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Calendar

March 31 — Effective date of amendments to rule G-36, on delivery of official statements to the Board

April 15 — Effective date of revisions to CUSIP number eligibility standards

April 19 — Effective date of DTC offering the use of its Participant Terminal System for the transmittal of municipal securities close-out messages through the Participant Exchange Service

June 30 — Comments due to SEC on proposed SEC rule on T+3 settlement

Summer 1993 — Estimated effective date for amendment to rule G-12(b) requiring managing underwriters to provide a registered securities clearing agency with the settlement date for a new issue as soon as the settlement date is known

July 1 — Planned effective date for an amendment to rule G-15(d)(iii) requiring all DVP/RVP customer transactions in depository eligible securities to be settled by book-entry, with two limited exceptions

July 1 — Planned effective date for an amendment to rule G-12(f)(i) requiring essentially all inter-dealer transactions to be compared in an automated comparison system

Pending — Amendment to rule G-35, on the Board's arbitration code

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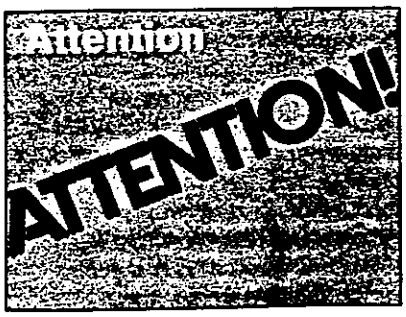

Route to:
- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☒ Operations
- ☐ Public Finance
- ☐ Compliance
- ☐ Training
- ☐ Other

Proposed SEC Rule on T+3 Settlement

On February 23, 1993, the Securities and Exchange Commission proposed for comment SEC Rule 15c6-1. The proposed rule would establish three business days, instead of five business days, as the standard, regular-way settlement timeframe for most securities transactions. The proposed effective date for the rule is January 1, 1996.

The text of the SEC Release describing the proposed rule and its rationale is reprinted below. As the Release notes, the proposed rule does not at this time include municipal securities within its scope. The SEC, however, specifically asks for comment on "how to achieve the safety and efficiency benefits of [a three business day settlement cycle] for municipal securities" and a reasonable timeframe for bringing municipal securities within the scope of the rule. The SEC also requests comment on a number of other specific aspects of the proposed rule, including its potential costs and benefits. Comments are due to the SEC by June 30, 1993.

The Board encourages participants in the municipal securities market to comment to the SEC on the proposed rule and the possibility of a three-day regular-way settlement cycle in the municipal securities market. The Board also asks that commentators addressing these issues send copies of their comment letters to the Board.

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 240
[Release Nos. 33-6976; 34-31904; IC-19282; File No. S7-5-93]
RIN: 3235-AF85
SECURITIES TRANSACTIONS SETTLEMENT
AGENCY: Securities and Exchange Commission
ACTION: Notice of Proposed Rulemaking and Request for Comments
SUMMARY: The Securities and Exchange Commission is publishing notice of its intention to adopt a new rule under the Securities Exchange Act of 1934 that would establish three business days, instead of five business days, as the standard settlement timeframe for broker-dealer transactions. The proposed rule is designed to reduce the risk to clearing corporations, their members, and public investors inherent in settling securities transactions by reducing the total number of unsettled trades at any given time. The rule also will facilitate additional risk reduction procedures by achieving closer conformity between the government securities and derivatives markets and the markets for other securities. The Commission is proposing an effective date of January 1, 1996, in order to allow market participants time to implement the necessary changes to allow three-business-day settlement in an efficient manner. The Commission requests comments on the proposed rule and, in particular, the costs associated with such a rule and whether the proposed implementation timetable should be adopted or modified.
DATES: Comments should be received on or before June 30, 1993.
ADDRESSES: Interested parties should submit three copies of comment letters to Jonathan G. Katz, Secretary, Securities and Exchange Commission ("Commission"), 450 Fifth Street, N.W., Mail Stop 6-1, Washington, D.C. 20549. Comments should refer to File No. S7-5-93. The Commission will make all comments available for public inspection and copying at its Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549.
FOR FURTHER INFORMATION CONTACT: Sonia G. Burnett, Attorney, Office of Securities Processing Regulation, Branch of Transfer Agent Regulation, at 202/272-2855, or Richard C. Strasser, Attorney, Office of Securities Processing Regulation, Branch of Clearing Agency Regulation, at 202/272-2415, Division of Market Regulation, Commission, 450 Fifth Street, N.W., Mail Stop 5-1, Washington, D.C. 20549.
SUPPLEMENTARY INFORMATION: The market crash of October 1987 highlighted both the strengths and weaknesses in the U.S. clearance and settlement system ("system"). On the one hand, the system survived great stress without a material failure. On the other hand, the stress within the system showed the need for improvements. Since that time, the

Commission, other federal regulators and industry organizations have spent considerable time studying clearance and settlement reform.[1] Numerous studies, culminating in the Bachmann Task Force Report, have recommended, among other things, shortening the settlement cycle in order to increase the safety and soundness of the system.[2]

Today the Commission proposes for comment Rule 15c6-1[3] under the Securities Exchange Act of 1934 ("Exchange Act")[4] that, if adopted, would establish three business days ("T+3"), instead of five business days ("T+5"), as the standard settlement timeframe for broker-dealer trades.

The Commission believes that significant risk reduction benefits can be gained from shortening the settlement cycle. The Commission, nevertheless, recognizes that broker-dealers may need to make operational and procedural changes to settle transactions in a shorter timeframe. The Commission therefore proposes a deferred effective date and invites comment on the cost of implementing such a rule and whether the proposed timetable for implementation should be adopted or modified.

I. *Background*

Although the U.S. clearance and settlement system[5] is one of the safest in the world, recent events have demonstrated that the system can be improved. The Market Breaks of October 1987 and October 1989 and the events surrounding the demise of Drexel Burnham Lambert Group, the holding company parent of Drexel Burnham Lambert, Inc. ("Drexel"), demonstrated that vulnerabilities exist in the clearance and settlement system.

Record volume and volatility during October 1987 proved detrimental to broker-dealers who were unable to resolve processing errors before settlement with their customers on T+5. Moreover, the steep decline in stock prices during that period, as well as the decline on October 16, 1989, left some broker-dealers vulnerable to loss from the positions of customers who were unable or unwilling to meet either margin calls or transaction settlement requirements. This in turn called into question the ability of those broker-dealers to meet their obligations to the clearing corporations. Indeed, turbulent market conditions in 1987 contributed to the demise of three clearing member firms, Metropolitan Securities, H.B. Shaine & Co., and American Investors Group. Clearing firms stand between the clearing corporation, on the one side, and market professionals, introducing firms, and public investors on the other.

Financial difficulties were not limited to clearing firms, however. During and after the week of October 19, 1987, more than 50 introducing firms failed, many as a result of the inability of their customers to meet margin calls and pay settlement obligations.[6] Further, because the markets are interwoven through common members, default at one clearing corporation could have triggered additional failures, resulting in risk to the entire system.

After the October 1987 Market Break, several groups sought to identify causes of the market decline and changes that could be made to shield market participants from the impact of sudden steep declines in the market.[7] All these studies identified clearance and settlement as an area which needed further attention.[8] As noted by Alan Greenspan, Chairman of the Federal Reserve Board, "The importance of strong clearing and settlement systems cannot be overemphasized. This area was identified by the Brady Commission[9] and others after the market break last year as a potential point of vulnerability in the U.S. financial system. The overloading of the . . . clearing systems last October induced breakdowns that dramatically

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[1] *See e.g.*, Division of Market Regulation, *The October 1987 Market Break* (February 1988) ("Market Break Report"); Working Group on Financial Markets, *Interim Report to the President of the United States* (May 1988) (Appendix D) (the Working Group is chaired by the Secretary of the Treasury and its members include the Chairmen of the SEC, the Commodity Futures Trading Commission, and the Board of Governors of the Federal Reserve System); Presidential Task Force on Market Mechanisms, *Report to the President of the United States* (January 1988) (the so-called "Brady Report"); and General Accounting Office, *Preliminary Observations on the October 1987 Crash* (January 1988).

[2] Group of Thirty, *Clearance and Settlement Systems in the World's Securities Markets* (March 1989) ("Group of Thirty Report"); U.S. Working Committee, Group of Thirty Clearance and Settlement Project, *Implementing the Group of Thirty Recommendations in the United States* (November 1990); and the Bachmann Task Force on Clearance and Settlement Reform in U.S. Securities Markets, *Report Submitted to the Chairman of the U.S Securities and Exchange Commission* (May 1992) ("Bachmann Task Force Report").

[3] 17 CFR 240.15c6-1.

[4] 15 U.S.C. § 78s(b)(1).

[5] The term "clearance" includes the comparison of data regarding the terms of settlement of securities transactions and the allocation of securities settlement responsibilities. After trade comparison, most trades clear through a continuous net settlement system ("CNS") operated by a clearing corporation registered with the Commission under Section 17A of the Exchange Act. Under CNS, the clearing corporation nets each clearing member's purchases and sales to arrive at a daily net receive or deliver obligation for each security and a daily net settlement payment obligation. The term "settlement" includes the delivery of securities in exchange for funds, pursuant to the terms of the original transaction, and the custody of securities. *See* § 3(a)(23)(A) of the Exchange Act, 15 U.S.C. § 78c(a)(23)(A).

[6] *See* Market Break Report, Chapter 10 at 20-21. Many customers, institutional and otherwise, open their accounts with an introducing broker. Introducing brokers use executing brokers (which are usually members of a clearing agency) to execute and clear customer trades. If the customer fails to meet margin calls made by the executing firm or fails to pay on T+5 the settlement amount for securities it has purchased, the introducing or executing broker must pay that debt. If the amount exceeds the introducing broker's ability to pay and it fails, the clearing member executing firm will be responsible for the customer's debt.

[7] *See* note 1 *supra*.

[8] Since 1987, considerable progress has been made toward increasing clearing corporations' capabilities to handle large volumes of trades and manage financial risk. Examples include increases in the number of cross-margining facilities sponsored by The Options Clearing Corporation and commodity clearing organizations, expansion of the depository system to include new financial products such as commercial paper, and development of extensive lines of communication between banking, securities, and commodities organizations.

[9] *See* Brady Report, note 1 *supra*.

increased uncertainty among investors and likely contributed to additional downward pressures on prices."[10]

At the same time, in March 1988, the Group of Thirty[11] organized a symposium in London to discuss the state of clearance and settlement in the world's principal securities markets. The symposium participants concluded that there was a need for international agreement on a uniform set of practices and standards for the clearance and settlement of securities transactions in order to improve the process. In light of this conclusion, the Group of Thirty organized a Steering Committee to work with a professional and broad-based Working Committee in order to produce a set of operational proposals for practices and standards in the area of clearance and settlement. The Working Committee was composed of clearance and settlement professionals from different countries.

In March 1989, the Group of Thirty issued a report by the Steering Committee setting forth nine recommendations ("Group of Thirty recommendations"),[12] including implementation of T+3 settlement, to modernize and improve clearance and settlement systems at a local level and to make them compatible with each other. These recommendations were:

- by 1990, trade comparison between direct market participants should occur by the day following the date of trade execution;
- by 1992, indirect market participants should be members of a trade comparison system which achieves positive affirmation of trade details;
- by 1992, each country should have an effective and fully developed central securities depository;
- by 1992, if appropriate, each country should implement a netting system;
- by 1992, a delivery versus payment system should be employed as the method for settling all securities transactions;
- countries should adopt a same-day funds payment method for settlement of securities transactions;
- a rolling settlement system should be adopted by all markets as follows: (a) by 1990, final settlement should occur on the fifth day after the date of trade execution, (b) by 1992, final settlement should occur on the third day after the date of execution;
- securities lending and borrowing should be encouraged as a method of expediting the settlement of securities transactions; and
- by 1992, each country should adopt the standards for securities numbering and messages developed by the International Standards Organization.

Following the release of the Group of Thirty Report, several countries initiated separate efforts to study how their clearance and settlement systems compared with the Group of Thirty recommendations. In the U.S., a Working Group was created for this purpose. The U.S. Working Group concluded that, while the U.S. was in compliance with seven of the Group of Thirty recommendations, continued consideration should be given to the implementation of the two remaining recommendations, T+3 settlement and settlement in same-day funds.[13]

Two subcommittees, the U.S. Steering Committee and a U.S. Working Committee of the Group of Thirty ("the U.S. committees") were formed to evaluate the benefits of shortening the settlement cycle and converting to the use of same-day funds. The U.S. committees urged adoption of the two recommendations and, in order to support a move to T+3 settlement, also recommended that: (1) book-entry settlement be mandatory for transactions between financial intermediaries and between financial intermediaries and their institutional customers; and (2) all new securities issues should be made eligible for depository services.

