Information and Rules	no charge		
Instructions for Beginning an Arbitration	no charge		
Study Outline: Municipal Securities Representative Qualification Examination	no charge		
Study Outline: Municipal Securities Principal Qualification Examination	no charge		
Study Outline: Municipal Securities Financial and Operations Principal	no charge		
MSRB Information for Municipal Securities Investors (Investor Brochure)	1 to 500 copies no charge Over 500 copies \$.01 per copy		
MSRB Information	1 to 500 copies no charge Over 500 copies \$.05 per copy		
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**Financial Statements—Fiscal Years
Ended September 30, 1987 and 1986**

Coopers
& Lybrand

certified public accountants

To the Members of the
Municipal Securities Rulemaking Board

We have examined the balance sheets of the Municipal Securities Rulemaking Board as of September 30, 1987 and 1986, and the related statements of revenues and expenses and change in fund balance and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the Municipal Securities Rulemaking Board as of September 30, 1987 and 1986, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

A handwritten signature in cursive script, appearing to read "Coopers & Lybrand".

1800 M Street, N. W.
Washington, D. C. 20036
November 13, 1987

MUNICIPAL SECURITIES RULEMAKING BOARD

BALANCE SHEETS

September 30, 1987 and 1986

	<u>1987</u>	<u>1986</u>
ASSETS		
Cash	\$ 41,650	\$ 54,553
Investments (Notes 1 and 2)	5,012,341	3,906,470
Assessment fees receivable (Note 1)	111,470	535,678
Accrued interest receivable	90,350	83,893
Other assets	40,702	15,760
Office furniture, equipment and leasehold improvements, at cost, less accumulated depreciation and amortization of \$143,593 in 1987 and \$95,413 in 1986 (Note 1)	<u>177,319</u>	<u>148,030</u>
	<u>\$5,473,832</u>	<u>\$4,744,384</u>
LIABILITIES AND FUND BALANCE		
Accounts payable	\$ 84,572	\$ 87,454
Accrued salaries and vacation pay	53,000	50,166
Deferred rent credit (Note 3)	<u>220,795</u>	<u>182,023</u>
	358,367	319,643
Commitments (Note 3)		
Fund balance	<u>5,115,465</u>	<u>4,424,741</u>
	<u>\$5,473,832</u>	<u>\$4,744,384</u>

The accompanying notes are an integral part of these financial statements.

**MUNICIPAL SECURITIES RULEMAKING BOARD
STATEMENTS OF REVENUES AND EXPENSES AND
CHANGE IN FUND BALANCE**
for the years ended September 30, 1987 and 1986

	1987	1986
Revenues:		
Assessment fees (Note 1)	\$2,201,829	\$4,489,810
Annual fees (Note 1)	264,500	249,900
Initial fees (Note 1)	29,400	33,800
Investment income	337,292	160,465
Board manuals and other	90,016	66,561
	<u>2,923,037</u>	<u>5,000,536</u>
Expenses:		
Salaries and employee benefits (Note 4)	796,048	726,068
Board and committee	476,329	456,037
Operations (Note 3)	424,080	369,788
Education and communication	336,296	306,647
Professional services	141,546	42,364
Depreciation and amortization (Note 1)	58,014	56,375
	<u>2,232,313</u>	<u>1,957,279</u>
Excess of revenues over expenses	690,724	3,043,257
Fund balance, beginning of year	4,424,741	1,381,484
Fund balance, end of year	<u>\$5,115,465</u>	<u>\$4,424,741</u>

The accompanying notes are an integral part
of these financial statements.

MUNICIPAL SECURITIES RULEMAKING BOARD
STATEMENTS OF CHANGES IN FINANCIAL POSITION
for the years ended September 30, 1987 and 1986

	<u>1987</u>	<u>1986</u>
Sources of funds:		
Operations:		
Excess of revenues over expenses	\$ 690,724	\$3,043,257
Noncash expenses - depreciation and amortization	<u>58,014</u>	<u>56,375</u>
Funds provided by operations	748,738	3,099,632
Decrease in assessment fee receivable	424,208	-
Disposition of fixed assets	20,897	10,762
Increase in accounts payable	-	25,427
Increase in accrued salaries and vacation pay	2,834	8,284
Increase in deferred rent credit	<u>38,772</u>	<u>81,133</u>
	<u>\$1,235,449</u>	<u>\$3,225,238</u>
Uses of funds:		
Increase in cash and investments	\$1,092,968	\$2,979,356
Increase in assessment fees receivable	-	109,713
Increase in accrued interest receivable	6,457	60,609
Increase in other assets	24,942	712
Purchase of fixed assets	108,200	74,848
Decrease in accounts payable	<u>2,882</u>	<u>-</u>
	<u>\$1,235,449</u>	<u>\$3,225,238</u>

The accompanying notes are an integral part
of these financial statements.

