MSRB REPORTS

Volume 3, Number 6 | Municipal Securities Rulemaking Board | November 1983

Cooke, Chairman Bober, Vice Chairman for 1983–84

Arthur T. Cooke, Jr., senior vice president for Bank of America NT & SA since 1976, has been elected by the Board to serve as Chairman for the fiscal year, beginning October 1, 1983. Mr. Cooke heads the administration units responsible for strategic and business planning, marketing, operations and personnel in the bank's Financial Services Division.

Bernard R. Bober, cofounder in 1968 of Ehrlich-Bober & Co., Inc., and its chairman, has been elected to serve as Vice Chairman. Mr. Bober is also chairman of Ehrlich-Bober Government Securities, Inc., and cochairman of Ehrlich-Bober Advisors, Inc.

The Chairman discusses important issues for 1983–84 on page three. The Board Members for the year are also listed on page three.

Important Approval

Rules G-12 and G-15
Confirmations of transactions in book-entry securities.

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New Handbook on Professional Qualification Now Available

The Board has recently published a handbook explaining its qualification requirements and procedures for municipal securities professionals. The entry-level professional seeking a career in the municipal securities industry and the professional moving from one area of responsibility to another or assuming additional responsibilities should find this handbook especially helpful.

The qualification requirements are grouped by chapter according to the categories of municipal securities professionals so that, at a glance, the basic steps for qualification in each category should be clear. Other topics are discussed at length in separate chapters: qualification examination procedures, waivers, and disqualification and lapse of qualification. The appendixes contain a table summarizing qualification requirements, a topical index to the Board qualification rules, and the text of the qualification rules. A glossary provides definitions for the special vocabulary used by the municipal securities industry.

A copy of the *Professional Qualification Handbook* will be mailed to each securities firm and bank dealer registered with the Board. For additional copies, write to the Municipal Securities Rulemaking Board, 1150 Connecticut Avenue, NW, Suite 507, Washington, DC 20036 or call (202) 223-9347. For each fiscal year, five copies may be obtained at no charge; each additional copy costs $1.50.

Questions concerning the handbook and professional qualifications should be directed to Peter H. Murray, Assistant Executive Director.

November–January

November 18—Effective date of G-25 guarantees against loss

30—Comments due on reclamation of deliveries

December 12—Effective date of G-12 and G-15 transactions in zero coupon, compound interest and multiplier securities

December 28—Effective date of G-12 and G-15 confirmation information for book-entry securities

January 1—Effective date of certain G-33 provisions

Pending—SEC approval of amendment to:
- G-12 and G-15 for automated comparison, clearance and settlement
- G-12 CUSIP number discrepancies

From the Chairman

The coming year may well mark the beginning of a new era for the MSRB and perhaps for the municipal securities industry as well. During the first five years of the MSRB's existence, the basic set of rules was written while the industry grappled with the task of adjusting to them. More recently the MSRB has directed its efforts to improving the way transactions were compared, cleared, and settled.

Our industry has a history of settling transactions by passing around mountains of paper—a system no one particularly liked or knew how to change. Over the past three years the MSRB adopted a number of rules and rule amendments designed to set the stage for automated clearance and settlement of transactions. Amendments were made to the delivery provisions of the MSRB's uniform practice rule, G-12, and rule G-34 relating to CUSIP numbers on new issues was adopted to set the stage for automation.

During the past year these efforts were given great impetus by the requirement that all municipal bonds be issued in registered form. In addition, the MSRB considered and adopted in July amendments to its rules that will require the use of automated comparison and settlement systems in certain circumstances. There can be no question that automation of the municipal securities industry is upon us. Clearly, this area of rulemaking is also one where regulation can produce direct benefits to the industry through a reduction in costs.

In the coming year the MSRB will continue to have to deal with problems that may develop as the TEFRA registration requirement makes itself felt and as the industry prepares for the implementation of the rule amendments pertaining to immobilization and book entry. The road to automation will undoubtedly have its share of bumps, twists, and turns. Further technological developments may also push the industry and the MSRB to deal with the automation of other segments of dealer functions.

Two other issues may be taken up by the MSRB in the coming year. First, the financial problems encountered by a number of issuers have raised many of the same questions that were asked at the time the MSRB was created. The MSRB will have to be sure that its rules are adequate to deal with the concerns that have been raised by investors in the aftermath of these situations. The other issue relates to the changes being wrought in the structure of the financial services industry and possible changes in the Glass-Steagall Act. Various pieces of legislation have been introduced in Congress which could substantially alter the financial services industry. Some of these changes might well have a significant impact on the MSRB.

Regardless of what specific issue may be before the MSRB for consideration, I ask that you follow the activities of the MSRB. It is a *self-regulatory organization* which means that your input is a necessary part and vital ingredient of the rulemaking process. Please feel free to contact me, other MSRB Board Members, or members of the staff on any matter that you think should be considered by the MSRB.

Arthur T. Cooke, Jr.
Senior Vice President
Bank of America, NT & SA
MSRB Chairman
1983–84

Board Members 1983–84

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Publications List

Manuals

MSRB Manual
Soft-cover, Commerce Clearing House manual (CCH), updated semi-annually or annually, containing rules of the Board; text of the Securities and Exchange Act of 1934, as amended; text of Securities Investor Act of 1979; samples of forms; lists of Board members and staff; and new developments.
October 1, 1983 .... $5.00

Professional Qualification Handbook
Analysis of requirements for qualification as a municipal securities representative, principal, sales principal, and financial operations principal; text of the rules; and glossary of terms (1983).
49 pages .... 5 copies per year (No charge)
Each additional copy ... $1.50

Manual on Close-Out Procedures
Discussion of the close-out procedures of rule G-12(h)(i) in question-and-answer format, glossary of terms, and text of rules (1981).
70 pages $2.00

Arbitration Procedures: Rules A-16 and G-35
Text of rules (1981).
12 pages .... (No charge)

Arbitration Information
Explanation of arbitration and the procedures for initiating arbitration, fee schedule, and glossary of terms.
12 pages .... (No charge)

How to Proceed With the Arbitration of a Small Claim
Explanation of arbitration procedures for filing an arbitration claim under $2,500, text of rules, and submission agreement form.
12 pages .... (No charge)

Reporter and Newsletter

MSRB Reports
MSRB reporter and newsletter to the municipal securities industry on proposed rule changes, rule changes, notices requesting comment from the industry and public, and news items.
Members of the industry and other interested parties listed on the *MSRB Reports* mailing list receive issues as published; additional copies are sent on request.

Examination Study Outlines

Study Outline: Municipal Securities Representative Qualifications Examination
Outline for Test Series 52 (1983).
30 pages .... (No charge)

Study Outline: Municipal Securities Principal Qualifications Examination
Outline for Test Series 53 (1982).
9 pages .... (No charge)

Study Outline: Municipal Securities Financial and Operations Principal
Outline for Test Series 54 (1978).
4 pages .... (No charge)

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

Reports

Report of the Conference on Registered Municipal Securities
Report resulting from the forum organized by the Board's Task Force on Registered Municipal Securities to define problems and to explore solutions to the registration requirement.
48 pages .... (No charge)

Prospects for Automation of Municipal Clearance and Settlement Procedures: Report to the Securities and Exchange Commission
Special edition of *MSRB Reports* publishing the SEC-requested report on the progress achieved in the development of automated clearance and settlement systems (1983).
45 pages .... (No charge)

Pamphlets

MSRB Information
A coated-stock, three-fold, single-sheet pamphlet describing Board authority, structure, responsibility, rulemaking process, and communication with industry.
1–500 copies .... (No charge)
Over 500 .... (.05 per copy)

MSRB Information for Investors
A coated-stock, four-fold, single-sheet pamphlet describing Board rulemaking authority, the rules protecting the investor, and communication with the industry and investors.
1–500 copies .... (No charge)
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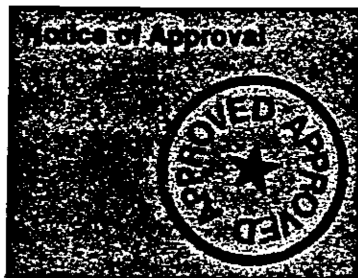

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Rules G-12 and G-15

Amendments Approved on Confirmations of Transactions in Book-Entry Securities

On September 29, 1983 the Securities and Exchange Commission approved certain amendments to Board rules G-12 and G-15 concerning confirmations of transactions in securities which are available only in book-entry form. At the request of the Board, the Commission has delayed the effectiveness of the amendments for a period of 90 days; the amendments will therefore be applicable to any confirmations of transactions in such securities mailed on or after December 28, 1983.

Board rules G-12 and G-15 set forth certain requirements concerning the information to be provided on inter-dealer and customer confirmations, respectively. Among other matters, confirmations are required to include, if the securities involved in the transaction are in registered form, a designation of that fact. The amendments would include in rules G-12 and G-15 a requirement that the transaction confirmation indicate that the securities involved in the transaction are available only in book-entry form, if that is the case.

The Board believes that purchasers of municipal securities available only in book-entry form should be advised of this fact on the confirmation, since purchasers of municipal securities customarily expect to be delivered (or to have access to) securities certificates. The Board believes that, in those relatively rare instances where securities are available only in book-entry form (and where this expectation will not be met), purchasers should be aware that this is the case, since their inability to obtain physical securities may raise concerns which might affect their investment decision, such as possible restrictions on their ability to hypothecate or otherwise pledge the securities. Further, purchasers may need to make special arrangements to take delivery of book-entry securities, particularly if they are not participants in a depository.

The Board notes also that the fact that securities are available only in book-entry form generally would be information that should be disclosed to the customer at the time of trade, in accordance with the requirements of Board rule G-17 on fair dealing.

October 4, 1983

Questions concerning the amendments should be directed to Donald F. Donahue, Deputy Executive Director.

Text of Amendments*

Rule G-12. Uniform Practice

(a) and (b) No change.

(c) Dealer Confirmations.

(i) through (v) No change.

(vi) In addition to the information required by paragraph (v) above, each confirmation shall contain the following information, if applicable:

(A) No change.

(B) if the securities are "fully registered," "registered as to principal only," or available only in book-entry form, a designation to such effect;

(C) through (F) No change.

(d) through (l) No change.

Rule G-15. Customer Confirmations

(a) and (b) No change.

(c) In addition to the information required by paragraphs (a) and (b) above, each confirmation to a customer shall contain the following information, if applicable:

(i) No change.

(ii) if the securities are "fully registered," "registered as to principal only," or available only in book-entry form, a designation to such effect;

(iii) through (vii) No change.

(d) through (i) no change.

*Underlining indicates additions; deleted language omitted.