In November 1990, the Commission held a Roundtable to discuss the recommendations of the U.S. committees. Roundtable participants generally agreed that the two recommendations should be adopted, but urged that the timetables for implementation be sufficiently flexible so that obstacles to implementation could be fully explored and practical solutions found and implemented. Roundtable participants expressed concern that broker-dealers conducting a predominantly retail business might have difficulty operating in a three-business-day settlement timeframe in the national clearance and settlement system because of the need, among other things, to obtain payment from retail clients for purchase transactions.

Subsequently, Chairman Breeden asked the U.S. Steering Committee to form a task force to evaluate independently whether and what changes to the clearance and settlement system should be pursued, and to determine a timetable for implementation of the changes.[14] An industry task force, headed by John W. Bachmann ("Bachmann Task Force" or "Task Force") took up that challenge.[15]

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[10] *See* Remarks by Alan Greenspan before the Annual Convention of the Securities Industry Association (November 30, 1988).

[11] The Group of Thirty, established in 1978, is an independent, non-partisan, non-profit organization composed of international financial leaders whose focus is on international economic and financial issues.

[12] *See* Group of Thirty Report, note 2 *supra*.

[13] "Same-day funds" refers to payment in funds that are available on payment date and generally are transferred by electronic means.

[14] Letter from Richard C. Breeden, Chairman, Commission, to Lewis W. Bernard, Chairman, U.S. Steering Committee, Group of Thirty, dated July 11, 1991.

[15] John W. Bachmann is the Managing Principal of Edward D. Jones & Co. of St. Louis, Missouri. In addition to Mr. Bachmann, the members of the Bachmann Task Force included: David M. Kelly, President and Chief Executive Officer, National Securities Clearing Corporation ("NSCC"); Richard G. Ketchum, Executive Vice President and Chief Operating Officer, National Association of Securities Dealers ("NASD"); John F. Lee, President, New York Clearing House; Gerard P. Lynch, Managing Director, Morgan Stanley and Company Inc.; James J. Mitchell, Senior Executive Vice President, Northern Trust Company; Richard J. Stream, Managing Director, Piper Jaffray and Hopwood and Company; and Arthur L. Thomas, Senior Vice President, Merrill Lynch and Co., Inc.

In May 1992, the Bachmann Task Force presented its findings and recommendations to the Commission. Among other things, the Task Force concluded that "time equals risk"[16] and that the settlement cycle for corporate and municipal securities should be compressed to T+3. The Task Force recommended that this be accomplished by July 1994.[17] On June 22, 1992, the Commission published the Task Force Report in the *Federal Register* for public comment.[18]

The Task Force recommendations generated substantial comment. The Commission received 1,000 comment letters from banks, broker-dealers, investment advisors, trade associations, clearing agencies, exchanges, transfer agents, and individual investors. Although many of these commentators expressed concern about the potential loss of access to physical certificates,[19] in large part they were supportive. Some of the commentators raised concerns about the specifics of implementation and about progress on industry initiatives that would facilitate a move to T+3 settlement. Indeed, the Commission considered these comments in formulating this proposal. Many of the issues noted by the commentators were identified by the Task Force and, as discussed in more detail below, efforts to address them are nearing completion.[20]

II. *T+3 Settlement: Need for the Proposed Rule*

In the U.S., the settlement cycle varies among markets. Settlement in the futures, options, and government securities markets occurs on the day after trade date ("T+1") using same-day funds. Settlement of most trades in corporate and municipal securities, on the other hand, takes place on the fifth business day after the trade date ("T+5") with money payments among financial intermediaries made in next-day funds[21] through the exchange of certified checks between clearing corporations and their participants (thus, financial intermediaries have good funds on "T+6").

Settlement of securities transactions on T+5 is largely a function of market custom and industry practice.[22] There is no federal rule that mandates a specific settlement cycle for securities.[23] Self-regulatory organization ("SRO") rules, however, define "regular way" settlement as settlement on T+5.[24]

In today's market environment, the value of securities positions can change suddenly and drastically causing a market participant to default on unsettled positions. Clearing corporations function as, among other things, post-trade processing facilities and guarantors of post-trade settlements.[25] To protect against the credit risk[26] and market risk[27] presented by unsettled positions, clearing corporations obtain contributions from their members to a pool of funds designed to provide a ready source of liquidity in case of a member default.[28] Any sizable loss in liquidating the open commitments of a defaulting member, however, would be assessed *pro rata* against all clearing members.[29]

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[16] *See* Bachmann Task Force Report for a discussion of the Task Force risk analysis.

[17] The Task Force made eight other recommendations that would facilitate settling securities transactions on T+3: revising the Automated Clearing House System; requiring an interactive institutional delivery process; settling all transactions among financial intermediaries and their institutional customers in book-entry form only and in same-day funds; depository eligibility for new issues; monitoring flipping (*i.e.*, the sale of stock back to the underwriting syndicate during the new issue stabilization period); expanding cross margining; streamlining the handling of physical certificates; and monitoring all market activity.

[18] *See* Securities Exchange Act Release No. 30802 (June 15, 1992), 57 FR 27812.

[19] Over 800 of the comment letters were from individual investors responding to the recommendation to streamline the handling of physical certificates. The letters indicate a belief that the Task Force recommendation to streamline the handling of physical certificates would result in the elimination of physical certificates and force investors to hold securities in street name. The Task Force did not propose eliminating physical certificates for those retail investors who choose to maintain their record of ownership in that form.

[20] The Commission will consider comments filed in response to publication of the Bachmann Task Force Report, note 2 *supra*, in connection with this proposal.

[21] The term "next-day funds" refers to payment by means of certified checks passing between the clearing corporation and its members.

[22] Indeed, prior to 1968, equity transactions in the U.S. were settled on the fourth day after the trade date ("T+4"), without causing undue harm to retail customers. Remarks of Commissioner Mary L. Schapiro before the Securities Industry Association Regional Conference (March 20, 1991).

[23] Regulation T imposes, among other things, initial margin requirements and payment rules on securities transactions. Specifically, Regulation T requires a margin call to be satisfied within seven business days after the margin deficiency was created or increased, and requires a broker or dealer to obtain full cash payment for customer purchases within seven business days of the date of the transaction. Regulation T is issued by the Board of Governors of the Federal Reserve System pursuant to the Exchange Act and its principal purpose is to regulate extensions of credit by and to brokers and dealers. *See* 15 U.S.C. § 78a *et seq.*, Part 220. In addition, Section 22(e) of the Investment Company Act of 1940 provides that no registered investment company shall suspend the right of redemption, or postpone the date of payment or satisfaction upon redemption of any redeemable security for more than seven days after tender of the security to the company, except under specified circumstances.

[24] *See e.g.*, National Association of Securities Dealers, Inc. Uniform Practice Code ¶ 3512, § 12 and New York Stock Exchange Rule 64. If Rule 15c6-1 is adopted, SROs will conform their rules to the timeframe established in Rule 15c6-1.

[25] Upon reporting matched trade information to its members, the clearing corporation becomes the counterparty to every trade and guarantees payment and delivery. *See* Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 ("Full Registration Order").

[26] "Credit risk" is the risk that the credit quality of one party to a transaction will deteriorate to the extent that it is unable to fulfill its obligations on settlement date. *See* Securities Exchange Act Release No. 30986 (July 31, 1992), 57 FR 35856.

[27] "Market risk" is the risk that the value of securities bought or sold will change between trade execution and settlement so that the purchase or sale will result in a financial loss.

[28] *See* Securities Exchange Act Release Nos. 16900 (June 17, 1980), 45 FR 4192 (announcing the Division of Market Regulation's standards for the registration of clearing agencies); 20221 (September 23, 1983), 48 FR 45167 ("Full Registration Order"); and 30879 (July 1, 1992), 57 FR 30279 (order approving modifications to the CNS portions of the National Securities Clearing Corporation ("NSCC"), Midwest Clearing Corporation, and Securities Clearing Corporation of Philadelphia clearing fund formulas).

[29] *See, e.g.*, NSCC Rule 4. *See also*, Market Break Report, Chapter 10.

The Bachmann Task Force Report argues persuasively that a shorter settlement period will reduce market risk to a clearing corporation, and thus to all members of the clearing corporation and to the market as a whole. The Task Force collected data indicating that moving settlement from T+5 to T+3 reduced the risk to National Securities Clearing Corporation ("NSCC")[30] by 58% in the event of the failure of an average large member during normal market conditions. Based on this quantitative risk assessment, the Task Force concluded that reducing the time between trade execution and settlement would reduce risk in the system and that the U.S. securities markets can be made safer by shortening the settlement cycle to T+3.

In view of this analysis and for the reasons set out below, the Commission believes that T+3 settlement represents an important and feasible near-term goal. First, at any given point in time, fewer unsettled trades will be subject to credit and market risk, and there will be less time between trade execution and settlement for the value of those trades to deteriorate.[31] Second, the proposed rule will reduce the liquidity risk among the derivative and cash markets and reduce financing costs by allowing investors that participate in both markets to obtain the proceeds of securities transactions sooner. Finally, a shorter settlement timeframe could encourage greater efficiency in clearing agency and broker-dealer operations.

III. *Description of Proposed Rule 15c6-1*

Proposed Rule 15c6-1 would provide that, unless otherwise expressly agreed by the parties at the time of the transaction, a broker or dealer is prohibited from entering into a contract for the purchase or sale of a security (other than an exempted security, government security,[32] municipal security, commercial paper, bankers' acceptances, or commercial bills)[33] that provides for payment of funds and delivery of securities later than the third business day after the date of the contract. The proposed rule would allow a broker or dealer to agree that settlement will take place in more or less than three business days. The agreement, however, must be express and reached at the time of the transaction.[34]

Most broker-dealers do not specify all of the terms of a trade before execution, but rely on industry custom and SRO rules for those terms. The Commission does not intend to change industry custom to require broker-dealers to specify contract terms. Accordingly, if adopted, Rule 15c6-1 is designed to establish T+3 as a new "default" contract term.[35]

Failure to meet contractual obligations to deliver by T+3 would result in a failure to settle at the clearing corporation. Open trades that fail to settle on settlement date typically are marked-to-the-market on a daily basis and carried forward to net against other open positions. Failure to settle a payment obligation to the clearing corporation generally could result in the suspension of the clearing member and the liquidation of all the clearing member's open positions.

The Commission notes that the proposed rule should not affect the ability of individual investors to obtain a physical certificate. Individual investors who desire to maintain record ownership in certificated form still will be able to do so.

Rule 15c6-1 would not apply to municipal securities. Differences between the corporate and municipal securities markets

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[30] NSCC is one of the largest U.S. clearing corporations and is registered as a clearing agency under Section 17A of the Act. NSCC has 350 netting members. As of April 30, 1992, total required deposits to NSCC's clearing fund were $368 million. Because members do not always withdraw excess funds, NSCC had on deposit $502 million.

[31] As noted by Commissioner Mary L. Schapiro, "A shorter settlement time period will reduce the number of outstanding trades, thereby reducing the counterparty risk and market exposure associated with unsettled securities transactions." *See* Remarks of Mary L. Schapiro to The Group of Thirty U.S. Steering Committee (March 1, 1990); *See also* Remarks of Mary L. Schapiro before the Securities Industry Association's Annual Operations Conference (May 17, 1990).

[32] The Commission notes that issuers (or guarantors) of mortgage-backed securities include government agencies or government sponsored enterprises ("GSEs") such as the Government National Mortgage Association, the Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation, as well as private entities. Mortgage-backed securities include pass-through certificates, representing an undivided interest in a pool of mortgages, and collateralized mortgage obligations ("CMOs"), representing an interest in part of the cash flow generated by a pool of mortgages or collection of pass-through certificates.