**MUNICIPAL SECURITIES RULEMAKING BOARD
NOTES TO FINANCIAL STATEMENTS**

1. Accounting policies

The Municipal Securities Rulemaking Board (the Board) was established in 1975 pursuant to authority granted by the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975, as an independent, self-regulatory organization charged with rulemaking responsibility for the municipal securities industry.

Assessment fees

The underwriting assessment fee is equal to a percentage of the face amount of all municipal securities which are purchased from an issuer as part of a new issue by or through such municipal securities broker or municipal securities dealer, whether acting as principal or agent, and which have a final stated maturity of not less than two years and an aggregate par value of not less than \$1,000,000. This fee amounted to .002% of all such sales from July 1, 1985 through June 30, 1987, and .001% from July 1, 1987 through September 30, 1987. Revenue from assessment fees is recognized upon the sale of the issue and is payable within 30 days of settlement between the underwriter and the issuer.

Annual fees

Each municipal securities broker and municipal securities dealer is required to pay an annual fee of \$100 with respect to each fiscal year of the Board in which the municipal securities broker or municipal securities dealer conducts business. This fee is due by February 15 of the fiscal year for which the fee is paid.

Initial fees

The initial fee is a one-time fee of \$100, which is to be paid by every municipal securities broker or municipal securities dealer registered with the Securities and Exchange Commission.

Revenue from initial fees is recognized when received by the Board.

Continued

**MUNICIPAL SECURITIES RULEMAKING BOARD
NOTES TO FINANCIAL STATEMENTS**

Investments

Investments in securities are stated at amortized cost, which closely approximates market value.

Depreciation and amortization

Depreciation of fixed assets is computed on the straight-line method over the estimated useful lives of the assets. Amortization of leasehold improvements is computed on the straight-line method over the shorter of the remaining lease period or the estimated useful life of the improvement.

2. Investments

A summary of investments is as follows:

	September 30,	
	1987	1986
T. Rowe Price U. S. Treasury Money Fund	\$ 47,894	\$ 94,938
U. S. Treasury Bills	-	606,891
U. S. Treasury Notes	4,964,447	3,204,641
	\$5,012,341	\$3,906,470

3. Lease agreements

On November 16, 1984, the Board leased new office space under a lease agreement expiring in November 1994. This agreement calls for the Board to receive a rent credit equal to one-half of the base monthly rent for the first 30 months of the lease. As a result, the monthly rental payments will be \$9,350 through May 1987 and \$18,700 a month for the remainder of the lease term, subject to an annual escalation based on the Consumer Price Index and a proportionate share of the increase in the costs of operating the building. For financial reporting purposes, the Board is recognizing rental expense evenly during the 10-year lease term at \$16,105 a month. The Board is required to maintain an irrevocable letter of credit of \$18,700, in lieu of a security deposit, payable to the lessor as part of the lease agreement. The lease may be renewed at the Board's option, for a period of five years, in accordance with the terms set forth in the lease agreement.

Continued

MUNICIPAL SECURITIES RULEMAKING BOARD
NOTES TO FINANCIAL STATEMENTS

Total lease expense for office space and equipment for the years ended September 30, 1987 and 1986, was \$267,385 and \$232,758, respectively.

4. Retirement plans

The Board has a defined-contribution retirement plan. All employees are eligible to participate upon attaining a minimum length of service. The Board makes contributions to an insurance company based on a percentage of the salaries of covered employees and their lengths of service. Retirement plan costs are funded as they accrue. Employees may also make voluntary contributions. Costs of the plan were approximately \$52,000 in 1987 and \$50,000 in 1986.

The Board also has a deferred compensation plan which covers all employees. The Board contributes \$.50 for every \$1 contributed by an employee, with a maximum Board contribution of 2% of the employee's annual salary. The cost of this plan was approximately \$12,000 in 1987 and \$10,000 in 1986.

5. Income taxes

Under provisions of the Internal Revenue Code and applicable income tax regulations of the District of Columbia, the Board is exempt from taxes on income other than unrelated business income. No provision for income taxes is required as of September 30, 1987 and 1986, since the Board had no unrelated business income.