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Rule G-12

Amendments Approved on Interest Payment Checks

On September 30, 1983 the Securities and Exchange Commission approved amendments to the provisions of rule G-12 regarding the dating of interest payment checks provided on inter-dealer deliveries. The amendments were effective upon approval by the Commission.

Board rule G-12 sets forth certain requirements concerning inter-dealer deliveries of securities. Among other matters, the rule provides that, with respect to deliveries of securities made within a certain period of time prior to the interest payment date, the delivering dealer may attach a check in lieu of the next-payable coupon, in the case of a delivery of bearer securities, or, in the case of a delivery of registered securities, the delivering dealer must attach a check for the value of the next interest payment to be received on the securities. Under the previous provisions of the rule, checks provided in lieu of the coupons or for the value of the next interest payment were required to be currently dated—that is, payable as of the date the delivery is presented—even if the coupons were not redeemable or the interest payment made for several weeks after the delivery.

The amendments approved by the Commission revise these requirements to permit the use of post-dated or due bill checks (*i.e.*, checks payable on the interest payment date) on ex-coupon or post-record-date deliveries made prior to the interest payment date.[1] The Board adopted the amendments due to its concern that the costs associated with the use of currently dated checks (*e.g.*, the cost of the use of the funds for the period from the delivery date to the interest payment date) would become excessive, and outweigh the benefits associated with the use of currently dated checks, as a result of the effectiveness of the registration requirements of the Tax Equity and Fiscal Responsibility Act of 1982.

October 5, 1983

Questions concerning the amendments may be directed to Donald F. Donahue, Deputy Executive Director.

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

(e) Delivery of Securities. The following provisions shall, unless otherwise agreed by the parties, govern the delivery of securities:

(i) through (vii) No change.

(viii) Coupon Securities.

(A) through (B) No change.

(C) If delivery of securities is <u>made on or after the thirtieth</u> calendar day prior to an interest payment date, <u>the seller</u> may deliver to the purchaser a draft or bank check of the seller or its agent, payable <u>not later than the interest payment date or the delivery date, whichever is later,</u> in an amount equal to the interest due in lieu of the coupon.

(ix) through (xiii) No change.

(xiv) Delivery of Registered Securities.

(A) through (F) No change.

(G) Payment of Interest. If a registered security is traded "and interest" and transfer of record ownership cannot be accomplished on or before the record date for the determination of registered holders for the payment of interest, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable <u>not later than the interest payment date or the delivery date, whichever is later,</u> for the amount of the interest.

(H) Registered Securities Traded "Flat." If a registered security is traded "flat" (i.e. is in default in the payment of interest) and transfer of record ownership cannot be accomplished on or before the record date for the determination of registered holders for the payment of interest, an interest payment date having been established on or after the trade date, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable <u>not later than the interest payment date or the delivery date, whichever is later,</u> for the amount of the payment to be made by the issuer, unless the security is traded "ex-interest."

(xv) and (xvi) No change.

(f) through (l) No change.

[1] Interest payment checks attached to deliveries made after the interest payment date would, of course, be required to be dated not later than the delivery date.

*Underlining indicates additions; deleted language omitted.

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Rule G-12

Comments Requested on Reclamation of Deliveries

The Board is circulating for public comment certain draft amendments to the provisions of rule G-12(g) regarding reclamations of deliveries of municipal securities. The draft amendments would make two substantive changes to these provisions of the rule as they relate to certain reclamations of securities, and would revise other provisions of the rule to clarify the operation of the reclamation procedure generally.[1] The draft amendments are being circulated for the purpose of eliciting comment prior to further consideration by the Board and filing with the Securities and Exchange Commission.

Provisions of Draft Amendments

The draft amendments propose to require that reclamations of securities which have been reported as lost or stolen be accompanied by evidence of the securities' status.— Board rule G-12(g) currently requires that reclamations of securities be accompanied by a notice of reclamation which states, among other matters, "the reason for . . . reclamation . . ."; the rule does not, however, require that the reclaiming dealer provide evidence substantiating the validity of the reason cited.

The Board has concluded that the absence of such an evidentiary requirement may not be appropriate in the case of a reclamation of securities which have been reported to be lost or stolen, since such a reclamation may have far more serious results than other types of reclamations, and since the delivery problem giving rise to the reclamation is not easily remedied, and the securities reclaimed may not have value to the recipient of the reclamation. Further, parties receiving reclamations of securities which have been reported to be lost or stolen typically attempt to verify the validity of the reclamation by contacting an agent of the issuer or other appropriate person to determine that such a report has been made; in contrast, parties receiving securities reclaimed for other reasons typically can verify the validity of the reclamation by inspecting the securities or checking internal records. Due to the serious nature of a reclamation of "lost or stolen" securities and the need to rely on outside verification of the validity of the reclamation, the Board believes that it may be desirable to require that evidence substantiating the fact that the securities are deemed to be "lost or stolen" securities be provided at the time the reclamation is made.

The draft amendments, therefore, would require that a reclamation of "lost or stolen" securities be accompanied by written evidence substantiating (1) that the securities have been reported to be lost or stolen, and (2) that the loss or theft which is the basis of the report has occurred on or before the date of the delivery being reclaimed. In most instances a single document such as a copy of a "stop payment" letter would be sufficient for both purposes. In certain instances, however, where the loss or theft is not discovered (and/or the report not made) until after the date of the delivery being reclaimed, several documents may be necessary; in these cases, for example, the reclaiming dealer may need to obtain a letter from the party filing the report indicating the date on which the loss or theft is believed to have occurred or the date after which the securities should have been in its possession.

The provision of such documentation, in the Board's view, would provide a more definitive basis for the reclamation, and eliminate the need for duplicative inquiries by each party receiving the reclamation to verify that a report of loss or theft has been filed.

The draft amendments propose to permit partial reclamations in the case of fraudulent or counterfeit securities, or securities which have been reported to be lost or stolen.— The Board has previously interpreted the provisions of rule G-12(g) to permit parties making reclamation to return only those securities which were not in deliverable form at the time of the original delivery (rather than returning all of the securities delivered); however, such parties were required, under this interpretation, to reclaim all of the securities needing to be reclaimed at the same time, rather than making partial reclamations of such securities with the balance to be reclaimed at a later date. The Board continues to believe that such an approach is generally appropriate in order to minimize the burdens of processing reclamations, and,

Comments should be submitted to the Board on or before November 30, 1983, and should be sent to the attention of Donald F. Donahue, Deputy Executive Director. Written comments will be available for public inspection.

[1] These revisions would incorporate into the rule text existing Board interpretations of the reclamation provisions.

accordingly, has included in the draft amendments language incorporating this requirement into the text of the rule.

In the case of reclamations of fraudulent or counterfeit securities or securities which have been reported to be lost or stolen, however, the Board believes that this approach may be unduly burdensome. Such securities typically do not have value to a party holding them in preparation for a reclamation, whether due to the disputed nature of such party's title to the securities or to the securities' intrinsic lack of value. As a consequence, the party holding such securities generally cannot finance the position, and may experience serious financial difficulties if it is forced to hold the securities for any length of time (particularly if it has made payments to parties returning the securities to it) until all of the securities needing to be reclaimed are recovered.

The Board believes that the burdens potentially imposed by the prohibition against partial reclamations of "lost or stolen," fraudulent or counterfeit securities are unnecessarily harsh. Accordingly, the draft amendments propose to permit partial reclamations of securities which are fraudulent or counterfeit, or which have been reported to be lost or stolen.

The draft amendments would clarify the operation of the reclamation procedure and make other technical changes in the rule.—In addition to the two substantive changes described above, the draft amendments would extensively revise the text of the rule to clarify the operation and effect of the reclamation procedure. The draft amendments would conform the definition of the term "reclamation" to accepted industry usage; specify the manner in which a reclamation is to be settled; clarify the effect of the reclamation; provide a more detailed procedure for demanding reclamation (in cases where the party who had previously delivered the securities needs to have them returned); and make other technical changes.

September 16, 1983

Text of Draft Amendments*

Rule G-12. Uniform Practice

(a) through (f) No change.

(g) Rejections and Reclamations.

(i) Definitions. For purposes of this section, the terms "rejection" and "reclamation" shall have the following meanings:

(A) "Rejection" shall mean refusal to accept securities which have been presented for delivery.

(B) "Reclamation" shall mean return by the receiving party of securities previously accepted for delivery.

(ii) Basis for Rejection. Securities presented for delivery may be rejected if the contra party fails to make a good delivery.

(iii) Basis for Reclamation and Time Limits. A reclamation may be made by the receiving party or a demand for reclamation may be made by the delivering party if, subsequent to delivery, information is discovered which, if known at the time of the delivery, would have caused the delivery not to constitute good delivery, provided such reclamation or demand for reclamation is made within the following time limits:

(A) Reclamation or demand for reclamation by reason of the following shall be made within one business day following the date of delivery:

(1) not good delivery because a coupon, or an interest check in lieu thereof, required by this rule to accompany delivery was missing; or

(2) not good delivery because a certificate or coupon was mutilated in a manner inconsistent with the provisions of paragraphs (e)(vii) or (ix) hereof; or

(3) not good delivery because a legal opinion or other documents referred to in paragraph (e)(xi) hereof were missing; or

(4) not good delivery because the securities (which are issuable in both bearer and registered form) were delivered in registered form and were not identified as such at the time of trade.

(B) Reclamation or demand for reclamation because an interest check accompanying delivery was not honored shall be made within three business days following receipt by the purchaser of the notice of dishonor.

(C) Reclamation or demand for reclamation by reason of the following shall be made within 18 months following the date of delivery:

(1) irregularity in delivery, including, but not limited to, delivery of the wrong issue (i.e., issuer, coupon rate or maturity date), duplicate delivery, delivery to the wrong party or location, or over delivery; or

(2) refusal to transfer or deregister by the transfer agent due to presentation of documentation in connection with the transfer or deregistration which the transfer agent deems inadequate; or

(3) information pertaining to the description of the securities was inaccurate for either of the following reasons:

(i) information required by subparagraph (c)(v)(E) of this rule was omitted or erroneously noted on a confirmation, or

(ii) information material to the transaction but not required by subparagraph (c)(v)(E) of this rule was erroneously noted on a confirmation.

(D) Reclamation or demand for reclamation by reason of the following may be made without any time limitation:

(1) the security delivered is reported missing or stolen, or is fraudulent or counterfeit; or

(2) not good delivery because notice of call for less than the entire issue of securities was published on or prior to the delivery date and the securities were not identified as "called" at the time of trade.

The running of any of the time periods specified in this paragraph shall not be deemed to foreclose a party's right to pursue its claim via other means, including arbitration.

(iv) Procedure for Rejection or Reclamation.