Mortgage-backed securities issued or guaranteed by U.S. government agencies or GSEs generally fall within the definition of government security in Section 3(a)(42) of the Exchange Act and would be treated as such under proposed Rule 15c6-1. Transactions in mortgage-backed securities issued by others (*e.g.*, CMOs) would fall within the scope of proposed Rule 15c6-1. Accordingly, the Commission invites comment on whether inclusion in a T+3 settlement timeframe would create difficulties for issuers or investors in the mortgage-backed securities market. The Commission also invites commentators to address whether additional safeguards related to clearance and settlement of mortgage-backed securities, particularly mortgage-backed securities that qualify as government securities, would be appropriate or desirable to address concerns identified during the 1989 demise of Drexel. *See* Testimony of Richard C. Breeden, Chairman, U.S. Securities and Exchange Commission, before the Committee on Banking, Housing, and Urban Affairs, United States Senate, Concerning the Bankruptcy of Drexel Burnham Lambert Group, Inc. (March 2, 1990). (Delivery and payment practices for mortgage-backed securities transactions led to gridlock during the demise of a holding company of a registered broker-dealer.)

[33] As noted above, because exchange-traded options routinely settle on T+1, transactions in such securities should be essentially unchanged. Transactions in corporate debt and equity, as well as limited partnership interests and securities issued by investment companies, would be covered by the rule. The Commission invites comment on whether the scope of the rule is appropriate and whether any particular characteristics of different types of securities (*e.g.*, mutual fund shares and limited partnership interests) will create difficulties for broker-dealers and investors if included in or excluded from the rule. For example, the Commission notes that mutual funds often permit investors to purchase shares by telephone. In that context, it may be necessary for mutual funds and broker-dealers to implement operational changes to confirm the sale to the investor, to receive the proceeds and settle the transaction, all within T+3.

[34] Thus, the proposed rule would permit broker-dealers to enter into trades, such as seller's option trades, that typically settle as many as sixty days after execution as specified by the parties to the trade at execution. It is not intended to permit broker-dealers to specify before execution of specific trades that a group of trades will be settled in a timeframe different from Rule 15c6-1.

[35] *See* note 24 *supra* and accompanying text.

may justify a different timetable for including municipal securities within a T+3 settlement cycle.[36] Nevertheless, the Commission remains interested in how to achieve the safety and efficiency benefits of T+3 settlement for municipal securities. Accordingly, the Commission seeks public comment on the most appropriate way and a reasonable timeframe for bringing municipal securities within the scope of the rule.

IV. *The Proposed Timetable for Commission Action*

The Commission recognizes that certain building blocks must be in place prior to compressing the settlement cycle.[37] Many of those building blocks, as discussed in more detail below, currently are being addressed by the SROs. In addition, the Commission recognizes that some brokers and dealers may need to make operational and procedural changes to comply with a three-day settlement period. In view of the need for more work at the SRO level and the Commission's desire to minimize the potential cost of complying with the proposed rule, the Commission is proposing an extended transition period to allow affected parties to implement necessary changes gradually.

Since 1987, the SROs have made significant progress on recommendations critical to achieving T+3 settlement. Specifically, the Depository Trust Company ("DTC")[38] is designing a system to convert from batch to interactive processing for the Institutional Delivery System.[39] In the current batch processing environment, participants receive the reports on T+1 with the goal of receiving affirmation on T+2. To move to T+3 settlement, the affirmation process must be completed on T+1. This can be accomplished through an interactive system whereby information is processed on receipt with reports distributed on request. DTC expects to implement the system on a voluntary basis during the third quarter of 1993.

Additionally, under the auspices of the Legal and Regulatory Subgroup ("Subgroup") of the U.S. Working Committee of the Group of Thirty, the SROs have drafted a uniform rule that would require book-entry settlement among financial intermediaries. The SROs are in the process of adopting the rule and expect to submit rule changes to the Commission for consideration in the first quarter of 1993.

The Subgroup also has considered the need for a uniform SRO rule requiring depository eligibility for all new issues and, in connection with this, requested the Division of Corporation Finance to consider recommending that the Commission promulgate a new disclosure requirement under the 1933 Act for initial public offerings ("IPOs").[40] In brief, the Subgroup has urged that the Commission require disclosure of whether the securities being offered in an IPO are depository-eligible and if not, why not. The Subgroup also has suggested that the registration statement include, as an exhibit, a letter from a securities depository registered with the Commission as a clearing agency confirming that the securities to be offered are, or will be (by the time of the public sale or following completion of an underwritten distribution), eligible for deposit

[36] The Commission recognizes that to date moving municipal securities to a T+3 settlement timeframe has not gained the same consensus as shortening the settlement cycle for publicly-traded corporate securities. The Municipal Securities Rulemaking Board ("MSRB") has noted a number of differences between the corporate and municipal securities markets that may make a move to T+3 settlement problematic. For example, while corporate issues number in the thousands, there are over a million municipal securities "maturities," each of which is a separate security for purposes of trading and clearance and settlement. Another difference involves issuers. Approximately 80,000 entities issue municipal securities. Municipal securities are not subject to provisions of the Securities Act of 1933 ("1933 Act") and are exempted from many provisions of the Exchange Act. The municipal securities industry also has not yet reached parity with the corporate securities industry with regard to the use of automated clearance systems. Automated clearance systems for municipal securities transactions depend on a nine-digit CUSIP number. "CUSIP" is an acronym for the Committee on Uniform Securities Identification Procedures. Although most outstanding municipal securities maturities have assigned CUSIP numbers, there probably are several thousand outstanding maturities that do not. Finally, trade data for municipal securities transactions is not captured on a central electronic trade execution or trade reporting system, making acceleration of the comparison cycle for municipal securities particularly difficult. The initial comparison rate for municipal securities inter-dealer trades, which require submission to NSCC on T+1, is 76% for regular-way trades and only about 45% for non-syndicate, when-issued trades. Letter from Hal Johnson, Deputy General Counsel, MSRB, to Dennis M. Earle, Executive Director, U.S. Working Committee, Group of Thirty Clearance and Settlement Project (March 18, 1991).

[37] In recognition of the importance of broker-dealer settlement practices to the clearance and settlement process, the Securities Acts Amendments of 1975 ("1975 Amendments") provided for federal regulation of the time and method by which broker-dealers settle securities transactions. In adopting the 1975 Amendments, Congress directed the Commission to act in the national interest to achieve safety and efficiency in clearance and settlement. Section 17A of the Exchange Act directs the Commission "to facilitate the establishment of a national system for the prompt and accurate clearance and settlement of transactions in securities (other than exempt securities)." *See* 15 U.S.C. §§ 78o, 78q-1, and 78w. That directive was revised by the Market Reform Act of 1990 to reflect the interdependence of options, futures, and equity markets that trade products involving securities or stock indexes. As noted above, recent events underscore that safety and efficiency necessitate changes in industry practice and the Commission has an obligation to lead and direct those changes. Nevertheless, the Commission recognizes that changes in industry practice and custom such as earlier settlement timeframes must involve marketplaces, marketplace regulators, and participants in those markets acting cooperatively.

[38] DTC is the largest U.S. securities depository and is registered with the Commission as a clearing agency under Section 17A of the Act. DTC is a New York State limited purpose trust company and member of the Federal Reserve System. DTC has over 500 participants including broker-dealers and banks. In 1992, DTC held on deposit corporate equity and debt securities, municipal securities, and commercial paper valued at over $5.5 trillion.

[39] In the Institutional Delivery System, brokers notify the depository of trades made by an investment manager on behalf of an institutional client. The investment manager and the client's custodian banks are notified of the trade and asked to affirm that the information is correct. Trades affirmed by T+3 settle automatically by book-entry at the depository on T+5.

[40] Letter from Richard B. Smith and Robert J. Woldow, Co-chairmen, Legal and Regulatory Subgroup, U.S. Working Committee for the Group of Thirty, to Mary E.T. Beach, Senior Associate Director, Division of Corporation Finance, dated December 17, 1992.

with that clearing agency.

Finally, NSCC and DTC, in consultation with Commission staff, have designed a same-day funds system which has been presented to their participants for comment. DTC has assembled a task force under the auspices of the U.S. Working Committee to examine issues that were identified in the comment process, such as how and when dividends and interest will be paid in a same-day funds system (*e.g.*, paid in same-day funds on the date of receipt or in next-day funds on payable date). The Commission recognizes the importance of these initiatives in achieving a shorter settlement cycle and expects to work diligently with the SROs to complete these objectives over the next three years.

The Commission realizes that the proposed rule could entail costs for investors, broker-dealers, banks and other market participants. Assuming the goal of earlier settlement is appropriate, however, the proposed schedule for implementation will allow broker-dealers a three-year period to make the necessary transitional changes. The Commission believes the substantial lead time will allow market participants to make the necessary changes in the most efficient way.

The Commission believes the benefits to be gained from implementing the proposed rule are important to the broker-dealer community and for the protection of investors. The Commission believes, therefore, that the cost impact for broker-dealers resulting from the shorter settlement timeframe will be significantly offset by the benefits to the national clearance and settlement system.

V. *Solicitation of Comments*

The Commission believes that adoption of this rule would reduce substantially many of the risks that exist within the current clearance and settlement system. Risk to the clearance and settlement system will be reduced because there will be fewer unsettled trades in the system at any given point in time.

The Commission invites commentators to address the merits of the proposed rule. Specifically, the Commission invites comment on the specific costs and benefits of the proposed rule. Interested persons may comment on broker-dealer costs to develop and employ procedures to comply with the proposed rule. Interested persons may also comment on any risk reduction benefits and costs savings that may result from the proposed rule.

Interested persons are invited to comment on the desirability of applying the shorter settlement cycle to limited partnership interests, mutual funds, or municipal securities. The Commission invites comment on whether the scope of the rule is appropriate and whether any particular characteristics of securities affected by the rule will create difficulties for broker-dealers and investors if included in or excluded from the rule. In addition, interested persons are invited to comment on whether the proposed implementation date of January 1, 1996 is sufficient for broker-dealers to make the necessary operational and procedural changes in an effective manner, or whether an implementation date of January 1, 1995 or July 5, 1995 would be equally sufficient.

The Commission also solicits comment on the desirability of adopting a disclosure requirement under the 1933 Act concerning depository eligibility of IPOs. Specifically, commentators should address whether such information would be material to investors in initial public offerings.

In addition to the specific requests for comment set forth above, the Commission requests comment on whether the proposed rule, if adopted, would have an adverse effect on competition or would impose a burden on competition that is neither necessary nor appropriate in furthering the purposes of the Exchange Act. Comments on this inquiry will be considered by the Commission in complying with its responsibilities under Section 23(a)(2) of the Exchange Act.

VI. *Initial Regulatory Flexibility Analysis*

The Commission has prepared an Initial Regulatory Flexibility Analysis ("IRFA") in accordance with 5 U.S.C. § 603 regarding proposed Rule 15c6-1. The IRFA notes the potential costs of operational and procedural changes that may be necessary to comply with the proposed rule. In addition, the IRFA notes the importance of the risk reduction that will result from a shorter settlement cycle. The Commission believes that the benefits of proposed Rule 15c6-1 would outweigh the costs incurred by broker-dealers in complying with the rule.

A copy of the IRFA may be obtained by contacting Richard C. Strasser, Attorney, Branch of Clearing Agency Regulation, Office of Securities Processing Regulation, Division of Market Regulation, Commission, 450 Fifth Street, N.W., Mail Stop 5-1, Washington, D.C. 20549.

List of Subjects in 17 CFR Part 240

Registration and regulation of brokers and dealers.

Text of the Proposed Amendment

In accordance with the foregoing, Part 240 of Chapter II of Title 17 of the Code of Federal Regulations is proposed to be amended as follows:

PART 240--GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o, 78p, 78s, 78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, and 80b-11, unless otherwise noted.

2. By adding §240.15c6-1 to read as follows:

§ 240.15c6-1 Settlement Cycle

A broker or dealer shall not effect or enter into a contract for the purchase or sale of a security (other than an exempted

security, government security, municipal security, commercial paper, bankers' acceptances, or commercial bills) that provides for payment of funds and delivery of securities later than the third business day after the date of the contract unless otherwise expressly agreed to by the parties at the time of the transaction.

By the Commission.

Jonathan G. Katz
Secretary

Dated: February 23, 1993

Volume 13, Number 2

MSRB REPORTS

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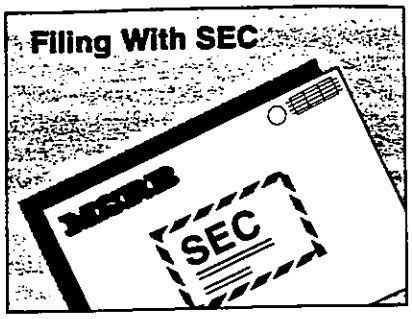

Route to:

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

Status of Amendments to Automated Clearance and Settlement Rules: Rules G-12 and G-15

Amendments Filed

Industry members should take note of the following dates for revisions to Board rules on automated clearance and settlement of municipal securities. These revisions will require some dealers and institutional customers to make changes in their current clearance and settlement practices. Accordingly, dealers now should assess whether they (or their institutional customers) will have to make changes and, if so, begin preparations for doing so.

