

market through its contacts with dealers, clearing agencies and vendors of critical services to the market just as it did after September 11. The proposed rule change, however, includes changes to MSRB's administrative procedures in Rule A-4 allowing special MSRB telephone conference call Board meetings on market emergencies to occur without the normal notice requirement of seven days or the normal quorum requirement of two-thirds of the Board's members. The proposed rule change also includes a format interpretation of Rule G-17, on fair practice, that would prohibit dealers from trading for the duration of a market emergency declared by the MSRB. These proposed rule changes thus provide a procedure for instituting a trading halt should a market emergency necessitate one in the future.

The proposed rule change specifically identifies the channels by which MSRB would make information known to municipal securities dealers in the event of a market emergency. It notes that this will be done through new outlets commonly used in the municipal securities industry, postings on the MSRB's Web site and by transmitting announcements to the electronic mail addresses provided to the MSRB by dealers under Rule G-40, on electronic mail contacts. Having an announced, written procedure for dealer notification would add a level of preparedness if a market emergency actually occurs. Just as important, it provides dealers with clear direction on where to look if the situation is uncertain and questions exist about whether an emergency has been declared. This also will help dealers determine if any other emergency rulemaking is in effect. After September 11 there was some confusion among municipal securities dealers about whether the regular-way settlement cycle for municipal securities had been changed to T+5 from the T+3 cycle mandated under MSRB Rules G-12(b)(ii) and G-15(b)(ii). This apparently was the result of announcements made concerning transactions in government bonds. In monitoring clearance and settlement data after September 11, the MSRB observed that some dealers were, as a practice, submitting all of their regular-way trades with a T+5 settlement date. Among other problems, this caused trade-matching failures in the central comparison system for inter-dealer transactions. The notification procedure for market emergency declaration will help direct the attention of dealers in municipal securities to the MSRB for announcements on possible rule

changes in the wake of an emergency and thus should help to avoid similar confusion in the future.²

The proposed rule change's interpretation of Rule G-17 follows a principle of securities law that a dealer must not "accept or execute any order for the purchase or sale of securities or induce or attempt to induce such purchase or sale if the dealer does not have the personnel and facilities to enable prompt execution and consummation of the transactions."³ The MSRB believes that, where a substantial failure has occurred in the systems necessary for clearance, settlement, confirmation, payment or delivery of transactions in municipal securities, or in other systems necessary for the prompt execution and consummation of municipal securities transactions or the fair and accurate pricing of municipal securities, it may become necessary, for the overall protection of market participants, to halt trading by all dealers.⁴ Clearance and settlement systems are a particular concern because of counter-party risk that escalates when unsettled transactions grow during volatile or chaotic markets. Other situations possibly warranting a temporary halt in trading might include a massive failure of telecommunication systems, or the corruption of essential data used by the municipal securities industry (for example, through a computer virus).

Interpretation of Rule G-17

The proposed Interpretation of Rule G-17 has the following elements:

- It is a violation of Rule G-17 for a dealer to continue to effect transactions in municipal securities during an MSRB-declared "market emergency."
- A "market emergency" for this purpose is defined as "a situation causing substantial failure in any of the systems necessary for clearance,

² The proposed rule change addresses only the procedure for announcing trading halts. Should changes in existing MSRB rules be necessary during an emergency, these could be adopted by the MSRB and approved summarily by the SEC. Section 19(b)(3)(B) of the Exchange Act grants the SEC authority to approve proposed rule changes summarily when "it appears to the Commission that such action is necessary for the protection of investors, the maintenance of fair and orderly markets, or the safeguarding of securities or funds."

³ See, e.g., Release No. 8363 (July 29, 1968), 33 FR 11150 (August 7, 1968).

⁴ The scope of the proposed rule change does not include the issuance of "regulatory halts" similar to those issued by exchanges and other SROs to stop trading in a specific security pending the announcement of news, or to allow news to be absorbed by the market before trading continues. Since this situation would not constitute an emergency effecting essential systems and market infrastructure, it is not included within the definition of a market emergency.

settlement, confirmation, payment or delivery of transactions in municipal securities, or in other systems necessary for the prompt execution and consummation of municipal securities transactions or the fair and accurate pricing of municipal securities."

- Prior to acting on a market emergency, MSRB will consult with the SEC.
- Official announcements by the MSRB on market emergencies will be communicated to dealers through news outlets commonly used in the municipal securities industry, by posting on the MSRB's World Wide Web site at <http://www.msrb.org>, and by transmittal of the announcement to the electronic mail addresses provided to the MSRB by dealers under Rule G-40.

Amendment to Rule A-4

Prior to making any decision on a specific market emergency, the MSRB will hold a special Board meeting to share information and discuss the situation. The MSRB's current procedure for holding special Board meetings is contained in Rule A-4. Among other provisions, the rule states that the Secretary of the Board will call special meetings at the request of the Chairman or at the written request of three or more members. Seven days written notice, signed by the Secretary of the Board (or three days notice if given or sent by telephone, e-mail or personal delivery), is required for special meetings. The quorum for any Board meeting is two-thirds of the Board (normally ten members), with at least one securities firm representative, one bank dealer representative and one public member. Formal action requires an affirmative vote of the majority of the Board (normally eight members).

During a time of crisis, market participants would want to know fairly quickly whether trading is to be halted. The existing seven-day and three-day notice requirements for special Board meetings thus seem impractical. Moreover, establishing communication with at least ten Board members and securing eight affirmative votes also might present a problem, particularly if the emergency in question affects the infrastructure of one or more major financial centers and members cannot be reached. The proposed rule change would streamline the process specifically for market emergency meetings. The proposed amendments to Rule A-4 provides the following procedure:

- The Executive Director, or his or her designee, will schedule a special telephone conference call meeting on the possible declaration of a market