(A) If a party elects to reject or reclaim securities, rejection or reclamation shall be effected by returning the securities to the party who had previously delivered them. In the case of a reclamation, the reclaiming party

*New language is underscored; deleted language has been omitted.

may reclaim all (or, in the case of a reclamation pursuant to subparagraph (D)(1) of paragraph (g)(iii) above, any part) of the securities which were not in "good delivery" form on the delivery date in lieu of reclaiming all of the securities delivered.

(B) The rejecting or reclaiming party shall also provide a written notice which contains sufficient information to identify the delivery to which the notice relates. The notice shall have attached to it a copy of the original delivery ticket or other proof of delivery, and shall state, to the extent not set forth on the attached document, the following:

(1) the name of the party delivering the securities;
(2) the name of the party receiving the securities;
(3) a description of the securities;
(4) the date the securities were delivered;
(5) the date of rejection or reclamation;
(6) the par value of the securities which are being rejected or reclaimed;
(7) in the case of a reclamation, the amount of money the securities are reclaimed for;
(8) the reason for rejection or reclamation; and
(9) the name and telephone number of the person to contact concerning the rejection of reclamation.

(C) A party demanding reclamation of securities shall send to the contra-party a notice demanding reclamation of the securities. Such notice shall have attached to it a copy of the original delivery ticket or other proof of delivery, and shall state, to the extent not set forth on the attached document, the information specified in items (1) through (9) of subparagraph (B) above.

(D) In the event of a reclamation or a demand for reclamation of a security reported missing or stolen, the reclaiming party or the party demanding reclamation shall also provide a document or documents made available by the issuer, an agent of the issuer, or other authorized person evidencing the report and evidencing that the loss or theft that is the subject of the report had occurred on or prior to the original delivery date.

(v) Manner of Settlement of Reclamation. Upon reclamation properly made pursuant to this rule, the party receiving the reclamation shall immediately give the party making the reclamation either the correct securities in proper form for delivery in exchange for the securities originally delivered, or the money amount (or the appropriate portion of the money amount) of the original transaction. A party receiving a notice of demand for reclamation shall reclaim the securities which are the subject of such notice as promptly as possible.

(vi) Effect of Rejection or Reclamation. Rejection or reclamation of securities shall not constitute a cancellation of the transaction. In the event of a reclamation of securities, unless otherwise agreed, the party to whom the securities have been reclaimed shall be deemed to be failing to deliver the securities, as of the original transaction settlement date, until such time as a proper delivery is made or the transaction is closed out in accordance with section (h) of this rule.

(h) through (l) No change.

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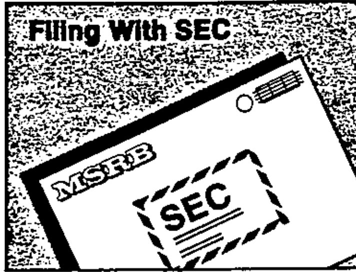

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Rule G-12

Amendments Filed on CUSIP Number Discrepancies

On October 4, 1983 the Board filed with the Securities and Exchange Commission proposed amendments to the provisions of Rule G-12 concerning CUSIP number discrepancies on deliveries. The proposed amendments would clarify that certain exceptions, stated in the rule, to the provisions permitting rejection of a delivery with a CUSIP number discrepancy do not apply to a delivery of a new issue security by an underwriter. The proposed amendments would also delete the reference in the rule to the effective date of the existing provision. The proposed amendments will not become effective until approved by the Commission.

Board rule G-12(e) sets forth certain requirements concerning inter-dealer deliveries of securities. Subparagraph (e)(ii)(B) of the rule provides that the securities delivered on a transaction must have the same CUSIP number as that specified on the confirmation of the transaction in accordance with the requirements of section (c) of the rule; a delivery of securities which did not meet this requirement could be rejected by the receiving dealer. This subparagraph also provides, however, that certain types of discrepancies between the CUSIP number shown on the confirmation and that assigned to the security (*i.e.*, discrepancies resulting from transcription errors or from the assignment of a substitute number) do not constitute an adequate basis for rejection of a delivery.

On July 6, 1983 Board rule G-34 on "CUSIP Numbers" became effective. Rule G-34 requires, among other matters, that the underwriter of a new issue municipal security which is eligible for CUSIP number assignment must have a number assigned to such security and have such number imprinted on or affixed in some other fashion to the security. Subsequent to the effective date of the rule, certain underwriters of new issue municipal securities questioned the relationship between the provisions of rule G-34 and the provisions of rule G-12(e)(ii)(B). These persons inquired, for example, whether a delivery by an underwriter of a new issue municipal security which had an incorrect CUSIP number imprinted upon it could be rejected by the receiving dealer. These persons also asked whether such a delivery could be rejected if the number was incorrect as a result of a transcription error. The Board advised these persons that rule G-34 clearly requires an underwriter making a delivery of a new issue municipal security to affix the correct CUSIP number to the security; failure to do so (whether by omitting the number entirely or by affixing an incorrect number) would be a violation of this requirement of rule G-34. Further, such a delivery could in many instances be rejected by the recipient, depending on the nature of the error in the printing of the number.

The Board is of the view that underwriters delivering new issue municipal securities should in all cases be delivering securities with the correct CUSIP number imprinted on them, and that in no circumstances should underwriters be permitted to deliver new issue municipal securities with incorrectly imprinted numbers. Although an underwriter delivering securities with incorrectly imprinted numbers could be subject to an enforcement action for violation of Board rule G-34, the Board believes that the delivery requirements of rule G-12(e) should be amended to permit persons receiving such deliveries from an underwriter to reject the delivery in all cases. The Board notes that this would further the objectives of Board rule G-34 by preventing securities with inaccurate CUSIP numbers from being introduced into the market; the Board also believes that this would provide a more immediate and effective means of ensuring compliance with the requirements of rule G-34. Accordingly, the proposed amendments would revise the provisions of rule G-12(e)(ii)(B) to make clear that in all cases new issue municipal securities delivered on inter-dealer transactions must have the correct CUSIP number imprinted on or otherwise affixed to them.

The proposed amendments also delete the last sentence of subparagraph (e)(ii)(B), which set forth the now-past effective date of the subparagraph.

October 4, 1983

Questions concerning the proposed amendments should be directed to Donald F. Donahue, Deputy Executive Director.

Text of Proposed Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

*Underlining indicates new language; broken line indicates deletion.

(e) Delivery of Securities. The following provisions shall, unless otherwise agreed by the parties, govern the delivery of securities:

(i) No change.

(ii) Securities Delivered.

(A) No change.

(B) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of subparagraph (c)(v)(F) of this rule; provided, however, that, for purposes of this subparagraph, a security (other than a new issue security delivered by an underwriter) shall be deemed to have the same CUSIP number as that specified on the confirmation (1) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (2) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security. ~~The provisions of this subparagraph (B) shall become effective on January 23, 1983.~~

(iii) through (xvi) No change.

(f) through (l) No change.

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Rule G-12

Notice of Withdrawal of Draft Amendment on Partial Deliveries

On May 2, 1983 the Board released for public comment a draft amendment to the provisions of Board rule G-12 regarding partial deliveries on transactions between municipal securities brokers and municipal securities dealers. The draft amendment would have specified that a party receiving a partial delivery on such a transaction in an amount of $25,000 par value securities or more would be required to accept such delivery. The Board has determined not to adopt the draft amendment at this time, for the reasons discussed below.

In response to the May 1983 exposure draft the Board received 22 letters of comment from members of the municipal securities industry and others. Certain of these commentators favored adoption of the draft amendment, asserting that it would reduce the total dollar volume of failed transactions in municipal securities and foster the use of automated systems for the clearance of transactions. Other commentators—the substantial majority—opposed adoption of the draft amendment. These persons argued that the draft amendment would increase dealers' interest costs, impose a serious burden on smaller dealers who sold securities to individual investors and small institutions (since these dealers would be unable to redeliver securities received on a partial delivery to such persons), and eliminate incentives for the completion of failed transactions. These persons also asserted that the relative lack of fungibility of municipal securities made it impossible to minimize the burdens imposed by the draft amendment through borrowing or purchasing replacement securities, and exposed the recipient of a partial delivery to significant market risk if the selling dealer was unable to deliver the balance of the securities owed on the transaction.

The Board is persuaded that the commentators opposing adoption of the draft amendment have raised significant concerns about the effect of the amendment were it to be adopted at present. Although the Board continues to believe that the draft amendment may offer benefits to the municipal securities industry, the Board has concluded that these potential benefits are currently outweighed by the potential negative effects cited by the commentators. Accordingly, the Board has determined to withdraw the draft amendment at this time.

The Board believes, however, that the potential negative effects of the adoption of the draft amendment that currently necessitate its withdrawal may be ameliorated over time as the industry's clearance systems become more efficient and a national clearance and settlement system for municipal securities transactions develops. The Board intends to continue to monitor the state of the industry's clearance systems, and, in particular, the impact of the adoption of automated clearance procedures on such systems. Should future developments warrant, the Board will revisit the question of the draft amendments at an appropriate date and may repropose the amendment for further comment at that time.

October 5, 1983

Questions concerning this notice should be directed to Donald F. Donahue, Deputy Executive Director.

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Rules G-12 and G-15

Amendments Approved on Transactions in Zero Coupon, Compound Interest and Multiplier Securities

On October 12, 1983, the Securities and Exchange Commission approved the Board's amendments to rules G-12 on uniform practice and G-15 on customer confirmations concerning the information to be set forth on both inter-dealer and customer confirmations of transactions in zero coupon, compound interest and multiplier securities.

Some new issues of municipal securities sold in recent years have had several maturities with a stated interest rate of 0% ("zero coupon" securities). Such securities are sold at deep discounts, with the investor's return received in the form of an accretion of this discount to par. Other issues, often described as "compound interest" or "multiplier" securities, have been issued with a stated rate of investment return; an investor purchasing such a security would receive at maturity a single payment (the "maturity value") representing both return of the initial principal value and payment of an investment return accrued over the life of the instrument at a stated, compounded rate.

In response to industry inquiries, the Board published a notice requesting comments and discussing the application of Board rules to transactions in zero coupon, compound interest and multiplier securities.[1] The notice, in part, reminded dealers that the Board's fair dealing rule, rule G-17, imposes an obligation on persons selling these securities to the public to disclose their important characteristics adequately. For example, it is essential that investors be made aware that such securities do not pay interest on a periodic basis. Further, the call features applicable to zero coupon, compound interest, and multiplier securities usually permit such securities to be called at a price substantially below the maturity value; the Board concluded that this is material information which should be disclosed at or before the time of trade. Additionally, because the tax considerations associated with investments in these types of securities are complex, investors purchasing such securities should be advised, at minimum, of the need to consult with tax advisors on the proper treatment of income received from such investments.