January 4, 1993: **Effective date for amendment to rule G-12(f)(ii) requiring book-entry settlement of essentially all inter-dealer transactions in depository eligible securities. This amendment has been approved by the Securities and Exchange Commission (SEC).**

Summer 1993: **Estimated effective date for amendment to rule G-12(b) requiring managing underwriters to provide a registered securities clearing agency with the settlement date for a new issue as soon as the settlement date is known. This amendment has been filed with the SEC and, if approved, will become effective 20 days prior to the initial implementation of National Securities Clearing Corporation's (NSCC's) redesigned bond comparison system.**

July 1, 1993: **Planned effective date for an amendment to rule G-15(d)(iii) requiring all DVP/RVP customer transactions in depository eligible securities to be settled by book-entry, with two limited exceptions. This amendment has been filed with the SEC.**

July 1, 1993: **Planned effective date for amendment to rule G-12(f)(i) requiring essentially all inter-dealer transactions to be compared in an automated comparison system. This amendment has been filed with the SEC.**

July 1, 1994: **Planned effective date for amendment to rule G-15(d)(ii) requiring essentially all DVP/RVP customer transactions to be confirmed/affirmed in a confirmation/affirmation system operated by a registered securities clearing agency. This amendment has been approved by the Board and is expected to be filed with the SEC early in 1994.**

In September 1992, the Board announced its implementation plan for expanding the use of automated systems operated by securities clearing agencies registered with the SEC (registered clearing agencies). The implementation plan includes amendments to Board rules G-12(f), on automated comparison and book-entry settlement of inter-dealer transactions, and amendments to rule G-15(d), on automated confirmation/affirmation and book-entry settlement of Delivery Versus Payment and Receipt Versus Payment (DVP/RVP) customer transactions. The plan provides for an 18-month "phase-in" period during which specific amendments become effective. This is designed to allow market participants to make necessary internal system adjustments, to educate institutional customers on changes that they will need to make, and to gain familiarity with planned revisions in automated clearance systems, such as the redesigned comparison system planned by NSCC.

The details of the amendments and the implementation plan have been discussed in several Notices published in *MSRB Reports* over the past 18 months.[1] This notice describes the current status of the plan. It also describes an amendment to

Questions about the amendments or the implementation schedule may be directed to Harold L. Johnson, Deputy General Counsel, or Judith A. Somerville, Uniform Practice Specialist.

[1] See *MSRB Reports*, Vol. 13, No. 1 (January 1993) at 5-6, Vol. 12, No. 3 (September 1992) at 9-10, Vol. 12, No. 1 (April 1992) at 31-35 and Vol. 11, No. 3 (September 1991) at 3-9.

rule G-12(b), on settlement dates for new issues, which has been filed by the Board with the SEC. This amendment has been added to the implementation plan to facilitate operation of the redesigned comparison system and thus to improve comparison rates.

Changes to Rule G-12 on Inter-Dealer Transactions

Book-Entry Settlement

An amendment to rule G-12(f)(ii), on book-entry settlement of inter-dealer transactions was approved by the SEC on December 23, 1992, and became effective on January 4, 1993.[2] The amendment requires that all inter-dealer transactions in depository eligible securities[3] be settled by book-entry at a depository, with one very minor exception. The exception states that the rule does not apply if securities involved in the transaction are ineligible at the depository exclusively used by one of the parties to the transaction (even though the securities may be eligible at other depositories).

The amendment effectively broadened the scope of rule G-12(f)(ii), since the rule formerly included an exemption which allowed certain transactions in depository eligible securities to be physically settled if one or both parties to the transaction were not depository participants. Under the rule as amended, dealers must participate in a depository, either directly or indirectly through an agent, for settlement of inter-dealer transactions in depository eligible securities.

Notice of New Issue Settlement Date

On March 19, 1993, the Board filed with the SEC an amendment to rule G-12(b) relating to settlement dates for when, as and if issued (when-issued) transactions between dealers.[4] The amendment applies to all new issues in which when-issued transactions will be submitted to a registered clearing agency for automated comparison.[5] If approved by the SEC, the amendment will require the managing underwriter for a new issue[6] to provide the registered clearing agency with notice of the settlement date for the issue[7] as soon as it is known, and thereafter to provide the registered clearing agency with immediate notice of any changes in the settlement date. The amendment would modify the current language of rule G-12(b), which requires only that the managing underwriter provide the registered clearing agency with six business days notice of the settlement date.

The amendment to rule G-12(b) will support operation of the automated comparison system for inter-dealer transactions in municipal securities. NSCC, the registered clearing agency providing central processing services for automated comparison of municipal securities, has redesigned its bond comparison system and currently is in the process of testing the system. The redesigned system is intended to provide an accelerated comparison cycle for municipal securities and to improve comparison rates, especially for when-issued transactions.

The redesigned comparison system will allow when-issued transactions to be submitted either with a yield or dollar price, or, if the settlement date is known, with a final money amount. When a when-issued transaction is submitted using different formats (*i.e.*, one side submits with a yield and the contra-side submits with final monies), the comparison system will need the settlement date to compute final monies for the yield or dollar price submissions. The amendment filed with the SEC would allow the comparison system to make these calculations, since the managing underwriter will provide notice of the settlement date as soon as it is known.

The Board has requested that the SEC approve the amendment to rule G-12(b) with an effective date that is 20 business days prior to the scheduled implementation date for the redesigned comparison system. The redesigned system currently is expected to become operational in June 1993.[8]

Automated Comparison

On April 12, 1993, the Board filed an amendment to rule G-12(f)(i) relating to automated comparison of inter-dealer transactions by a registered clearing agency.[9] If approved by the Commission, the amendment will remove exemptions in the rule that currently allow certain inter-dealer transactions to be compared using paper confirmations.[10] Under the amendment, all inter-dealer transactions that are eligible for comparison will have to be compared in an automated comparison system. In general, all inter-dealer transactions in municipal securities having CUSIP numbers are eligible for automated comparison. The planned effective date for the amendment to rule G-12(f) is July 1, 1993.

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[2] See SEC Release 34-31645, approved December 23, 1992.

[3] The term "depository eligible securities" in the context of this notice means securities that are, at the time of settlement of the transaction, eligible for book-entry settlement in a securities depository registered with the SEC. Board rules at this time do not require dealers to make application to a depository to secure depository eligibility for a new issue.

[4] SEC File No. SR-MSRB-93-3. Comments concerning the filing may be directed to the SEC and should refer to this file number.

[5] Rule G-12(f)(i) currently requires most inter-dealer transactions in municipal securities with CUSIP numbers to be submitted for automated comparison. As described in this Notice, the Board has filed an amendment to rule G-12(f) that will remove certain exemptions from rule G-12(f) and thus require essentially all inter-dealer transactions in securities with CUSIP numbers to be submitted for comparison. In addition, as described in a notice on CUSIP Number Eligibility Standards and Requirement to Obtain CUSIP Numbers: Rule G-34, *MSRB Reports*, Vol. 13, No. 2 (April 1993) at 15-16, essentially all new issue municipal securities after April 15, 1993, will be required to have CUSIP numbers assigned.

[6] The term "managing underwriter" is interpreted to include, in addition to syndicate managers, any dealer acting as sole underwriter or placement agent on a new issue.

[7] The settlement date which must be given is the initial settlement date that will be used for when-issued transactions in the inter-dealer market. This generally will be the same date as settlement between the underwriter and the issuer.

[8] See SR-NSCC-93-2, filed with the SEC on January 6, 1993.

[9] SEC File No. SR-MSRB-93-6. Comments concerning the filing may be directed to the SEC and should refer to this file number.

[10] The exemption currently in the rule allows an inter-dealer transaction to be compared using paper confirmations if one or both parties to the transaction are not participants in a registered securities clearing agency offering comparison services for municipal securities. Under the amendment, a dealer engaging in inter-dealer transactions will have to have access to an automated comparison system, either through direct membership in a registered securities clearing agency or through the use of an agent that will obtain automated comparison of inter-dealer transactions for the dealer.

Changes To Rule G-15 Relating to Institutional Customer Transactions

Book-Entry Delivery

On April 1, 1993, the Board filed an amendment to rule G-15(d)(iii) relating to book-entry settlement of DVP/RVP transactions with customers.[11] With two minor exceptions, the amendment would require that dealers settle all DVP/RVP customer transactions in depository eligible securities using book-entry delivery. The amendment would remove an exemption currently in rule G-15(d) which allows certain DVP/RVP customer transactions in depository eligible securities to be settled with a physical delivery when one or both parties to the transaction are not participating in a depository. Under the amendment, dealers would have to ensure that customers receiving the DVP/RVP privilege have access to a depository, either directly or through a clearing agent, so that book-entry settlement of depository eligible securities can be accomplished.

As noted above, the amendment includes two minor exceptions to the general requirement of book-entry settlement of depository eligible securities. One exception is that the rule does not apply if securities involved in the transaction are ineligible at the depository exclusively used by one of the parties to the transaction (even though the securities may be eligible at other depositories). The second exception allows a dealer to effect a physical RVP settlement with an issuer or trustee if the issuer or trustee is purchasing securities for the purpose of retiring them. This exception is designed to accommodate concerns expressed by trustees who have stated that a delivery of physical certificates is necessary in this instance so that the trustee can effect call lotteries in a timely manner without the danger of calling securities that have been purchased.

In its filing of the amendment with the SEC, the Board has requested that the SEC approve the amendment with an effective date of July 1, 1993.

Automated Confirmation/Affirmation

The Board also has approved an amendment to rule G-15(d)(ii) relating to the use of an automated confirmation/affirmation system for customer transactions. Under the amendment, dealers would be required to use an automated confirmation/affirmation system for all DVP/RVP customer transactions that are eligible for processing in such automated systems. In general, any institutional customer transaction in municipal securities with a CUSIP number is eligible for automated confirmation/affirmation. Thus, once the amendment has been approved by the SEC and has become effective, dealers will have to ensure that customers receiving the DVP/RVP privilege have access to, and in fact will use, an automated confirmation/affirmation system, either through direct communication with a depository or through the use of a clearing agent.

Although the Board has not yet filed this amendment with the SEC, the Board's implementation plan for completing the transition to automated clearance and settlement systems includes a July 1, 1994, effective date for the amendment. In setting this extended effective date, the Board took into consideration various difficulties that have been reported by dealers in using automated confirmation/affirmation systems and in obtaining the full co-operation from institutional customers and their clearing agents in affirming transactions. Because the process of addressing these difficulties may be time-consuming, the Board strongly encourages dealers to begin efforts now to: (i) review internal clearance procedures to ensure proper use of the confirmation/affirmation system; (ii) identify those institutional customers who are not now using the system to affirm all transactions in a timely manner; and (iii) work with customers as necessary so that all eligible transactions can be confirmed/affirmed in the system by July 1, 1994.

April 12, 1993

Text of Proposed Amendments*

Rule G-12. Uniform Practice

(a) no change.

(b) *Settlement dates.*

(i) no change.

(ii) Settlement Dates. Settlement dates shall be as follows:

(A) through (B) no changes.

(C) for "when, as and if issued" transactions, a date agreed upon by both parties, which date shall not be earlier than the fifth business day following the date the confirmation indicating the final settlement date is sent, or, with respect to transactions between the manager and members of a syndicate or account formed to purchase securities from an issuer, a date not earlier than the sixth business day following the date the confirmation indicating the final settlement date is sent; *provided, however,* that for when, as and if issued transactions compared through the automated comparison facilities of a registered clearing agency under section (f) of this rule, a managing underwriter shall provide the registered clearing agency ~~with not less than six business days notice of settlement for the issue, and the settlement date shall not be less than five business days following the date notice of the final settlement date is provided to the registered clearing agency~~ with the settlement date as soon as it is known and shall immediately inform the registered clearing agency of any changes in such settlement date; and

(D) no change.

(c) through (e) no changes.

(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~~

[11] SEC File No. SR-MSRB-93-5. Comments may be directed to the SEC and should refer to this file number.

* Underlining indicates additions; strikethrough indicates deletions.

