

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51534; File No. SR-MSRB-2005-05)

April 12, 2005

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Amendment to Rule G-8, on Recordkeeping, to Add Requirement for Predispute Arbitration Agreements with Customers, and Amendment to Rule A-11, on Indemnification, to Delete Obsolete References to Arbitrators

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 21, 2005, the Municipal Securities Rulemaking Board (“MSRB” or “Board”), filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I and II below, which Items have been prepared by the MSRB. The MSRB filed an amendment to the proposed rule change on April 1, 2005.<sup>3</sup> The MSRB has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A)(iii) of the Act,<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. However, the MSRB has set an effective date of May 1, 2005, to coincide with recent amendments to NASD Rule 3110(f), on predispute arbitration

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The amendment replaces, in its entirety, the previously filed proposed rule language to MSRB Rule G-8 with new language to conform with the language of NASD Rule 3110(f) that is set to become effective on May 1, 2005 (“Amendment No. 1”).

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

agreements with customers.<sup>6</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The MSRB is filing with the Commission a proposed rule change consisting of technical amendments to Rule G-8, on recordkeeping, and Rule A-11, on indemnification. The MSRB has set an effective date for the amendments of May 1, 2005. The text of the proposed rule change is available on the MSRB's Web site (<http://www.msrb.org>), at the MSRB's principal office, and at the Commission's Public Reference Room.

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

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

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

1. Purpose

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<sup>6</sup> In November 2004, the SEC approved amendments to NASD Rule 3110(f) that require NASD member firms to modify their predispute arbitration agreements with customers to provide enhanced disclosure about the arbitration process. The amendments also require NASD members to provide copies of predispute arbitration agreements and relevant arbitration forum rules to customers upon request; clarify the use of certain limiting provisions; and require firms seeking to compel arbitration of claims initiated in court to arbitrate all of the claims contained in the complaint if the customer so requests. See Release No. 34-50713 (November 22, 2004), effective May 1, 2005.

In 1997, the MSRB determined that it was no longer cost-effective to continue operating an arbitration program since so few cases were being filed with its program. Accordingly, the MSRB amended Rule G-35, on arbitration, to provide that it would not accept any new arbitration claims filed on or after January 1, 1998 (the “1997 Amendments”).<sup>7</sup> The MSRB noted that any customer or securities dealer with a claim, dispute or controversy against a dealer involving its municipal securities activities may submit that claim to the arbitration forum of any self-regulatory organization (“SRO”) of which the dealer is a member, including NASD. Bank dealers, however, are unique in that they are subject to MSRB rules but are not members of any other SRO. Thus, it was necessary to provide an alternative arbitration forum for claims involving the municipal securities activities of bank dealers. The 1997 Amendments accomplished this by providing that as of January 1, 1998 every bank dealer, as defined in Rule D-8,<sup>8</sup> shall be subject to NASD’s Code of Arbitration Procedure for every claim, dispute or controversy arising out of or in connection with the municipal securities activities of the bank dealer acting in its capacity as such, and that bank dealers shall abide by NASD’s Code as if they were “members” of NASD for purposes of arbitration. The enforcement mechanism for bank dealers was not altered by the amendments; the bank regulatory agencies continue to be responsible for the inspection and enforcement of bank dealers’ municipal securities activities, including arbitration.

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<sup>7</sup> File No. SR-MSRB-97-04, approved in Release No. 34-39378 (December 1, 1997).

<sup>8</sup> Rule D-8 defines “bank dealer” to mean a municipal securities dealer which is a bank or a separately identifiable department or division of a bank as defined in Rule G-1.

At the time of the 1997 Amendments, the MSRB agreed to continue operating its arbitration program in order to administer its current, open cases and any new claims received prior to January 1, 1998, but stated that it would discontinue administering its program when all such cases were closed. On May 14, 2002, the MSRB transferred its final, open case to NASD. Accordingly, in August 2002, the MSRB submitted a filing to the SEC to delete Sections 1 through 37 of Rule G-35, on arbitration, thereby effectively discontinuing the operation of its arbitration program.<sup>9</sup> The filing also incorporated by reference into Rule G-35 the NASD Code of Arbitration Procedure and all future amendments thereto.<sup>10</sup>

When the MSRB deleted Sections 1 through 37 of its arbitration code in 2002, the requirements governing predispute arbitration agreements (previously in Section 36 of Rule G-35) were also deleted. While Rule G-35 currently provides that bank dealers shall abide by the NASD Code of Arbitration Procedure, NASD's requirement for predispute arbitration agreements is not contained in that Code. Instead, the NASD requirement is set forth in its Rule 3110, on books and records, and IM-3110(f), on customer account information. NASD Rule 0116, on application of NASD rules to exempted securities, provides that NASD Rule 3110 and the related interpretive materials

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<sup>9</sup> File No. SR-MSRB-2002-09 (August 19, 2002), approved in Release No. 34-46666 (October 16, 2002).

<sup>10</sup> At the request of the SEC's Division of Market Regulation, the MSRB requested that, pursuant to Section 36 of the Act and Rule 0-12 thereunder, the SEC grant an exemption from the requirements of Section 19(b) of the Act and Rule 19b-4 thereunder to allow the MSRB to incorporate by reference into Rule G-35 any changes to the NASD's Code without requiring that the MSRB submit a separate filing for each such change. See letter from Diane G. Klinke, General Counsel, MSRB, to Jonathan G. Katz, Secretary, SEC, dated April 4, 2002. The SEC granted this exemption in Release No. 34-49260 (February 17, 2004).

(among other rules and interpretive materials) do not apply to municipal securities. Thus, there currently is no requirement specifically governing the way bank dealers or municipal-only dealers use predispute arbitration agreements with customers. To remedy this situation, the MSRB is filing a technical amendment to Rule G-8, on recordkeeping, to add such a requirement. The language of the proposed amendment tracks the language of NASD Rule 3110(f), on predispute arbitration agreements with customers, as recently amended.<sup>11</sup> The proposed amendment to Rule G-8 will become effective on May 1, 2005, to coincide with the effective date of NASD's recent amendments to its Rule 3110(f). In addition, the MSRB is filing a technical amendment to Rule A-11, on indemnification, to delete its obsolete references to arbitrator indemnification.

## 2. Statutory Basis

The MSRB believes that the proposed rule change is consistent with Sections 15B(b)(2)(C) and (D) of the Act,<sup>12</sup> which provide that MSRB rules shall:

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest...[and] if the Board deems appropriate, provide for the arbitration of claims, disputes, and controversies relating to transactions in municipal securities....

The MSRB believes that the proposed rule change is consistent with these provisions in that it would provide for the protection of investors and the public interest by ensuring that there is a requirement governing the use of predispute arbitration agreements with customers by brokers, dealers and municipal securities dealers, including bank dealers

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<sup>11</sup> See note 6, above.

<sup>12</sup> 15 U.S.C. 78o-4(b)(2)(C), (D).

and municipal-only dealers. The proposed rule change also would ensure consistent treatment across the securities markets regarding the use of such agreements.

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

The MSRB does not believe that the proposed rule change will result in any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received on the proposed rule change.

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

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days from the date on which it was filed, and the MSRB provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6).

investors, or otherwise in furtherance of the purposes of the Act.<sup>15</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-MSRB-2005-05 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-MSRB-2005-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule

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<sup>15</sup> See Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C). For purposes of calculating the 60-day abrogation period, the Commission considers the period to commence on April 1, 2005, the date that the MSRB filed Amendment No. 1.

change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2005-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).