Maturity Value of the Securities

The amendments require that the quantity of securities shown on confirmations of transactions in zero coupon, compound interest and multiplier securities shall be the maturity value of the securities.

Board rules G-12 and G-15 require that confirmations of transactions state the "par value of the securities." The amendments reflect the fact that zero coupon, compound interest and multiplier securities are likely to be traded and sold on the basis of their maturity value.[2]

Description of the Interest Rate

The amendments provide that the interest rate shown on confirmations of transactions in the subject securities shall be stated as "0%."

Board rules G-12 and G-15 require that inter-dealer and customer confirmations set forth certain descriptive details about the securities, including the "interest rate." The confirmation rules require that a confirmation of a transaction in a zero coupon security state the interest rate as "0%." The Board also concluded that confirmations of transactions in compound interest and multiplier securities should identify the "interest rate" as "0%." The Board believed that such information will help to alert purchasers to the fact that they will not receive "interest" payments in the same fashion as with more traditional municipal securities and also may prevent customers from mistakenly assuming that the subject securities pay "interest" in addition to the investment return included in the maturity value.

Transaction Moneys

The amendments provide that, with respect to confirmation disclosure of transaction moneys for transactions involving zero coupon, compound interest and multiplier securities, a figure representing accrued interest is not required to be included on the confirmation.

Rules G-12 and G-15 require that confirmations show the "total dollar amount of [the] transaction," as well as its components—an "extended principal amount" and an "amount of accrued interest." Since zero coupon securities have a stated interest rate of "0%," they would not have "accrued interest." A confirmation of a transaction in such securities,

Questions regarding this notice may be addressed to Angela Desmond, General Counsel.

[1]The October 1982 notice is set forth in *MSRB Reports*, vol. 2, no. 2 (October/November 1982), at 13–15 as well as in the "New Developments" section of the CCH *MSRB Manual*, ¶10,225.
[2]The Board notes that, in the case of a zero coupon security, the maturity value of the security will be the same as the "par value," since such securities are initially sold at a stated (deep discount) percentage of "par value."

therefore, sets forth an "extended principal amount" and an (equal) "total dollar amount," with both the initial principal and the investment return (accreted discount) included in this single sum. A similar method of presenting the money detail on the confirmation of a transaction in a compound interest or multiplier security is now permitted. As is the case with zero coupon securities, the price of a transaction in these instruments may be based upon the present value of the single "maturity value" amount. The Board is of the view that breaking up this single present value amount into initial principal and "accrued interest" components would not provide additional meaningful information to the customer.

Yield and Dollar Price Calculation

The amendments clarify the application of the yield disclosure requirements of rule G-15 to customer confirmations of transactions in the subject securities by deleting the adjective "premium" in the rule's reference to the computation of yield "to premium call."

Rule G-15 requires that customer confirmations must set forth the yield and the related dollar price. The yield shown on the confirmation must be the lowest of the yield to premium call, yield to par option, or yield to maturity. This requirement is currently applicable to transactions in zero coupon, compound interest, and multiplier securities and the Board is firmly of the view that the continued application of this requirement is appropriate. As is the case with traditional municipal securities, these types of securities may have call features providing for the call to commence at a premium price (above the compounded or the accreted value of the security as of the call date) which then declines to a price equal to the value of the security as of the call date. Since the latter calls are not really appropriately described as "par options," the word "premium" has been deleted to clarify that a dealer seeking to determine the lowest "yield to call" should take these calls, as well as the premium calls, into consideration.

The amendments included a similar change in the dollar price computation provisions of rule G-12(c)(v)(I) relating to inter-dealer confirmations.

The amendments will become effective on December 12, 1983.

October 12, 1983

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (b) No change.

(c) Dealer Confirmations

(i) through (iv) No change.

(v) Each confirmation shall contain the following information:

(A) through (H) No change.

(I) yield at which transaction was effected and resulting dollar price, except in the case of securities which are traded on the basis of dollar price or securities sold at par, in which event only dollar price need be shown (in cases in which securities are priced to [premium] call or to par option, this must be stated and the call or option date and price used in the calculation must be shown, and where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to [premium] call price to par option, or price to maturity);

(J) through (N) No change.

The confirmation for a transaction in securities traded on a discounted basis (other than discounted securities traded on a yield-equivalent basis) shall not be required to show the pricing information specified in subparagraph (I) nor the accrued interest specified in subparagraph (K). Such information shall, however, contain the rate of discount and resulting dollar price. Such confirmation may, in lieu of the resulting dollar price and the extended principal amount specified in subparagraph (L), show the total dollar amount of the discount.

The confirmation for a transaction in securities maturing in more than two years and paying investment return solely at redemption shall not show the par value of the securities specified in subparagraph (D) and shall not be required to show the amount of accrued interest specified in subparagraph (K). Such confirmation shall, however, show the maturity value of the securities and specify that the interest rate on the securities is "0%."

The initial confirmation for a "when, as and if issued" transaction shall not be required to contain the information specified in subparagraphs (H), (K), (L), and (M) of this paragraph or the resulting dollar price as specified in subparagraph (I).

(vi) No change.

(d) through (l) No change.

Rule G-15. Customer Confirmations

(a) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation of the transaction containing the following information:

(i) through (viii) No change.

(ix) yield and dollar price as follows:

(A) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to [premium] call, price to par option, or price to maturity.

(B) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to [premium] call, yield to par option, or yield to maturity shall be shown.

(C) for transactions at par, the dollar price shall be shown.

In cases in which the resulting dollar price or yield shown on the confirmation is calculated to [premium] call or par option, this must be stated, and the call or option date and price used in the calculation must be shown;

(b) through (d) No change.

(e) The confirmation for a transaction in securities maturing in more than two years and paying investment return solely at redemption shall not show the par value of the securities specified in subparagraph (iv) of paragraph (a) and shall not be required to show the amount of accrued interest specified in subparagraph (iv) of paragraph (a). Such confirmation shall, however, show the maturity value of the securities and specify that the interest rate on the securities is "0%."

[(e)] through [(i)] renumbered as (f) through (j). No substantive change.

*Underlining indicates new language; brackets indicate deletions.

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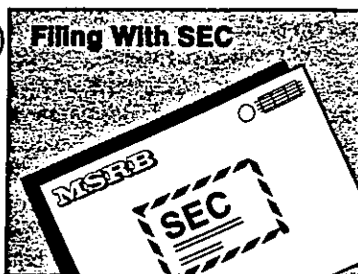

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Rules G-12 and G-15

Amendments Filed on Use of Automated Clearance Services

On September 7, 1983, the Board filed with the Securities and Exchange Commission certain proposed amendments to rules G-12 and G-15 regarding the use of automated clearance and settlement systems with respect to certain inter-dealer and customer transactions.[1] The proposed amendments, which are substantially similar to amendments issued in exposure draft form on March 14, 1983, require (1) that certain transactions between municipal securities brokers and dealers be compared and, where eligible, settled via book-entry through the facilities of a registered clearing agency, and (2) that certain transactions between municipal securities brokers and dealers and customers be confirmed, acknowledged, and, where eligible, settled via book-entry through the facilities of a registered securities depository. The Board is requesting that the Commission approve the proposed amendments for a "phased-in" implementation, with the requirements relating to the automated comparison or confirmation of transactions to become effective on August 1, 1984, and the requirements relating to the book-entry settlement of transactions to become effective on February 1, 1985.

Background

Board rule G-12 sets forth certain standards governing the confirmation, comparison, clearance and settlement of transactions between municipal securities brokers and municipal securities dealers. Rule G-15 sets forth standards, substantially similar to those of rule G-12(c), regarding confirmations of transactions sent by municipal securities brokers and dealers to customers; the rule does not currently set forth standards concerning the clearance and settlement of such transactions.[2]

Since its inception the Board has viewed the promotion of efficiency in the clearance and settlement of municipal securities transactions as an important objective of its rulemaking. The Board has taken a variety of actions to achieve this end, including actions to facilitate the clearance of physical securities and also, in certain cases, actions to remove obstacles to the development and use of automated clearance systems. As the Board has been implementing these changes to industry practices, several organizations have been putting into place programs for the automated clearance of municipal securities transactions. Experience with these programs has demonstrated that automated clearance techniques can be successfully adopted for use in the clearance of municipal securities transactions. The Board has actively monitored the development of and experience with these systems, and has sought to encourage their use through its participation in industry educational meetings and otherwise.[3]

The Board has recently concluded that it would be appropriate at this time to take regulatory action that would significantly increase the usage of automated systems for the clearance and settlement of municipal securities transactions. The Board has arrived at this view for several reasons:

(1) The Board is satisfied that the use of automated clearance systems will, in the aggregate, result in substantial cost savings to the municipal securities industry and other participants in the municipal securities markets. The extremely repetitive and labor-intensive processes currently followed in the clearance of most municipal securities transactions, and the relative inefficiency in clearance resulting from such processes, impose substantial burdens on industry members and others in terms of operational expenses, interest costs, and increased capital needs. The elimination of the need to follow these processes through the use of automated systems to clear municipal securities transactions will unquestionably reduce such burdens and expenses substantially in the aggregate.

(2) The Board also believes that the transition to the use of registered form municipal securities mandated by the Tax Equity and Fiscal Responsibility Act of 1982 both increases the difficulties in the clearance of physical municipal securities and provides an opportunity for the adoption of more

Questions concerning the proposed amendments may be directed to Donald F. Donahue, Deputy Executive Director.

[1]A photocopy of the G-12 and G-15 notice of filing on the use of automated clearance and settlement systems was mailed with the September 1983 issue of *MSRB Reports.* The notice is printed here for your convenience.

[2]In an exposure draft dated August 15, 1983 the Board circulated for comment amendments to the rule which would establish such standards. *See MSRB Reports,* vol. 3, no. 5 (September 1983), at 21–24.

[3]On April 19, 1983 the Board filed with the Commission a report on the *Prospects for Automation of Municipal Clearance and Settlement Procedures* which reviews these regulatory and other actions by the Board and other organizations in detail. Copies of this report are available from the Board's office upon request.

efficient clearance systems. The municipal securities industry's unfamiliarity with the general use of registered instruments, and the necessity to record all transfers of securities on the books of a registrar or transfer agent will reduce further the industry's efficiency in handling physical municipal securities, contributing to increases in costs. These increases in costs, together with increases in issuance costs resulting from the registration requirement, have prompted many municipal securities issuers and industry members to consider, and a substantial number to adopt, automated clearance systems as the means of distributing and subsequently trading issues of registered municipal securities. The Board is of the view that this process can be further encouraged by regulatory action to increase the use of such systems.