~~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. In the event that a transaction submitted to a registered clearing agency for comparison in accordance with the requirements of this paragraph (i) shall fail to compare, the party submitting such transaction shall use the post-original comparison procedures provided by the registered clearing agency in connection with such transaction until such time as the transaction is compared or final notification of a failure to compare the transaction is received from the contra-party.~~

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, a transaction eligible for automated trade comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission (registered clearing agency) shall be compared through a registered clearing agency. Each party to such a transaction shall submit or cause to be submitted to a registered clearing agency all information and instructions required from the party by the registered clearing agency for automated comparison of the transaction to occur. In the event that a transaction submitted to a registered clearing agency for comparison in accordance with the requirements of this paragraph (i) shall fail to compare, the party submitting such transaction shall use the post-original-comparison procedures provided by the registered clearing agency in connection with such transaction until such time as the transaction is compared or final notification of a failure to compare the transaction is received from the contra-party.

(ii) through (iii) no changes.

(g) through (l) no changes.

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

(a) through (c) no changes.

(d) *Delivery/Receipt vs. Payment Transactions.*

(i) no change.

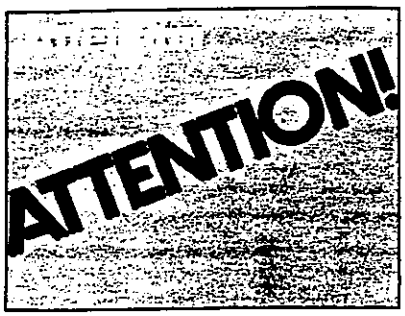
~~(ii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security to which a CUSIP number has been assigned on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent with respect to such transaction 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.~~

(ii) Except as provided in this paragraph, no broker, dealer or municipal securities dealer shall effect a customer transaction for settlement on a delivery vs. payment or receipt vs. payment (DVP/RVP) basis unless the facilities of a clearing agency registered with the Securities and Exchange Commission (registered clearing agency) are used for automated confirmation and affirmation of the transaction. Each broker, dealer and municipal securities dealer executing a customer transaction on a DVP/RVP basis shall: (A) ensure that the customer has the capability, either directly or through its clearing agent, to affirm transactions in an automated confirmation/affirmation system operated by a registered clearing agency; and (B) submit or cause to be submitted to a registered clearing agency all information and instructions required by the registered clearing agency for the production of a confirmation that can be affirmed by the customer or the customer's clearing agent; provided that a transaction that is not eligible for automated confirmation and affirmation through the facilities of a registered clearing agency shall not be subject to this paragraph (ii).

~~(iii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction 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 with respect to such transaction 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.~~

(iii) Notwithstanding the provisions of section (c) of this rule, no broker, dealer or municipal securities dealer shall effect a delivery vs. payment or receipt vs. payment (DVP/RVP) customer transaction that is eligible for book-entry settlement in a depository registered with the Securities and Exchange Commission (depository) unless the transaction is settled through the facilities of a depository or through the interface between two depositories. Each broker, dealer and municipal securities dealer settling such a customer transaction on a DVP/RVP basis shall: (A) ensure that the customer has the capability, either directly or through its clearing agent, to settle transactions in a depository; and (B) submit or cause to be submitted to a depository all information and instructions required from the broker, dealer or municipal securities dealer by the depository for book-entry settlement of the transaction to occur; provided that, if a party to a DVP/RVP customer transaction has made arrangements, through its clearing agent or otherwise, to use one or more depositories exclusively, a transaction by that party shall not be subject to the requirements of this paragraph (iii) if the transaction is ineligible for settlement at all such depositories with which such arrangements have been made; and further provided that purchases made by trustees or issuers to retire securities shall not be subject to this paragraph (iii).

(e) no change.



Route to:
- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☒ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

CUSIP Number Eligibility Standards and Requirement to Obtain CUSIP Numbers: Rule G-34

Notice

Effective April 15, 1993, the eligibility criteria for CUSIP numbers for municipal securities will be revised to eliminate the current criteria that make certain small issues ineligible.

Rule G-34 requires dealers to ensure that CUSIP numbers are assigned to all new issues of municipal securities that are eligible for CUSIP number assignment. Beginning April 15, 1993, the eligibility criteria for CUSIP numbers for municipal securities, as applied by the CUSIP Service Bureau, will be revised. Under the revisions, new issues of municipal securities will be eligible for CUSIP number assignment without regard to the par value of the issue. This is a change from the former eligibility criteria which excluded certain small issues from eligibility (those under $500,000 or, in some cases, under $250,000, in par value.) Thus, beginning April 15, dealers underwriting new issues (or serving as financial advisors in competitive offerings) should ensure that CUSIP numbers are obtained for all such issues, regardless of par value.

The Board requested the CUSIP Board of Trustees to make the revisions in CUSIP eligibility. Prior to doing so, the Board requested comment from the industry. In response to a June 1992 Request for Comments,[1] the Board received seven comment letters,[2] six of which expressed support for the revisions.

Reprinted below is correspondence between the Board and the CUSIP Agency Board of Trustees concerning this matter. Should any questions arise whether a specific issue is eligible for CUSIP numbering, the CUSIP Service Bureau should be contacted.[3] The telephone number for the CUSIP Service Bureau is (212) 208-8345.

March 16, 1993

[1] See *MSRB Reports*, Vol. 12, No. 2 (July 1992) at 5-7.

[2] The comment letters are available for inspection at the Board's offices.

[3] The only issues which the Board is aware of as being ineligible under the new criteria are those with a redemption provision that allows certificates to be called in numerical order of certificate number. Certificates within such an issue are not interchangeable (fungible) in the marketplace because of the operation of this call provision. Dealers should not make application for CUSIP numbers for these issues.

Letter from the Board to the CUSIP Agency Board of Trustees

February 22, 1993

M. K. Klugman
Vice Chairman
CUSIP Agency Board of Trustees
American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, DC 20036

Dear Mr. Klugman:

As you are aware, the Municipal Securities Rulemaking Board in July 1992 published a Request for Comment on whether the eligibility criteria for assigning CUSIP numbers for municipal securities should be revised to remove the limitation that currently prevents CUSIP numbers from being assigned to municipal issues with small par values.[1] The Board noted that the increasing reliance of the municipal securities industry on automated systems for processing, clearing and settling municipal securities suggested the need for a more universal assignment of CUSIP numbers to municipal securities. The Board also noted that the movement of the securities industry in the United States toward meeting the Group of Thirty project goals also would require this result.

Board rule G-34 requires dealers to ensure that CUSIP numbers are assigned to all new issues of municipal securities if the securities are eligible for CUSIP number assignment under CUSIP eligibility criteria. Therefore, if the CUSIP eligibility criteria for municipal securities are changed to remove the restriction for municipal securities issues with small par

[1] See *MSRB Reports* July 1992.

values, the rule automatically would require underwriters (or placement agents that are dealers) to obtain CUSIP numbers for these issues.

The Board received seven comment letters on its Request for Comment.[2] Six of the comment letters expressed support for the changes to the CUSIP eligibility requirements. Four commentators stated that increased CUSIP eligibility would expedite clearance and settlement. Three commentators agreed that the "G30" goals of shortening the comparison and settlement cycle and achieving a book entry delivery environment would be enhanced by increasing CUSIP eligibility. One commentator observed that smaller issues will experience greater liquidity with CUSIP numbers because the potential purchaser will be better able to evaluate the purchase and provide a wider selection of comparative bids. The same commentator also noted that custodial fees are lower for issues with CUSIP numbers. Another commentator added that the cost to obtain CUSIP numbers is minimal and should not have an effect on the marketability of an initial offering.

The Board believes that the comment letters illustrate the general support of the municipal securities industry for removing the CUSIP eligibility restriction for small municipal issues. Although the Board is cognizant of the concern expressed by one commentator relating to the cost of obtaining CUSIP numbers for very small issues, the Board believes that the arguments for more universal CUSIP number assignment are persuasive. Accordingly, the Board recommends to the CUSIP Board of Trustees that the eligibility criteria for CUSIP numbers for municipal securities be revised to eliminate the current criteria that make small issues ineligible.

The Board appreciates the consideration by the CUSIP Board of Trustees of this request. Questions regarding this letter may be directed to Hal Johnson of the Board's staff.

Sincerely,

Charles W. Fish
Chairman

[2] The Request for Comment and comment letters received are attached.

Letter from the CUSIP Agency Board of Trustees to the Board

March 16, 1993

Mr. Charles W. Fish
Chairman
Municipal Securities Rulemaking Board
1818 N Street N.W., Suite 800
Washington, D.C. 20036-2491

Dear Mr. Fish:

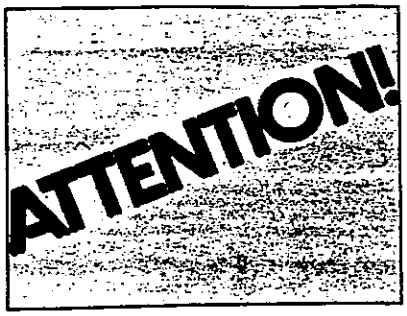
We are pleased to learn of the Board's recommendation that the eligibility criteria for CUSIP numbers for municipal securities be revised to make "small" issues eligible. As I noted in my letter of August 13, 1992, the CUSIP Service Bureau must deny numerous CUSIP number requests each week due to the existing minimum principal amount requirement. The CUSIP Agency Board of Trustees agrees with your assessment that a more universal assignment of CUSIP numbers to municipal securities will be necessitated by an increased reliance on automated clearance and settlement systems.

Consequently, at the February 23 CUSIP Board meeting, the CUSIP Agency Board of Trustees passed a motion to eliminate the principal amount restriction for municipal securities effective April 15, 1993, subject to the continuance of other CUSIP eligibility criteria. Specifically, the CUSIP Service Bureau will maintain its requirements that appropriate documentation (*i.e.*, official statements, notices of sale, legal opinion) be filed with CUSIP in order to obtain numbers. In this manner, the integrity and accuracy of CUSIP data can be maintained at the high level established over the past 25 years.

The support of the municipal securities industry, as well as the MSRB, is extremely encouraging and will allow CUSIP to assist the securities industry in achieving their goals of a reduced settlement cycle, and reduced market risk.

Sincerely,

M.K. Klugman
Chairman
CUSIP Agency Board of Trustees



Route to:

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

Continuing Education Effort by Securities Industry Regulators

Notice

The Board has joined with five other self-regulatory organizations to develop a continuing education program for securities industry registered representatives and principals.

Representatives of six leading securities industry self-regulatory organizations (SROs) have agreed to work together on the development of a single continuing education program for registered representatives and principals for the entire securities industry.

The SROs are unanimous in their view that the complexity of today's products and markets require that those who deal with the public or are in supervisory positions maintain minimum standards of competence and professionalism. Because of continuous change, the SROs believe there may be a need for a formal, industry-wide continuing education program to keep industry professionals up to date on products, markets, and rules.

The SROs have agreed to form an industry task force that would review information gathered by the SROs and develop the elements of such a program. By working together, the SROs hope to avoid the adoption of multiple state or SRO requirements, which would create an inefficient and unnecessary burden on their members.

The mission of the task force would be to:

1. Review information on continuing education already developed by the SROs.
2. Review the need for a continuing education program for securities industry professionals.
3. Review information on continuing education programs already under study by state securities regulators and consider state requirements in the design and implementation of any such SRO program for the securities industry.
4. Define the nature and scope of any such continuing education program for securities industry professionals.
5. Determine the appropriateness of including an assessment feature in any such program.
6. Lay out a plan of action for the design and implementation of any such program.

The task force, which will represent a cross-section of the industry, will be asked to submit an interim report to the SROs within three months of its first meeting. The task force will solicit input from a wide range of members and other interested persons, including state input through the North American Securities Administrators Association (NASAA). Task force members are Mary Alice Brophy, First Vice President and Director of Compliance, Dain Bosworth Inc.; Ronald E. Buesinger, Corporate Secretary and Senior Vice President, A.G. Edwards & Sons, Inc.; Elena Dasaro, Compliance Official, H.C. Wainwright & Co., Inc.; David A. DeMuro, Senior Vice President and Associate General Counsel, Shearson Lehman Brothers; Sheldon Goldfarb, Deputy General Counsel, Goldman, Sachs & Co.; John P. Gualtieri, Vice President and Insurance Counsel, Prudential Insurance Company of America; Therese Haberle, Vice President, Fidelity Investments; Stephen Hammerman, Vice Chairman, Merrill Lynch, Pierce, Fenner & Smith, Inc.; James Harrod, General Principal, Investment Representative — Training and Development, Edward D. Jones & Co.; Todd A. Robinson, Chairman and CEO, Linsco/Private Ledger Corp.; Richard C. Romano, President, Romano Brothers & Co.; William R. Simmons, Senior Vice President and Associate National Sales Director, Dean Witter Reynolds, Inc.