(3) The Board also deems such action to be appropriate at this time in view of the adoption in 1982 of certain amendments to the rules of the National Association of Securities Dealers, Inc., and various of the securities exchanges to mandate the use of automated clearance systems for certain transactions in corporate securities with customers.[4] These amendments generally preclude broker-dealers who are participants in a securities depository from effecting transactions for the accounts of customers who also are participants in a securities depository on a receipt-vs.-payment ("RVP") or delivery-vs.-payment ("DVP") basis unless the facilities of a securities depository are used for the confirmation and book-entry settlement of such transactions. The Board has concluded that the adoption at this time of rule changes similar to these amendments would offer benefits to members of the municipal securities industry in terms of a lessening of the "DK" problem with respect to municipal securities transactions. This action would also permit the municipal securities industry to implement necessary changes with the benefit of the experience of those involved in preparing for compliance with the amendments previously adopted by other self-regulatory organizations.

For these reasons the Board has adopted the proposed amendments, which are described more fully below.

The July 1982 Proposal

The Board's initial consideration of the adoption of rule amendments mandating the use of automated clearance systems was prompted by comments from members of the municipal securities industry and others urging the Board to adopt requirements with respect to municipal securities transactions similar to those for corporate securities transactions proposed by the SIA/NYSE task force and incorporated in the rule changes of the other self-regulatory organizations described above. As a result of these comments the Board released an exposure draft on July 26, 1982 proposing the adoption of substantially the same requirements with respect to municipal securities transactions.[5] Under the July 1982 proposal, transactions in depository-eligible securities effected between a municipal securities broker or dealer and a customer, both of whom were, directly or indirectly, participants in such depository (or another depository or clearing corporation interfaced with such depository), were required to be confirmed, acknowledged, and settled via book-entry through the facilities of such depository, if the transactions were to be effected on a DVP or RVP basis. If, in the case of a transaction subject to the provisions of the July 1982 proposal, the customer refused to use the facilities of the depository, the municipal securities broker or dealer would not be permitted, under the proposal, to effect the transaction on a DVP or RVP basis; in the case of a DVP transaction, therefore, this would require that the customer submit payment for the securities prior to the actual delivery.

The Board received 24 letters of comment on the July 1982 proposal from investors, municipal securities brokers and dealers, and others. The majority of the commentators supported the adoption of requirements for the use of automated confirmation and book-entry settlement systems for customer DVP/RVP transactions. The commentators did, however, raise certain issues with respect to the specifics of the July 1982 proposal:

(1) Certain of the commentators expressed the view that the limitation of the requirement to those transactions which involved depository-eligible securities inappropriately restricted the benefits that would be realized from the requirement, in view of the limited number of issues of municipal securities eligible at the depositories.[6] These commentators suggested that the requirement should be expanded to require automated confirmation and acknowledgement of any transaction between participants that involved a security which had been assigned a CUSIP number, with the limitation to depository-eligible securities applicable only to the book-entry settlement portion of the proposed requirement.

(2) Certain commentators expressed concern that identifying customers as depository participants (which would be necessary for purposes of complying with the requirements of the July 1982 proposal) would be a difficult process, and that the determination of whether securities were depository-eligible would also cause delays in the confirmation of transactions. These comments suggested to the Board that some means should be found of minimizing these difficulties.

(3) Other commentators generally expressed the view that adoption of such a requirement with respect to customer DVP/RVP transactions would not be appropriate without the development of similar requirements with respect to inter-dealer transactions.

The March 1983 Proposals

The Board considered the comments received on the July 1982 proposal at its February 1983 meeting. At that time the Board approved the release of two further exposure drafts:

[4]In 1980 the Securities Industry Association and the New York Stock Exchange formed a joint task force to propose solutions to the problem of the increasing number of rejections of deliveries to institutional customers' clearing agents due to a lack of instructions regarding the acceptance of such deliveries (the so-called "'DK' problem"). After considerable discussion the joint task force proposed a partial solution to the "DK" problem involving the increased use of securities depositories to confirm and settle delivery-vs.-payment and receipt-vs.-payment transactions. The joint task force's proposal was accepted by several of the securities industry self-regulatory organizations who filed rule changes to implement the proposal with respect to corporate securities transactions. These rule changes were approved by the Commission on November 9, 1982 (*see* Exchange Act Release No. 19227), and became effective on January 1, 1983.

[5]The July 1982 exposure draft is contained in *MSRB Reports*, vol. 2, no. 6 (August 1982), at 3–5, and also in the "New Developments" section of the CCH *MSRB Manual*, ¶10,224 at 10,700–04.

[6]As of the beginning of March 1983, approximately 82,000 issues of municipal securities were eligible for deposit at one or more of the securities depositories, out of a total of approximately 1,300,000 municipal issues.

a revised version of the proposal concerning customer DVP/RVP transactions and a proposal to adopt similar requirements with respect to inter-dealer transactions; the exposure drafts were released on March 14, 1983.[7]

The March 1983 customer DVP/RVP proposal addressed the comments previously received by proposing (1) to expand the coverage of the proposed requirement for the use of the automated confirmation and acknowledgment systems to all issues of municipal securities with an assigned CUSIP number,[8] and (2) to include requirements that certain information be obtained from customers in connection with DVP/RVP transactions, including information regarding the customer's clearing arrangements that would be helpful in determining whether the customer was a depository participant.[9] Under the March 1983 customer DVP/RVP proposal, therefore, municipal securities transactions effected on a DVP or RVP basis between a depository-participant dealer and a depository-participant customer must be confirmed and acknowledged through the facilities of a depository, if the transaction involves an issue of securities which has been assigned a CUSIP number, and be settled via book-entry through the facilities of the depository, if the securities are depository-eligible.

The March 1983 inter-dealer exposure draft proposed to apply substantially similar requirements to inter-dealer transactions. Under the inter-dealer proposal, if the two parties to a transaction were participants in one or more clearing corporations offering automated comparison services for municipal securities, and if the securities involved in the transaction were eligible for such services,[10] then the parties would be obliged to compare the transaction through these automated systems. Similarly, under the inter-dealer proposal, compared transactions between depository-participant dealers involving depository-eligible securities would be required to be settled via book-entry through the facilities of the depository. The one significant distinction between the inter-dealer and the customer DVP/RVP proposals was the limitation of the inter-dealer proposal to only those dealers who were directly participating in a clearing corporation or a securities depository.

The Board received 27 letters of comment on the March 1983 proposals, primarily from municipal securities brokers and dealers and other interested members of the municipal securities industry. The majority of these letters again were supportive of the general substance of the proposals.

The Proposed Amendments

The requirements of the proposed amendments are substantially the same as those of the March 1983 exposure drafts. With respect to inter-dealer transactions, the proposed amendments incorporate into rule G-12 a new section (f), which provides (1) that transactions must be compared through the automated facilities of a registered clearing corporation if the parties of the transaction are clearing corporation participants and the securities are eligible for comparison, and (2) that successfully compared transactions must be cleared and settled via book-entry through the facilities of a securities depository if the parties are depository participants and the securities are depository-eligible. With respect to customer DVP/RVP transactions, the proposed amendments incorporate into rule G-15 a new section (d) which provides as follows:

(1) With respect to all DVP/RVP transactions with customers, the proposed amendments require that the municipal securities broker or dealer (a) obtain the name and address of the customer's clearing agent and the name and account number of the customer as known to the agent, (b) identify such transactions as DVP or RVP transactions on the trading ticket, (c) send the confirmation to the customer not later than the first business day following the trade date, and (d) obtain a representation (either written or oral) from the customer that instructions regarding the transaction will be transmitted to the customer's agent by certain specified times.

(2) With respect to DVP/RVP transactions between dealers and customers which are depository participants, the proposed amendments require that the transaction be confirmed and acknowledged through the facilities of a securities depository if the securities involved in the transaction have been assigned a CUSIP number, and that the transaction be settled via book-entry if the securities are depository-eligible.

The proposed amendments, however, are different from the proposals contained in the March 1983 exposure drafts in two important respects. First, the proposed amendment to rule G-12 applies to inter-dealer transactions involving indirect, as well as direct, clearing corporation or depository participants; that is, municipal securities brokers and dealers who are not direct participants in a clearing corporation or depository, but who clear through an entity (a bank or other clearing agent) who is a participant, would be subject to the provisions of the proposed amendment to rule G-12. This change was proposed by several of the commentators on the March 1983 inter-dealer exposure draft, who asserted that it would promote further efficiency in the clearance and settlement of inter-dealer transactions by significantly increasing the number of transactions required to be cleared by automated means. The Board agreed with this suggestion, and determined to incorporate it in the proposed amendments. The Board noted also that such a revision

[7]The March 1983 exposure drafts are contained in *MSRB Reports*, vol. 3, no. 2 (April 1983), at 3–8, and also in the "New Developments" section of the CCH *MSRB Manual*, ¶10,239 and ¶10,240 at 10,737–43.

[8]The Board noted in the March 1983 customer DVP/RVP exposure draft that the expansion of the coverage of the requirement to include all issues with assigned CUSIP numbers would eliminate the problem of determining the depository-eligibility of securities. It therefore would no longer be necessary to make such a determination for purposes of confirmation processing, and the submitting party would subsequently be advised by the depository as to the eligibility of the securities, in preparation for the clearance and settlement of the transactions.

[9]The draft indicated that these requirements would apply to all DVP/RVP transactions with customers, including transactions not subject to the requirements for the use of automated confirmation and book-entry clearance systems. The Board believes that these requirements will promote efficiency in the clearance of DVP/RVP transactions generally by ensuring that more complete information regarding the clearance of the transaction is obtained and that information and instructions regarding the transaction are furnished promptly.

[10]Municipal securities asssigned a CUSIP number are generally deemed eligible for comparison services by clearing corporations offering such services. The group of securities subject to the proposed requirement for automated comparison, therefore, is the same as that subject to the requirement for automated confirmation under the customer DVP/RVP transactions proposal.

would make the proposed amendment regarding inter-dealer transactions more consistent with that concerning customer DVP/RVP transactions.

The second significant difference between the proposed amendments and the March 1983 proposals is the manner of implementation of the requirements. Certain of the commentators on the March 1983 exposure drafts suggested that the requirements proposed in the exposure drafts be implemented in stages, with one commentator proposing that different groups of transactions become subject to the requirements at different times, and others urging that different portions of the proposed requirements become effective at different times. The Board concurred with this suggestion, and determined to "phase in" the requirements of the proposed amendments over time. Accordingly, the proposed amendments provide that the requirements for the use of automated comparison or automated confirmation and acknowledgement systems shall become effective on August 1, 1984, and the requirements for the use of book-entry settlement systems shall become effective on February 1, 1985.