The SROs involved in this effort and the person at each organization to be contacted with questions and comments are: Howard Baker, American Stock Exchange, Inc. (212) 306-1880; Darrell Dragoo, Chicago Board Options Exchange, (312) 786-7050; Loretta J. Rollins, Municipal Securities Rulemaking Board (202) 223-9503; Frank McAuliffe, National Association of Securities Dealers, Inc., (301) 590-6694; Donald van Weezel, New York Stock Exchange, Inc., (212) 656-5058; and Diana Anderson, Philadelphia Stock Exchange, (215) 496-5177. NASAA, which has been working with the SROs, is represented by Lewis Brothers, Virginia Securities Division, (804) 786-9006.

February 18, 1993

Questions or comments about this notice may be directed to Loretta J. Rollins, Professional Qualifications Administrator.

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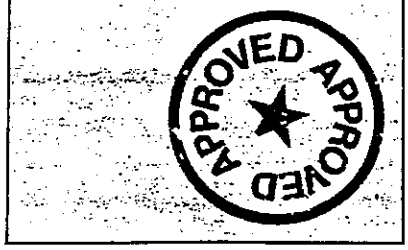
Notice of Approval



Route to:

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

Delivery of Official Statements to the Board: Rule G-36

Amendment Approved

The amendment expands the scope of rule G-36 to include all primary offerings, with the exception of limited placements. It requires underwriters to send to the Board copies of official statements (along with completed Forms G-36(OS)) if such documents are prepared by or on behalf of the issuer.

On March 31, 1993, the Securities and Exchange Commission approved an amendment to rule G-36, on delivery of official statements to the Board.[1] The amendment expands the scope of rule G-36 to include all primary offerings, with the exception of limited placements. It requires underwriters to send to the Board copies of official statements (along with completed Forms G-36(OS)) if such documents are prepared by or on behalf of the issuer. The amendment became effective upon approval by the Commission.

Background

Rule G-36 requires that brokers, dealers and municipal securities dealers deliver to the Board, among other things, copies of final official statements for most primary offerings, if such documents are prepared by or on behalf of the issuer.[2] These official statements then are made available to interested parties through the Board's Municipal Securities Information Library™ (MSIL™) system.[3] The rule previously provided an exemption from this delivery requirement for primary offerings exempt from SEC Rule 15c2-12 — the SEC rule that requires the preparation of a final official statement for most primary offerings of municipal securities. These exempt issues include primary offerings with authorized denominations of $100,000 or more if such securities (i) have maturities of nine months or less; (ii) have put options (at par or greater) at least as frequently as every nine months until redemption or repurchase; or (iii) are "limited placements" as that term is used in SEC Rule 15c2-12.[4]

Summary of Amendment

The amendment expands the scope of rule G-36 to include two of the exempted categories of offerings described above, relating to securities with maturities of nine months or less and securities with put periods of nine months or less. The amendment requires that, if an official statement is prepared for such an offering, the underwriter must send two copies of the official statement and two copies of a completed Form G-36(OS) to the Board. The underwriter is required to send the documents to the Board within one business day of settlement or closing of the issue.

In creating the MSIL system, the Board repeatedly has expressed its concern that the general lack of access to information about municipal securities and their issuers is detrimental to the overall integrity and efficiency of the municipal securities market. The Board determined to adopt the

Questions about the amendment may be directed to Jill C. Finder, Assistant General Counsel, or Thomas A. Hutton, Director of MSIL.

[1] SEC Release No. 34-32086.

[2] For purposes of rule G-36, the following terms have the following meanings:
(i) A "final official statement" is defined as a document or set of documents prepared by an issuer of municipal securities or its representative, setting forth, among other things, information concerning the issuer(s) of such securities and the proposed issue that is complete as of the date of delivery of the document or set of documents to the underwriter.
(ii) A "primary offering" is an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including certain remarketings.

[3] Municipal Securities Information Library and MSIL are trademarks of the Board.

[4] A "limited placement" is a primary offering sold to no more than thirty-five persons, each of whom the underwriter believes (i) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment and (ii) is not purchasing for more than one account or with a view to distributing the securities.

amendment because it believes that expanding the scope of rule G-36 to include offerings with maturities of nine months or less and offerings with put periods of nine months or less will result in a more complete collection of disclosure documents, thereby increasing the overall integrity, efficiency and liquidity of the municipal securities market.

March 31, 1993

Text of Amendment*

Rule G-36 Delivery of Official Statements, Advanced Refunding Documents and Forms G-36(OS) and G-36(ARD) to Board or its Designee

(a) through (b) No change.

(c) *Delivery Requirements for Issues not Subject to Securities Exchange Act Rule 15c2-12.*

(i) through (ii) No change.

(iii) This section shall not apply to primary offerings of municipal securities, regardless of the amount of the issue, if the issue qualifies for an exemption set forth in paragraph (1) of section (c) of Securities Exchange Act rule 15c2-12~~(e)~~.

(d) through (g) No change.

* Underlining indicates additions; strikethrough indicates deletions.

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Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [X] Sales
- [X] Operations
- [ ] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

Use of PEX System for Close-Outs: Rule G-12

Notice

The Board has determined that:

- **A close-out notice sent to a dealer using the PEX system qualifies as a written notice sent "return receipt requested" under Board rule G-12(h).**

The Depository Trust Company (DTC) recently announced that, as of April 19, 1993, it will offer the use of its Participant Terminal System (PTS) for the transmittal of municipal securities close-out messages through the Participant Exchange Service (PEX) system. The Board has determined to permit dealers to use this system to send the written close-out notices, required under the Board's close-out procedures, to dealers who are participating in the system.

Under rule G-12(h), a dealer taking action in a close-out must provide telephonic notice to the appropriate party, followed no later than the next business day with a written notice.[1] The rule generally requires written notices to be sent "return receipt requested."[2] The Board previously has interpreted this provision to allow the use of certified mail, registered mail and messenger services that obtain acknowledgments of delivery from the recipient and make those acknowledgments accessible to the sender.[3] The Board has concluded that the PEX system also will meet the purposes of the rule by providing efficient transmission of written close-out notices and acknowledgments of receipt to the senders. Based on a review of the preformatted PEX message screens for municipal securities close-out notices, the Board believes that, if completed correctly, these screens would meet the information requirements of rule G-12(h).[4]

DTC will publish a list of PEX participants in its "Eligible Municipal Securities" directory. A listed PEX participant (at its own option) may use the PEX system to send a written close out notice in lieu of sending the notice by "return receip requested" mail. A dealer listed as a PEX participant is required to accept a notice sent through the system and may not demand a notice in paper form. A dealer that transmits a written notice to a recipient via the PEX system thereafter must use the PEX system for all written notices required to be sent to that recipient on that close-out. These steps will help to ensure that close-out messages sent through the PEX system are properly monitored and acknowledged by dealers participating in the program.

The Board emphasizes that rule G-12(h) will continue to govern all aspects of the municipal securities close-outs on which the PEX system is used. In particular, the Board reminds dealers that the telephonic notices required under rule G-12(h) must continue to be used and that any questions about a close-out should be resolved at that time and not delayed until the sending of the written notice. A dealer receiving a municipal securities close-out notice via the PEX system must acknowledge it through the system, providing the sending dealer with confirmation that the message was received. This acknowledgment is equivalent, under the rule, to signing for a letter received "return receipt requested." If a deficient notice or a notice on an unrecognized transaction is received through the system, the receiving dealer must acknowledge the notice and call the sending dealer to resolve the problem.[5] This should be an infrequent occurrence, since the written notices merely confirm previously made telephone calls.

March 31, 1993

Questions about this notice may be directed to Harold L. Johnson, Deputy General Counsel, or Judith A. Somerville, Uniform Practice Specialist.

[1] Telephone and written notices are required when dealers (i) originate a close-out; (ii) retransmit a close-out; (iii) extend delivery dates; and (iv) execute a close-out. The Board's *Manual on Close-Out Procedures* contains a detailed explanation of the procedures required by rule G-12(h).

[2] There is one exception to the general rule requiring notices to be sent "return receipt requested." After a notice of close-out has been retransmitted once, copies of second and subsequent retransmittals of the notice must be sent to the originator. Rule G-12(h) does not require these to be sent "return receipt requested."

[3] *MSRB Manual on Close-Out Procedures*, Question and Answer 16, on page 8.

[4] The PEX screens for municipal securities close-outs do not require dealers to include the addresses of the parties to the close-out, as does rule G-12(h). The Board has concluded that this information is not necessary on PEX notices because the system will be limited to DTC members, who will use DTC identification numbers.

[5] This is identical to the procedure used for receipt of a written notice by "return receipt requested" mail. Under rule G-12(h), a dealer may not refuse to accept a written notice of close-out. *MSRB Manual on Close-Out Procedures*, Question and Answer 25, on page 11. The failure of a dealer to acknowledge a close-out notice actually received through the PEX system would be tantamount to a refusal to accept a notice.

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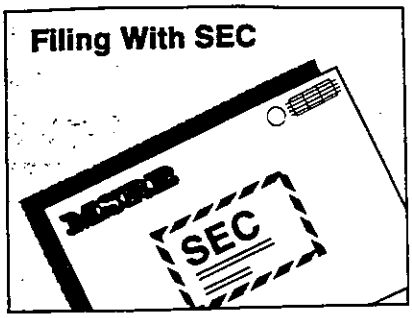

Route to:

- [x] Manager, Muni Dept.
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- [ ] Trading
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- [ ] Training
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Arbitration Changes: Rule G-35

Amendments Filed

The amendments will conform the provisions of the Board's arbitration code to recent amendments to the Uniform Code approved by SICA.

On March 23, 1993, the Board filed with the Securities and Exchange Commission (Commission) amendments to rule G-35, the Board's Arbitration Code.[1] The amendments relate to various sections of the Arbitration Code, and are based on changes adopted by the Securities Industry Conference on Arbitration (SICA).[2] The Board has requested that the Commission delay the effectiveness of the amendment to Section 36, concerning predispute arbitration agreements, until one year after Commission approval to provide dealers with sufficient time to amend their arbitration agreements.

Summary of Amendments

Matters Subject to Arbitration (Section 1)

At its January 1992 meeting, SICA unanimously adopted a rule governing class actions which provides that class actions between dealers and their customers are to be resolved in court, rather than through arbitration. Currently, the Board's Arbitration Code does not specifically address class action claims. Thus, the amendment would add new language (identical to SICA's Uniform Code of Arbitration (Uniform Code)) to exclude class action claims from Board arbitration proceedings. The amendments also provide that a claimant may pursue a claim in arbitration even if that claim is the subject of a class action, as long as the claimant has complied with any court-imposed conditions for properly withdrawing from the class. In addition, the amendments prohibit dealers from attempting to compel a customer to arbitrate a claim included in a class action, or from attempting to enforce an arbitration agreement against any customer that has initiated a class action claim in court and who has not opted out of the class, until a court denies class certification, the class is decertified, or the court excludes the customer from the class.

Persons Subject to the Board's Arbitration Code (Section 2)

Section 15B(b)(2) of the Act states that:

> The Board shall propose and adopt rules to effect the purposes of [the Act] with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers.

In general, Board rules state that they apply to "brokers, dealers, and municipal securities dealers." However, Sections 1 and 2 of the arbitration code speak in terms of "municipal securities broker and municipal securities dealer." Thus, the amendments conform these references to the statutory reference, thereby promoting consistency among Board rules.

Joinder and Consolidation — Multiple Parties (Section 5)

In the past, the various self-regulatory organizations (SROs) had conflicting policies concerning joining multiple parties in the same claim. In reviewing this issue, SICA believed that two competing interests must be weighed: convenience to the parties and prejudice to the respondents. Section 20 of the Federal Rules of Civil Procedure, concerning joinder and consolidation, strikes an appropriate balance between these two interests. Accordingly, SICA amended its Uniform Code to conform to the language of the Federal Rules. The amendments to rule G-35 track this language and provide that (i) all claimants may join in one action if their claims arise out of the same transaction; (ii) all respondents may be joined in one action if the claims asserted against them arise out of the same transaction; and (iii) judgments may be apportioned according to the claimants' rights to relief and the respondents' liabilities. In addition, the amendments clarify that parties are permitted to file claims with multiple claimants, that the Director of Arbitration is permitted to consolidate claims that have been filed separately, and that all further determinations made by an arbitration panel concerning such matters shall be deemed final.