The Board believes that this "phase-in" approach is appropriate to permit time for all persons affected by the amendments to prepare for their implementation. The Board notes that a significant number of persons affected by the proposed amendments (*e.g.*, dealer banks, sole municipal securities firms) were not subject to the comparable amendments adopted by certain of the other self-regulatory organizations for effectiveness January 1, 1983. Consequently, such persons will need time to complete all of the preparatory tasks (*e.g.*, training of personnel, reprogramming, recoding of customer accounts, etc.) necessary for smooth implementation of the proposed amendments. In addition, those persons already subject to these other amendments will also need some period of time to prepare for implementation of the proposed amendments, to complete tasks necessitated by the application of these requirements to municipal securities transactions. The Board believes that it is reasonable to expect that these preparatory tasks will be completed by August 1, 1984.

The Board also believes that the requirement for book-entry settlement of subject transactions should be further deferred, to permit persons with little familiarity with automated clearance and settlement systems time to gain experience in the use of automated confirmation or comparison systems before applying the additional requirement for book-entry settlement. In contrast to the corporate securities markets, many significant participants in the municipal securities markets have not previously been participants in automated clearance systems. The Board believes that a "phased-in" implementation of the requirements of the proposed amendments will permit these persons to adapt to the use of automated systems in a reasonable and orderly fashion, rather than imposing on them a complete alteration of their clearance methods as of a single date. Accordingly, the proposed amendments specify that the requirements for book-entry settlement of subject transactions will become effective on February 1, 1985.

In addition to these substantive changes, the Board also made several technical revisions in the requirements of the proposed amendment to rule G-15 relating to all customer DVP/RVP transactions. These revisions (1) conform the language of the requirement that confirmations of such transactions be sent within one business day to the language of the existing confirmation provisions of rule G-15; (2) eliminate the implication that the municipal securities broker or dealer must obtain the customer's representation regarding the timing of the transmission of instructions to the customer's agent in writing; and (3) conform the time limits for such transmission to those followed in the existing automated confirmation systems. The language of the proposed amendments has also been redrafted in some respects in accordance with suggestions made by certain commentators.

The proposed amendments also effect certain structural changes to rules G-12 and G-15. The proposed amendments rescind existing section (f) of rule G-12; the Board believes that the existing section (f) is no longer necessary, since all of its requirements are duplicative of other Board rules (most particularly, rule G-33 on calculations). The proposed amendments also retitle rule G-15 "Confirmation, Clearance and Settlement of Transactions with Customers," and redesignate the existing provisions of the rule as new section (a), "Customer Confirmations." New sections (b) and (c) of the revised rule G-15 are designated in the proposed amendments as "reserved for future rulemaking"; the Board released on August 15, 1983 an exposure draft of new sections (b) and (c) of the revised rule, which would establish standards for settlement dates and physical deliveries on transactions with customers.[11]

Additional Comments

In addition to those comments reviewed above, the commentators on the July 1982 and March 1983 exposure drafts raised a variety of issues concerning the proposals set forth in the exposure drafts, as follows:

(1) Certain of the commentators on the July 1982 exposure draft disputed the existence or the causes of a "DK" problem with respect to municipal securities transactions. The Board continues to believe that the summary of the "DK" problem and its causes set forth in the July 1982 exposure draft is substantially accurate. That description indicated that the "DK" problem in the clearance of municipal securities is likely to be at least as severe as that in the clearance of other types of securities; the concerns expressed by others of the commentators appear to confirm this view. The exposure draft analysis attributed the "DK" problem to delays in the receipt of confirmations by customers, and in the receipt of instructions by customers' clearing agents, due to problems with the mail service and fluctuations in the volume of transactions. The proposed amendments to rule G-15 would substantially eliminate those problems by automating the confirmation and instructions transmission processes.

(2) Certain of the commentators on the July 1982 exposure draft expressed concern that the depositories' limited experience in handling municipal securities transactions and the

[11] *See MSRB Reports*, vol. 3, no. 5 (September 1983), at 21–24.

municipal securities industry's limited experience in using automated systems for the clearance of transactions might make the adoption of such a proposal premature. The Board believes that the existing programs for the automated clearance and settlement of municipal securities transactions have been successful and have clearly demonstrated the feasibility and usefulness of such systems for municipal securities. With respect to the inexperience of certain municipal securities brokers and dealers, the Board believes that the provision in the proposed amendments for a "phased-in" implementation of the requirements should alleviate any difficulties in this regard.

(3) Commentators on both the July 1982 and March 1983 proposals stressed the importance of functioning interfaces between the clearing corporations and depositories offering automated clearance and settlement services for municipal securities transactions, and also urged that the depositories develop essentially identical eligibility standards. The Board shares the commentators' perception of the importance of both of these issues, but does not believe that the adoption of the proposed amendments should be delayed pending their resolution. Further, the Board understands that the two depositories currently involved in the book-entry settlement of municipal securities transactions already are interfaced with respect to transactions in registered municipal securities, and have agreed in principle on an interface between their system for bearer municipal securities.

(4) Several commentators on the March 1983 proposals urged that the Board require that all municipal securities brokers and dealers become participants in registered clearing agencies. The Board continues to believe that it would not be appropriate to propose such a rule at this time.

(5) One commentator on the March 1983 proposals noted that the Federal Reserve banks were considering making available for municipal securities transactions services comparable to their existing book-entry delivery system for certain U.S. government securities; this commentator urged the Board to include in the proposed amendments a provision recognizing the potential existence of such services. The Board views with interest the Federal Reserve banks' consideration of the establishment of such a system for municipal securities transactions, but believes that it would be inappropriate to include in the proposed amendments at this time a provision relating to a book-entry delivery system that does not currently exist with respect to the issues of municipal securities potentially subject to the proposed amendments.[12] At such time as the Federal Reserve banks implement such a system the Board will consider the adoption of appropriate amendments to its rules with respect to the use of such a system.

(6) Certain of the commentators questioned whether the proposed amendments would require the use of a system such as The Depository Trust Company's Institutional Delivery ("ID") system for purposes of automated comparison in the event that such system is made available for this purpose and one of the parties to an inter-dealer transaction is a participant in the depository offering such a system but does not participate in any other registered clearing agency. The Board understands that the ID system and comparable systems may be made available in the near future for purposes of submission of transaction information to an automated comparison system. In the event that this occurs, persons participating only in a depository offering such a system would be considered to be members of a registered clearing agency for purposes of the proposed amendment to rule G-12 and would therefore be subject to the requirements of the proposed amendment to rule G-12 with respect to automated comparison of inter-dealer transactions.

(7) Certain of the commentators on both the July 1982 proposal and the March 1983 proposals questioned their application to a dealer bank whose affiliated trust department was a depository participant. The Board believes that it is clear that such dealer banks would be considered to be participants in the depository, and, as such, subject to the provisions of the proposed amendments.

(8) Certain of the commentators on the March 1983 inter-dealer proposal expressed concern that the proposal appeared to require the use of other services offered by registered clearing agencies (*e.g.,* envelope delivery services) for the settlement of transactions in securities that were not depository-eligible. The Board did not intend such a result, and has deleted the language in the text of the proposed amendment to rule G-12 that appeared to these commentators to impose such a requirement.

(9) One of the commentators on the March 1983 inter-dealer proposal construed the proposal as requiring the use of transaction "netting" services offered by the clearing corporations, and objected to such a requirement. The Board wishes to emphasize, as it had previously stated in the March 1983 exposure draft, that the proposed amendment to rule G-12 does not require the use of "netting" services on inter-dealer transactions.

Impact on Competition

Certain of the commentators on the July 1982 and March 1983 proposals questioned their effect on competition between municipal securities brokers and dealers and on competition among persons offering clearing or custodial services. The Board does not believe that the proposed amendments will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act of 1934, as amended, and, in particular, Sections 15B(b)(2)(C) and Section 17A of the Act.[13] Further, the Board believes that any competitive impact

[12]The Board understands that the Federal Reserve banks may shortly make available a book-entry system for municipal project notes. However, since project notes are not depository-eligible securities, the book-entry delivery requirements of the proposed amendments would not conflict with the Federal Reserve's plans.

[13]Section 15B(b)(2)(C) of the Act requires and empowers the Board to adopt rules

> designed . . . 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 . . .

Section 17A of the Act mandates the establishment of a national system for the clearance and settlement of securities transactions, including municipal securities transactions.

resulting from the proposed amendments will be relatively insignificant and far outweighed by the cost savings to be realized, in the aggregate, by the municipal securities industry and investors in municipal securities.

With respect to competition between municipal securities brokers and dealers, the Board believes that the limitation of the application of the proposed amendments to only those persons who have elected to participate in a clearing corporation or depository minimizes substantially the competitive effects directly attributable to the adoption of the proposed amendments. The Board does not perceive that the requirement in the proposed amendments for the use of automated confirmation or comparison systems will have any impact on competition between municipal securities brokers and dealers, since the requirement simply modifies the means of transmission of transaction information and the procedure for comparison of such information for all persons subject to the requirement, without making any distinction among classes of such persons.

With respect to the requirement in the proposed amendments for book-entry settlement of certain transactions, the Board believes that such a requirement may have a different impact on municipal securities brokers and dealers whose clients are primarily individual rather than institutional investors, since the former class of dealers may have greater need to withdraw securities (previously delivered to them via book-entry in accordance with the proposed amendments) from the depository to satisfy delivery obligations to their clients, and, consequently, incur higher costs. The Board notes, however, that the need to withdraw securities can be substantially minimized through the use of safekeeping arrangements; the Board also believes that this differential in cost impact, to the extent it is, in fact, experienced, is substantially outweighed by the aggregate cost savings and increased clearance efficiency resulting from the proposed amendments. The Board does not perceive any other potential impact on competition between municipal securities brokers and dealers resulting directly from the adoption of the proposed amendments.

With respect to competition between clearing agents and competition between custodial or safekeeping agents, the Board does not believe that any significant effects on competition will be realized that are not significantly outweighed by the aggregate cost savings and increased efficiency resulting from the adoption of the proposed amendments.

September 9, 1983

Texts of Proposed Amendments*

Rule G-12. Uniform Practice

(a) through (e) No change.

(f) Use of Automated Comparison, Clearance, and Settlement Systems.

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, with respect to a transaction in municipal securities which are eligible for comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission, if both parties to such transaction are members in one or more of such clearing agencies (and such clearing agencies are interfaced or linked for comparison purposes), each party to the transaction shall submit to its clearing agency information concerning the transaction, as required by the clearing agency's rules, for purposes of automated trade comparison. The provisions of this paragraph (i) shall apply to transactions effected on or after August 1, 1984.

(ii) Notwithstanding the provisions of section (e) of this rule, if a transaction submitted to one or more registered clearing agencies for comparison in accordance with paragraph (i) above has been compared successfully, and if such transaction involves municipal securities which are eligible for deposit at one or more securities depositories registered with the Securities and Exchange Commission in which both parties to the transaction are members, the parties to such transaction shall settle the transaction by book-entry through the facilities of the depository or through the interface or link, if any, between the depositories. The provisions of this paragraph (ii) shall apply to transactions effected on or after February 1, 1985.

(iii) For purposes of this section (f) a municipal securities broker or municipal securities dealer who clears transactions through an agent who is a member of a registered clearing agency or a registered securities depository shall be deemed to be a member of such registered clearing agency or registered securities depository.

(g) through (k) No change.

Rule G-15. Confirmation, Clearance and Settlement of Transactions with Customers

(a) Customer Confirmations.

(i) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation of the transaction containing the following information:

(A) name, address, and telephone number of the broker, dealer, or municipal securities dealer, provided, however, that the address and telephone number need not be stated on a confirmation sent through the automated confirmation facilities of a clearing agency registered with the Securities and Exchange Commission;

(B) name of customer;

(C) designation of whether the transaction was a purchase from or sale to the customer;

(D) par value of the securities;

(E) description of the securities, including at a minimum the name of the issuer, interest rate, maturity date and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities, and in the case of any securities, if necessary for a materially complete description of the securities, the name of any com-

*Underlining indicates additions; deleted material has been omitted. The texts of the proposed amendments currently pending at the Commission.

pany or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown;

(F) trade date and time of execution, or a statement that the time of execution will be furnished upon written request of the customer;

(G) CUSIP number, if any, assigned to the securities;

(H) settlement date;

(I) yield for dollar price as follows:

(1) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity.

(2) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown.

(3) for transactions at par, the dollar price shall be shown.

In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated, and the call or option date and price used in the calculation must be shown;

(J) amount of accrued interest;

(K) extended principal amount;

(L) total dollar amount of transaction;

(M) the capacity in which the broker, dealer or municipal securities dealer effected the transaction, whether

(1) as a principal for its own account,

(2) as an agent for the customer,

(3) as an agent for a person other than the customer, or

(4) as an agent for both the customer and another person; and

(N) instructions, if available, regarding receipt or delivery of securities, and form of payment, if other than as usual and customary between the parties.

(ii) If the broker, dealer or municipal securities dealer is effecting a transaction as agent for the customer or as agent for both the customer and another person, the confirmation shall set forth

(A) either the name of the person from whom the securities were purchased or to whom the securities were sold for the customer or a statement that this information will be furnished upon request of the customer, and

(B) the source and amount of any commission or other remuneration received or to be received by the broker, dealer or municipal securities dealer in connection with the transaction.

(iii) In addition to the information required by paragraphs (i) and (ii) above, each confirmation to a customer shall contain the following information, if applicable:

(A) the dated date if it affects the price or interest calculation, and the first interest payment date if other than semi-annual;

(B) if the securities are "fully registered," "registered as to principal only," or available only in book-entry form, a designation to such effect;

(C) if the securities are "called" or "pre-refunded," a designation to such effect, the date of maturity which has been fixed by the call notice, and the amount of the call price;

(D) if the securities are "callable," a statement that the yield set forth pursuant to item (2) of subparagraph (a)(i)(I) may be affected by the exercise of a call provision, and that information relating to call provisions is available upon request. A statement, in a footnote or otherwise, to the following effect will be deemed to satisfy this requirement: "Call features may exist which could affect yield; complete information will be provided upon request";

(E) denomination of securities other than bonds and, if other than the following, denominations of bonds:

(1) for bearer bonds, denominations of $1,000 or $5,000 par value, and

(2) for registered bonds, denominations which are multiples of $1,000 par value, up to $100,000 par value;

(F) any special instructions or qualifications, or factors affecting payment of principal or interest, such as (1) "ex legal," or (2) if the securities are traded without interest, "flat," or (3) if the securities are in default as to the payment of interest or principal, "in default," or (4) with respect to securities with periodic interest payments, if such securities pay interest on other than a semi-annual basis, a statement of the basis on which interest is paid; and

(G) such other information as may be necessary to ensure that the parties agree to the details of the transaction.

(iv) The confirmation for a transaction in securities traded on a discounted basis (other than discounted securities traded on a yield-equivalent basis) shall not be required to show the yield and dollar price information specified in subparagraph (I) of paragraph (a)(i) nor the accrued interest specified in subparagraph (J) of paragraph (a)(i). Such confirmation shall, however, contain the rate of discount and resulting dollar price. Such confirmation may, in lieu of the resulting dollar price and the extended principal amount specified in subparagraph (K) of paragraph (a)(i), show the total dollar amount of the discount.

(v) The confirmation for a transaction in securities maturing in more than two years and paying investment return solely at redemption shall not show the par value of the securities specified in subparagraph (D) of paragraph (a)(i) and shall not be required to show the amount of accrued interest specified in subparagraph (J) of paragraph (a)(i). Such confirmation shall, however, show the maturity value of the securities and specify that the interest rate on the securities is "0%."

(vi) The initial confirmation for a "when, as and if issued" transaction shall not be required to contain the information specified in subparagraphs (H), (J), (K), (L) and (N) of paragraph (a)(i) or the resulting dollar price as specified in item (1) of subparagraph (I).

(vii) Information requested pursuant to this rule shall be given or sent to the customer within five business days following the date of receipt of a request for such information; provided however, that in the case of information

relating to a transaction executed more than 30 calendar days prior to the date of receipt of a request, the information shall be given or sent to the customer within 15 business days following the date of receipt of the request.

(viii) For purposes of this rule, the time of execution of a transaction shall be the time of execution reflected in the records of the broker, dealer or municipal securities dealer pursuant to rule G-8 of the Board or Rule 17a-3 of the Commission.

(ix) For purposes of this rule, the term "customer" shall mean any person other than a broker, dealer or municipal securities dealer acting in its capacity as such or an issuer in transactions involving the sale by the issuer of a new issue of its security.

(b) [reserved for future rulemaking]

(c) [reserved for future rulemaking]

(d) Delivery/Receipt vs. Payment Transactions

(i) No broker, dealer or municipal securities dealer shall accept an order from a customer pursuant to an arrangement whereby payment for securities received (RVP) or delivery against payment of securities sold (DVP) is to be made to or by an agent of the customer unless all of the following procedures are followed:

(A) the broker, dealer or municipal securities dealer shall have received from the customer prior to or at the time of accepting such order, the name and address of the agent and the name and account number of the customer on file with the agent;

(B) the memorandum of such order made in accordance with the requirements of paragraph (a)(vi) or (a)(vii) of rule G-8 shall include a designation of the fact that it is a delivery vs. payment (DVP) or receipt vs. payment (RVP) transaction;

(C) the broker, dealer or municipal securities dealer shall give or send to the customer a confirmation in accordance with the requirements of section (a) of this rule with respect to the execution of the order not later than the close of business on the next business day after any such execution; and

(D) the broker, dealer or municipal securities dealer shall have obtained a representation from the customer (1) that the customer will furnish the agent instructions with respect to the receipt or delivery of the securities involved in the transaction promptly upon receipt by the customer of each confirmation, or the relevant data as to each execution, relating to such order, (2) that, with respect to a transaction subject to the provisions of paragraph (ii) below, the customer will furnish the agent such instructions in accordance with the rules of the registered clearing agency through whose facilities the transaction has been or will be confirmed, and (3) that, with respect to all other transactions, the customer will assure that such instructions are delivered to the agent no later than:

(a) in the case of a purchase by the customer where the broker, dealer or municipal securities dealer is to deliver the securities to the customer's agent against payment (DVP), the close of business on the fourth business day after the trade date of execution of the transaction as to which the particular confirmation relates; or

(b) in the case of a sale by the customer where the broker, dealer or municipal securities dealer is to receive the securities from the customer's agent against payment (RVP), the close of business on the third business day after the date of execution of the transaction as to which the particular confirmation relates.

(ii) No broker, dealer or municipal securities dealer who is, or whose clearing agent is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security to which a CUSIP number has been assigned on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the confirmation and acknowledgment of such transaction. The provisions of this paragraph (ii) shall apply to transactions effected on or after August 1, 1984.

(iii) No broker, dealer or municipal securities dealer who is, or whose clearing agent is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security which is eligible for book-entry settlement through the facilities of such clearing agency on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the book-entry settlement of such transaction. The provisions of this paragraph (iii) shall apply to transactions effected on or after February 1, 1985.

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- [ ] Training
- [ ] Other ______

Rule G-15

Amendment Approved Concerning Address and Telephone Number Information on Confirmations

On September 30, 1983 the Securities and Exchange Commission approved an amendment to the provisions of Board rule G-15 on customer confirmations. The amendment exempts confirmations sent to customers by means of an automated confirmation system made available by a registered securities depository from the current requirement of Board rule G-15 that customer confirmations state the confirming party's address and telephone number. The Board is satisfied that the customers who use such automated confirmation systems are generally sophisticated investors who will know how to contact the confirming dealer without the provision of the address and telephone number on the confirmation. The Board notes also that the securities depositories making available such automated confirmation systems generally publish directories listing system users and appropriate contact personnel.

The amendment was effective upon Commission approval.

October 4, 1983

Text of Amendment*

Rule G-15. Customer Confirmations

(a) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation of the transaction containing the following information:

(i) name, address, and telephone number of the broker, dealer, or municipal securities dealer, provided, however, that the address and telephone number need not be stated on a confirmation sent through the automated confirmation facilities of a clearing agency registered with the Securities and Exchange Commission;

(ii) through (xiii) No change.

(b) through (i) No change.

Questions concerning the amendment may be directed to Donald F. Donahue, Deputy Executive Director.

*Underlining indicates additions.

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Rule G-17

Notice of Interpretation on Prompt Dealer Deliveries to Customers

From time to time the Board has received inquiries from purchasers of municipal securities concerning the duty of municipal securities brokers and dealers to deliver securities to customers under the Board's rules. In particular, customers have asked what, if any, remedies are available when long delays occur between the purchase, payment and delivery of municipal securities. The Board has advised such individuals that under rule G-17, the Board's fair dealing rule, a municipal securities broker or dealer has a duty to deliver securities sold to customers in a prompt fashion.

The Board is mindful that a dealer's failure to deliver municipal securities often is caused by its failure to receive delivery of the securities from another dealer or by other circumstances beyond its control. It, nevertheless, believes that a dealer's duty to deliver securities promptly to customers is inherent in rule G-17.[1] A violation of that duty could occur, for example, if a dealer sells securities to a customer when it knows that it cannot effect delivery by the specified settlement date or within a reasonable length of time thereafter and does not disclose that fact to its customers.