Questions about the amendments may be directed to Jill C. Finder, Assistant General Counsel, or Denise P. Person, Arbitration Administrator.

[1] SEC File No. SR-MSRB-93-4.

[2] Since 1977, SICA has worked to develop a Uniform Code of Arbitration in an effort to promote consistency in the securities industry arbitration process. Board rule G-35 closely follows the Uniform Code.

Designation of Time and Place of Hearings (Section 16)

Currently, the Director of Arbitration is authorized to determine the time and place of the initial hearing and an arbitration panel is authorized to determine the time and place of subsequent hearings, "unless the law directs otherwise." Some SROs have experienced problems with this section. Thus, SICA amended the Uniform Code to delete the conditional language ("unless the law directs otherwise"), thereby making final the Director's and arbitrators' determinations concerning the time and place of hearings. This amendment is intended to ensure that a dealer cannot unfairly control the selection of a hearing location and in so doing cause a customer to incur unreasonable costs in pursuing an arbitration claim.

Failure to Appear (Section 19)

The amendments to this section merely clarify that arbitrators are authorized to proceed with and dispose of a case if a party fails to appear at a hearing or at any continuation of a hearing session.

Discovery (Section 22)

The amendments to this section merely clarify when discovery requests may be served.

Party Service of Amended Pleadings (Section 29)

Rule G-35 currently provides that, when a claim is amended, the arbitration staff serves copies of such amended pleadings on the other parties. This intermediary role results in unnecessary delays and additional costs to the Board's arbitration program. The amendments are designed to save administrative time and costs by requiring that parties serve copies of amended pleadings on all other parties and provide the Director of Arbitration with sufficient additional copies for each arbitrator.

Awards (Section 31)

While arbitrators may rule in a party's favor and grant a monetary award, this does not necessarily mean that the prevailing party will receive that award in a timely manner, or at all. In an effort to facilitate the prompt payment of awards, SICA amended the Uniform Code to provide for the accrual and payment of interest on awards. Accordingly, the amendments provide that interest shall accrue on awards that are not paid within 20 calendar days of receipt unless an appeal or motion to vacate has been filed in court. The amendments also provide that interest on awards shall be assessed at either the prevailing "legal" rate in the state where the award was rendered or at a rate specified by the arbitrators.

In addition, the amendments require that awards contain (among other information) the names of counsel, if any. This amendment is intended to enhance the general flow of information about arbitration proceedings.

Agreement to Arbitrate (formerly entitled "Miscellaneous") (Section 32)

Currently, this section incorporates the Board's arbitration code into every duly executed submission agreement. If a party does not sign a submission agreement, then it could be argued that the party is not bound by the code. Certain other documents, however, are recognized as contractual agreements to arbitrate. Thus, the amendments are intended to ensure that a party who does not sign a submission agreement, but is subject to other agreements to arbitrate, also is bound by the Board's arbitration code.

Use of Simplified Arbitration for Small Claims (Section 34)

The amendments to paragraph (a), concerning use of simplified arbitration procedures, eliminate the requirement that a customer demand use of such procedures before they can be implemented. The amendments also eliminate the requirement that parties first consent in writing to use of these procedures. All SROs use simplified arbitration procedures in cases involving public customers where the amount in dispute does not exceed $10,000 without requiring that the customer demand use of such procedures or that the parties agree in writing to such use. The amendments to rule G-35 simply codify this current SRO practice.

The amendments to paragraph (d), concerning referring claims, counterclaims, and third-party claims to a panel of arbitrators, are intended to correct earlier changes to this section, in conformity with Section 12(a) of the Board's arbitration code.

The amendments to paragraph (h), concerning submission of further documentary evidence in simplified arbitration procedures, add new language which (1) codifies the applicability of Board discovery procedures to simplified arbitrations when a public customer demands a hearing; and (2) establishes a procedure to resolve discovery disputes when no hearing is demanded or consented to. This latter amendment includes setting shorter time frames for discovery under such circumstances, in keeping with the Board's (and SICA's) policy of expediting small claims.

Simplified Arbitration — Intra-Industry (Section 35)

The amendments to paragraph (a) merely clarify that only those inter-dealer small claims that are subject to the Board's arbitration code shall be resolved pursuant to the simplified procedures set forth in this section.

The amendments to paragraph (c), concerning referring claims, counterclaims, and third-party claims to a panel of arbitrators, are intended to correct earlier changes to this section, in conformity with Section 12(b) of the Board's arbitration code.

Predispute Arbitration Agreements (Section 36)

The amendments add new language requiring that all new predispute arbitration agreements signed by customers must include a prescribed statement excluding class actions from the arbitration contract and clarifying investors' ability to pursue class actions in court.[3] This language is intended to prohibit dealers from bringing class actions to arbitration and from attempting to enforce an agreement to arbitrate against a member of a class action. This amendment shall apply only to new agreements signed by an existing or new customer. As

[3] See the amendments to Section 1, above, concerning class actions.

noted above, the Board has requested that the Commission delay the effectiveness of this particular amendment to Section 36 until one year after Commission approval, in order to provide dealers with sufficient time to amend their arbitration agreements.

March 23, 1993

Text of Proposed Amendments*

Rule G-35. Arbitration

Every ~~municipal securities~~ broker, dealer and municipal securities dealer shall be subject to the Arbitration Code set forth herein.

Arbitration Code

Section 1. *Matters Subject to Arbitration*

(a) This Arbitration Code shall apply to every claim, dispute or controversy arising out of or in connection with the municipal securities activities of a ~~municipal securities~~ broker, dealer or municipal securities dealer acting in its capacity as such which is submitted to arbitration pursuant to section 2 of this Arbitration Code, except in the event that all of the parties to the claim, dispute or controversy agree to arbitrate it in another forum.

(b) *Class Action Claims*

(1) A claim submitted as a class action shall not be eligible for arbitration under this Code.

(2) A claim filed by a member or members of a putative or certified class action shall not be eligible for arbitration under this Code if the claim is encompassed by a putative or certified class action filed in federal or state court, or is ordered by a court to a non self-regulatory organization forum for classwide arbitration. Such claims shall be eligible for arbitration pursuant to paragraph (a), above, or pursuant to the parties' contractual agreement, if any, if a claimant demonstrates that it has elected not to participate in the putative or certified class action or, if applicable, has complied with any conditions for withdrawing from the class prescribed by the court.

Disputes concerning whether a particular claim is encompassed by a putative or certified class action shall be referred by the Director of Arbitration to a panel of arbitrator(s) in accordance with section 12 or section 34 of this Code, as applicable. Either party may elect instead to petition the court with jurisdiction over the putative or certified class action to resolve such disputes. Any such petition to the court must be filed within 10 business days from receipt of notice that the Director of Arbitration is referring the dispute to a panel of arbitrator(s).

(3) No broker, dealer or municipal securities dealer and/or associated person of a broker, dealer or municipal securities dealer shall seek to enforce any agreement to arbitrate against a customer that has initiated in court a putative class action or is a member of a putative or certified class with respect to any claims encompassed by the class action unless and until:

(i) the class certification is denied; or

(ii) the class is decertified; or

(iii) the customer is excluded from the class by the court; or

(iv) the customer elects not to participate in the putative or certified class action or, if applicable, has complied with any conditions for withdrawing from the class prescribed by the court.

(4) No broker, dealer or municipal securities dealer and/or associated person of a broker, dealer or municipal securities dealer shall be deemed to have waived any of its rights under this Code or under any agreement to arbitrate to which it is a party except to the extent stated in this paragraph (b).

Section 2. *Persons Subject to the Provisions of the Arbitration Code*

Any claim, dispute or controversy subject to arbitration in accordance with section 1 of this Arbitration Code shall be submitted to arbitration pursuant to this Arbitration Code at the instance of:

(a) a ~~municipal securities~~ broker, dealer or municipal securities dealer against another ~~municipal securities~~ broker, dealer or municipal securities dealer;

(b) a person other than a ~~municipal securities~~ broker, dealer or municipal securities dealer against a ~~municipal securities~~ broker, dealer or municipal securities dealer; or

(c) a ~~municipal securities~~ broker, dealer or municipal securities dealer against a person other than a ~~municipal securities~~ broker, dealer or municipal securities dealer, provided that the submission to arbitration is pursuant to a duly executed and enforceable agreement to arbitrate and is in accordance with section 29 of the Act.

Sections 3 through 4. no change.

Section 5. *Initiation of Proceedings*

Except as otherwise provided herein, an arbitration proceeding under this Arbitration Code shall be instituted as follows:

(a) through (c) no change.

(d) *Joinder and Consolidation—Multiple Parties*

~~(1) With respect to any dispute, claim or controversy submitted to arbitration, any party or person eligible to submit a claim under this Arbitration Code shall have the right to proceed in the same arbitration against any other party or person upon any claim directly related to such dispute.~~

(1) Permissive Joinder. All persons may join in one action as claimants if they assert any right to relief jointly, severally, or arising out of the same transaction, occurrence or series of transactions or occurrences and if any questions of law or fact common to all these claimants will arise in the action. All persons may be joined in one action as respondents if there is asserted against them jointly or severally, any right to relief arising out of the same transaction, occurrence or series of transactions or occurrences and if any questions of law or fact common to all respondents will arise in the action. A claimant or respondent need not assert rights to or defend against all the relief demanded. Judgment may be given for one or more of the claimants according to their respective rights to relief, and against one or more respondents according to their respective liabilities.

*Underlining indicates additions; strikethrough indicates deletions.

(2) ~~For purposes of this subsection, the Director of Arbitration shall be authorized to determine preliminarily whether a claim is directly related to the matter in dispute and to join any other party to the dispute and to consolidate the matter for hearing and award purposes.~~ In arbitrations where there are multiple claimants, respondents and/or third-party respondents, the Director of Arbitration shall be authorized to determine preliminarily whether such parties should proceed in the same or separate arbitrations. Such determination will be considered subsequent to the filing of all responsive pleadings.

(3) The Director of Arbitration shall be authorized to determine preliminarily whether claims filed separately are related and shall be authorized to consolidate such claims for hearing and award purposes.

(4) ~~(3) All final~~ Further determinations ~~in~~ with respect ~~of joining,~~ to joinder, consolidation and multiple parties under this subsection shall be made by the arbitration panel and shall be deemed final.

Sections 6 through 15. no change.

Section 16. *Designation of Time and Place of Hearings*

~~Unless the law directs otherwise,~~ t The time and place of the initial hearing shall be determined by the Director of Arbitration and for each ensuing hearing thereafter by the arbitration panel. Notice of the initial hearing shall be delivered at least eight business days prior to the date fixed for hearing by personal service or registered or certified mail to each of the parties and for each hearing thereafter as the arbitration panel shall determine, unless the parties shall by their mutual consent waive the notice provisions provided under this section. Attendance at a hearing constitutes a waiver of notice thereof.

Sections 17 through 18. no change.

Section 19. *Failure to Appear*

If any of the parties, after due notice is given as provided herein, fails to be present or represented at a hearing or at any ~~adjourned~~ continuation of a hearing session, the arbitrators may, in their own discretion, proceed with the arbitration of the claim, dispute or controversy. In such cases, all awards shall be rendered as if each party had entered an appearance in the matter submitted.

Sections 20 through 21. no change.

Section 22. *Discovery*

(a) no change.

(b) *Document Production and Information Exchange*

(1) Any party may serve a written request for information or documents ("information request") upon another party twenty (20) business days or more after service of the statement of claim by the Director of Arbitration or upon ~~service~~ filing of the answer ~~by the Director of Arbitration~~, whichever is earlier. The requesting party shall serve the written information request on all parties and file a copy with the Director of Arbitration. The parties shall endeavor to resolve disputes regarding an information request prior to serving any objection to the request. Such efforts shall be set forth in the objection.

(2) through (4) no change.

(c) through (e) no change.

Sections 23 through 28. no change.

Section 29. *Amendment of Pleadings*

(a) After the filing of any pleadings, if a party desires to file a new or different pleading, such change must be made in writing and filed with the Director of Arbitration with sufficient additional copies for each arbitrator. The party filing a new or different pleading shall serve on all other parties a copy of the new or different pleading in accordance with the provisions set forth in section 5(c)(1). ~~The Director of Arbitration shall endeavor to serve promptly by mail or otherwise upon all other parties a copy of said change.~~ The other parties may, within 10 business days from the receipt of service, file a response with all other parties and the Director of Arbitration in accordance with section 5(c)(1).