The Board notes that customers who fail to receive securities are not entitled to take advantage of the Board's procedures to close out a failed transaction which are available only for inter-dealer transactions under rule G-12. However, if a customer sustains a loss or otherwise is damaged by his dealer's failure to deliver securities, he may seek recovery through the Board's arbitration program or through litigation. These remedies may accrue to the customer whether or not a dealer's failure to deliver violates rule G-17.

This interpretation became effective October 13, 1983, the date of filing with the Commission.

October 13, 1983

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

[1]The duty of a securities professional to complete promptly transactions with customers also has been found to flow from the federal securities laws by the SEC and the courts.

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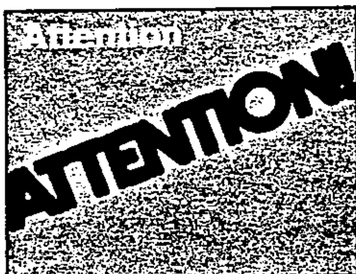

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Rule G-25

Amendment Approved on Guarantees Against Loss

On September 19, 1983, the Securities and Exchange Commission approved the Board's amendment to rule G-25(b), concerning guarantees against loss. The rule generally prohibits a municipal securities dealer from guaranteeing a customer against loss and provides that "bona fide put options" and "repurchase agreements issued in the ordinary course of business" are not guarantees for purposes of the rule.

The amendment requires that the terms of all put options and repurchase agreements be provided to customers in writing with or on the confirmations of the transactions and be recorded on dealers' books and records in accordance with the requirements of Board rule G-8(a)(v).[1] The Board is of the view that the amendment strengthens the anti-manipulative effect of the rule since any put options or repurchase agreements with customers not so disclosed and recorded are prohibited under the rule. At the same time, the exemptions for put options and repurchase agreements are preserved, thereby permitting municipal securities dealers the flexibility necessary to enter into legitimate financing and other arrangements in the course of doing business.

The amendment becomes effective November 18, 1983.

September 19, 1983

Questions concerning the amendment may be directed to Angela Desmond, General Counsel.

Text of Amendment*

Rule G-25. Improper Use of Assets

(a) No change.

(b) Guaranties. No broker, dealer, or municipal securities dealer shall guarantee or offer to guarantee a customer against loss in

(i) No change.

(ii) a transaction in municipal securities with or for a customer;

~~Bona fide~~ Put options and repurchase agreements ~~issued in the ordinary course of business~~ shall not be deemed to be guaranties against loss <u>if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v).</u>

(c) No change.

[1]Notice soliciting comments on draft amendment to rule G-25(b) were published in *MSRB Reports*, vol. 2, no. 6 (August 1982) and vol. 3, no. 1 (January 1983); notice of filing was published in *MSRB Reports*, vol. 3, no. 5 (September 1983).

*Underlining indicates new language; broken line indicates deletions.

Route To:
- [ ] Manager, Muni. Dept.
- [ ] Underwriting
- [ ] Trading
- [x] Sales
- [x] Operations
- [x] Public Finance
- [x] Compliance
- [ ] Training
- [ ] Other ______

Letters of Interpretation

Rule G-1

Separately identifiable department: inclusion of IDB-related activities

This responds to your letter of June 14, 1983 concerning your request for an interpretation of Board rule G-1, which defines a "separately identifiable department or division" of a bank. In particular, you request our advice concerning whether certain activities engaged in by your Corporate Finance Division (the "Division") should be considered "municipal securities dealer activities" for purposes of the rule. Your letter and a subsequent telephone conversation set forth the following facts:

The Division acts as financial advisor to certain corporate customers of the Bank. Some of these customers wish to raise money through the issuance of IDBs. In order to assist these corporations in the placement of the IDBs, the Division contacts from one to ten institutional investors and provides them with information regarding the terms of the proposed financing and basic facts about the corporation. If the investor expresses interest in the financing, a confidential memorandum describing the financing, prepared by the corporation with the assistance of the Division, is sent.

During negotiations between the corporation and the investor, the Division may act as a liaison between the two parties in the communication of comments on the financing documents. According to the Bank, the Division is not an agent of the corporation and is not authorized to act on behalf of the corporation in accepting any terms or conditions associated with the proposed financing. For its services, the Division usually receives a percentage of the total dollar amount of securities issued, with a minimum contingent on the successful completion of the deal. While the Bank has established a separately identifiable division pursuant to rule G-1, the Division is not part of it.

Your inquiry was discussed by the Board at its July meeting. The Board is of the view that the activities of the Division, as described, constitute the sales of municipal securities for purposes of the definition of municipal securities dealer activities in Board rule G-1. Therefore, these activities should be conducted in the Bank's registered separately identifiable department by persons qualified under the Board's professional qualifications rules.—*MSRB interpretation of July 26, 1983, by Richard B. Nesson, General Counsel.*

Rules G-1 and G-9

Microfilming of Records

I am writing in response to your letter of May 20, 1983 regarding our previous conversations about the requirements of Board rules G-1 and G-9 as they would apply to the bank's retention of dealer department records on microfilm. In your letter and our previous conversations you indicated that the bank wishes to retain all of the records required to be maintained by its municipal securities dealer department on microfilm, with the hard copy of each record destroyed immediately after it has been microfilmed. You inquired as to the circumstances under which this method of record retention could be used. You also inquired about the extent to which municipal securities dealer department records could be commingled with records of other departments on the same strips of microfilm.

As you are aware, Board rule G-9(e) provides that

> a record ... required to be preserved by this rule ... may be retained ... on microfilm, electronic or magnetic tape, or by the other similar medium of record retention, provided that [the] municipal securities broker or municipal securities dealer shall have available adequate facilities for ready retrieval and inspection of any such record and for production of easily readable facsimile copies thereof and, in the case of records retained on microfilm, electronic or magnetic tape, or other similar medium of record retention, duplicates of such records shall be stored separately from each other for the periods of time required by this rule.

Therefore, the following three conditions must be met, if records are to be retained on microfilm:

(1) facilities for ready retrieval and inspection of the records (such as a microfilm reader or other similar piece of equipment) must be available;

(2) facilities for the reproduction of a hard copy facsimile of a particular record must also be available; and

(3) duplicate copies of the microfilms must be made and stored separately for the necessary time periods.

If these conditions are met, the retention of records by means of microfilm is satisfactory for purposes of the Board's rules, and hard copy records need not be retained after the microfilming is completed.

With respect to the establishment of a separately identifiable municipal securities dealer department of a bank, Board rule G-1 provides that all of the records relating to the municipal securities activities of such department must be

> separately maintained in or separately extractable from such [department's] own facilities or the facilities of the

bank . . . [and must be] so maintained or otherwise accessible as to permit independent examination thereof and enforcement of applicable provisions of the Act, the rules and regulations thereunder and the rules of the board.

These requirements would not preclude you from maintaining the required records on microfilm which also contained other bank records, as long as the required records were "separately extractable." The course of action you propose, maintaining all municipal securities dealer department records together as the first items on a roll of microfilm, would seem to be an appropriate way of complying with these requirements.—*MSRB interpretation of June 6, 1983, by Donald F. Donahue, Deputy Executive Director.*

Rule G-12

Money Settlement Procedures in Close-Out Executions

I am writing in response to your letter of August 23, 1983 concerning certain problems in the settlement of money amounts due on close-out executions. You note in your letter that rule G-12(h)(i)(D) provides that

> the purchaser must be prepared to defend the price at which the close-out is executed relative to market conditions at the time of the execution . . . [,]

and also that

> [a]ny moneys due on the transaction, or on the close-out of the transaction, shall be forwarded to the appropriate party within ten business days of the date of execution of the close-out notice.

You inquire as to the relationship between these two provisions in the case of a close-out procedure involving several retransmittals. You also suggest a method of handling payments of moneys due in situations where a dispute as to the fairness of the execution price occurs.

In the type of situation which is the subject of your inquiry, a municipal securities dealer ("dealer A") may issue a close-out notice to a second dealer ("dealer B") who is failing to deliver to him certain municipal securities. If dealer B has an offsetting fail-to-receive of such securities from a third dealer ("dealer C"), dealer B will retransmit the close-out notice (in accordance with the requirements of the rule) to dealer C. Similarly, dealer C may retransmit the notice to a fourth dealer ("dealer D") owing him the securities.[1] In the event of such retransmittals, the ultimate recipient of the retransmitted close-out (in this case, dealer D) is the party for whose account and liability any close-out would be executed, and who, therefore, would absorb any loss in the event of an adverse market movement. As a consequence, the ultimate recipient of the notice (dealer D) is most often the person who would require the purchaser originating the notice (dealer A, in our example) to defend the fairness of the close-out execution price.

When a close-out notice which has been retransmitted is executed, the money settlement is most frequently made by each party sending to the immediately preceding party (*i.e.*, in the event of a loss, dealer B sends to A, C sends to B, D sends to C) the differential between the close-out execution price and the original contract price. In your letter you inquire as to the responsibility of the intermediate dealers in the retransmittal sequence (dealers B and C, in our example) to send such payments of money amounts due in the event that the ultimate recipient of the notice (dealer D) challenges the execution price and refuses to make payment until the dispute is resolved.

Your question was referred to the Board for its consideration. The Board has authorized me to advise you that, in its view, the close-out rules would not require the intermediate dealers to forward full payment of the money amount due in the event that the ultimate recipient of the close-out notice and execution, for whose account and liability the close-out has been executed, disputes the fairness of the execution price and refuses to make payment until the dispute is resolved. In terms of the example, if dealer D disputes the execution price, dealers B and C would not be obliged to make full payment of the money amount due until the dispute is resolved; upon resolution of the dispute, of course, all parties must make the necessary payments promptly. The Board believes that this result is the most equitable to all parties, since otherwise one of the intermediate dealers would be obliged to defend the fairness of the execution price, rather than the dealer who originated and executed the close-out notice.

In your letter you also suggest that, in the event of a dispute as to the fairness of a close-out execution price, the parties involved in the close-out should make appropriate payments of the undisputed portion of the money amount due, with the disputed portion remaining unpaid until the dispute is resolved by mutual agreement or arbitration. The Board agrees that your proposal might be a desirable method of dealing with disputes regarding close-out execution prices. The Board notes, however, that the acceptance of a partial payment of the amount due might, in certain circumstances, be viewed as a waiver of any claim for the additional balance; further, this approach would seem to complicate the bookkeeping involved in accounting for the results of a close-out execution. If the parties to a particular close-out execution are satisfied that these problems are not significant, your suggested approach might be an appropriate procedure in the event a dispute as to the fairness of the execution price arises.—*MSRB interpretation of September 23, 1983, by Donald F. Donahue, Deputy Executive Director.*

[1] The retransmittal process can, of course, continue, if additional municipal securities dealers are involved in the particular transaction sequence.