(b) No change.

Section 30. no change.

Section 31. *Awards*

(a) through (d) no change.

(e) Upon receipt by a broker, dealer or municipal securities dealer ("dealer") of a monetary award rendered against it, the dealer, within 20 calendar days, shall:

(1) deliver the amount of the award to the prevailing party (subject to any action required of the prevailing party by the award as a precedent to payment), or

(2)(i) if the dealer is considering a motion to vacate the award or an appeal of the award:

(A) deposit the amount of the award with a bank (the "escrow agent") in an escrow account pursuant to an escrow agreement which includes certain provisions described below, or

(B) provide to the prevailing party an irrevocable standby letter of credit ("letter of credit") for the amount of the award setting forth the terms and conditions for payment described below.

(ii) Immediately upon deposit by the dealer of the amount of the award in an escrow account, the dealer must notify the prevailing party in writing of the deposit of the arbitration award, the name and address of the escrow agent, and the final date a motion to vacate or an appeal may be filed according to relevant state or federal law ("motion or appeal date"). The escrow agreement must provide that, if a motion to vacate or an appeal is not filed by the motion or appeal date, or filed but later withdrawn by the dealer prior to the entry of a final court order, the escrow agent will deliver the amount of the award to the prevailing party within two business days after the motion or appeal date or the withdrawal date. If a motion to vacate or an appeal is filed, the amount of the award shall be held by the escrow agent until the entry of a final court order on the motion or appeal. The escrow agreement must provide that, within 10 business days of the entry of the final court order, the escrow agent will deliver the amount of the award in accordance with the court's order.

(iii) If a letter of credit is provided, it must provide that the amount of the award will be disbursed to the prevailing party by the letter of credit issuer upon certification by the prevailing party that the dealer has not paid the amount of the award and:

(A) a motion to vacate or an appeal has not been filed by the motion or appeal date, or
(B) a motion to vacate or an appeal has been filed but later withdrawn by the dealer prior to the entry of a final court order, or
(C) a final court order on the motion to vacate or appeal has been entered in favor of the prevailing party.

(iv) Any costs incurred in this escrow account or in the application for and issuance of the letter of credit shall be borne by the dealer.

(f) A monetary award shall bear interest from the date of the award: (i) if not paid within 20 calendar days of receipt; or (ii) if the award is the subject of a motion to vacate or an appeal which is denied, or which has been filed but later withdrawn by a party prior to the entry of a final court order; or (iii) as specified by the arbitrator(s) in the award. Interest shall be assessed at the legal rate, if any, then prevailing in the state where the award was rendered, or at a rate set by the arbitrator(s).

(g) ~~(f)~~ The award shall contain: (1) the names of the parties and the names of counsel, if any; (2) a summary by the arbitrators of the issues in controversy, the damages and/or other relief requested, the damages and/or other relief awarded, and a statement of any other issues resolved; ~~and~~ (3) the names of the arbitrators; (4) the dates the claim was filed and the award was rendered; (5) the number and dates of hearing sessions, and the location of the hearing(s), and (6) the signatures of those arbitrators concurring in the award.

(h) ~~(g)~~ no change.

Section 32. ~~Miscellaneous~~ *Agreement to Arbitrate*

This Arbitration Code shall be deemed a part of and incorporated by reference in every agreement to arbitrate under the rules of the Municipal Securities Rulemaking Board, including a duly executed Submission Agreement ~~which shall be binding on all parties~~.

Section 33. no change.

Section 34. *Simplified Arbitration for Small Claims Relating to Transactions with Customers*

(a) Any claim, dispute or controversy, arising between a customer and a broker, dealer or municipal securities dealer, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding $10,000 (exclusive of attendant costs and interest), shall ~~upon demand of the customer or by written consent of the parties~~ be arbitrated as hereinafter provided.

(b) and (c) no change.

(d) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent(s) one copy of the Submission Agreement and one copy of the statement of claim. Within 20 calendar days from receipt of the statement of claim, the respondent(s) shall serve each party with an executed Submission Agreement and a copy of respondent's answer. Respondent's executed Submission Agreement and answer shall also be filed with the Director of Arbitration with sufficient additional copies for the arbitrator(s) along with any deposit required under rule A-16. The answer shall designate all available defenses to the claim and may set forth any related counterclaim and/or related third-party claim the respondent(s) may have against the claimant or any other person. If the respondent(s) has interposed a third-party claim, the respondent(s) shall serve the third-party respondent with an executed Submission Agreement, a copy of respondent's answer containing the third-party claim, and a copy of the original claim filed by the claimant. The third-party respondent shall respond in the manner herein provided for response to the claim. If the respondent(s) files a related counterclaim exceeding $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of ~~three (3) or five (5)~~ arbitrators, the size and composition of which shall be determined in accordance with section 12(a) of this Code, or the arbitrator may dismiss the counterclaim and/or third-party claim without prejudice to the counterclaimant(s) and/or third-party claimant(s) pursuing the counterclaim and/or third-party claim in a separate proceeding. The costs to the claimant under either proceeding shall in no event exceed the total amount specified in rule A-16.

(e) through (j) no change.

(k) In his discretion, the arbitrator may, at the request of any party, permit such party to submit additional documentation relating to the pleadings:

(1) If a hearing is demanded or consented to in accordance with section 34(f), the Discovery provisions under section 22 of this Code shall apply.

(2) If no hearing is demanded or consented to, any written request for information or documents ("information request") shall be filed with the Director of Arbitration within 10 business days of notification of the identity of the arbitrator selected to decide the claim, dispute or controversy. The requesting party shall serve simultaneously its information request on all parties. Any response or objection to the information request shall be served on all parties and filed with the Director of Arbitration within 5 business days of receipt of the information request. The arbitrator shall resolve all disputes under this subsection on the papers submitted.

(l) no change.

Section 35. *Simplified Arbitration for Small Claims Relating to Intra-Industry Transactions*

(a) Any claim, dispute or controversy between or among brokers, dealers and municipal securities dealers, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding $10,000 (exclusive of attendant costs and interest), shall be arbitrated as hereinafter provided.

(b) No change.

(c) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent(s) one copy of the Submission Agreement and one copy of the statement of claim. Within 20 calendar days from receipt of the statement of claim, the respondent(s) shall serve each party with an executed Submission Agreement and a copy of respondent's answer. Respondent's executed Submission Agreement and answer shall also be filed with the Director of Arbitration with sufficient additional copies for the arbitrator(s) along with any deposit required under rule A-16. The answer shall designate all available defenses to the claim, state whether or not a hearing is requested, and may set forth any related counterclaim and/or related third-party claim the respondent(s) may have against the claimant or any other person. If the

respondent(s) has interposed a third-party claim, the respondent(s) shall serve the third-party respondent with an executed Submission Agreement, a copy of respondent's answer containing the third-party claim, and a copy of the original claim filed by the claimant. The third-party respondent shall respond in the manner herein provided for response to the claim. If the respondent(s) files a related counterclaim exceeding $10,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of ~~three (3) or five (5)~~ arbitrators, the size and composition of which shall be determined in accordance with section 12(b) of this Code, or the arbitrator may dismiss the counterclaim and/or third-party claim without prejudice to the counterclaimant(s) and/or third-party claimant(s) pursuing the counterclaim and/or third-party claim in a separate proceeding. The costs to the claimant under either proceeding shall in no event exceed the total amount specified in rule A-16.

(d) through (i) no change.

Section 36. *Predispute Arbitration Agreements with Customers*

(1) through (4) No change.

(5) All agreements shall include a statement that:

"No person shall bring a putative or certified class action to arbitration, nor seek to enforce any predispute arbitration agreement against any person who has initiated in court a putative class action; who is a member of a putative class who has not opted out of the class with respect to any claims encompassed by the putative class action until:

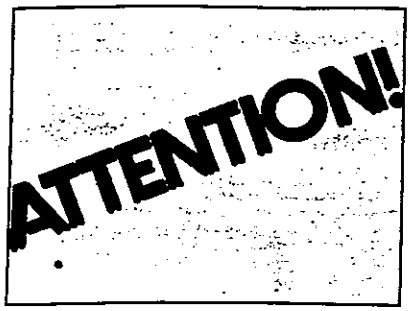
(a) the class certification is denied; or

(b) the class is decertified; or

(c) the customer is excluded from the class by the court.

Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein."

(6) ~~(5)~~ The requirements of paragraphs (1) through (4), above, ~~this section~~ shall apply only to new agreements signed by an existing or new customer of a dealer after December 1, 1989. The requirements of paragraph (5), above, shall apply only to new agreements signed by an existing or new customer of a dealer after [one year from the date of Commission approval].



Route to:
- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☐ Public Finance
- ☐ Compliance
- ☐ Training
- ☐ Other

Arbitrator Training

The Board wishes to apprise arbitrators of the following programs offered by other self-regulatory organizations (SROs) and non-SRO forums:

The American Arbitration Association (AAA), in cooperation with the American Stock Exchange, Inc., the New York Stock Exchange, Inc., the National Association of Securities Dealers, Inc., and a number of local and regional SROs, will present "Securities Arbitrator Training: Managing the Arbitration Process" on the following dates and locations:

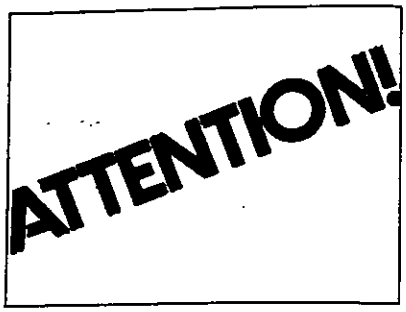
April 14, 1993	Hartford, CT
April 20, 1993	Atlanta, GA
April 27, 1993	Minneapolis, MN
April 29, 1993	Philadelphia, PA
May 5, 1993	Nashville, TN
May 7, 1993	Dania (Ft. Lauderdale), FL
May 12, 1993	San Francisco, CA
May 14, 1993	Houston, TX

The Board is a co-sponsor of these one-day programs which are for individuals who currently serve, or have an interest in serving, as arbitrators in securities disputes. Registrants will have the opportunity to exchange ideas with nationally recognized securities experts, participate in panel discussions and review hearing procedures through the use of a specially designed, stop-action videotape.

Topics to be covered include:

- Review of Securities Arbitration Procedures
- Hearing Procedures
- Disclosure and Ethical Issues Confronting the Arbitrator
- Preparing the Arbitrator's Award: Dealing with the Issues
- Review of Recent Court Decisions: the Powers and Duties of the Arbitrator

The fee for AAA dues-paying members is $140; $165 for non-members ($140 for MSRB-registered dealers). To register, or for further information, contact Bets Radley, Department of Education and Training, AAA, 140 West 51st Street, New York, NY 10020, (212) 484-3233, Fax (212) 765-4874.



Route to:
- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☐ Public Finance
- ☐ Compliance
- ☐ Training
- ☐ Other

Financial Statements — Fiscal Years Ended September 30, 1992 and 1991

Report of Independent Accountants

To the Members of the
Municipal Securities Rulemaking Board, Inc.

We have audited the accompanying balance sheets of the Municipal Securities Rulemaking Board, Inc. (the Board) as of September 30, 1992 and 1991, and the related statements of revenues and expenses and changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits using generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Securities Rulemaking Board, Inc. as of September 30, 1992 and 1991, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Washington, D.C.
January 19, 1993

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.

BALANCE SHEETS

September 30, 1992 and 1991

ASSETS

	1992	1991
Cash and cash equivalents (Note 1)	$ 559,614	$ 212,618
Investments (Note 1)	4,046,826	2,827,849
Accounts receivable (Note 1)	676,728	559,328
Accrued interest receivable	40,224	38,573
Other assets	270,237	20,665
Fixed assets, net (Notes 1 and 5)	638,439	268,174
	$6,232,068	$3,927,207

LIABILITIES AND FUND BALANCE

Accounts payable	$ 155,564	$ 188,409
Accrued salaries and vacation pay	51,119	51,392
Deferred rent credit (Note 2)	65,791	96,791
	272,474	336,592
Commitments (Notes 2 and 6)		
Fund balance	5,959,594	3,590,615
	$6,232,068	$3,927,207

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

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN FUND BALANCE

for the years ended September 30, 1992 and 1991

	1992	1991
Revenues:		
Assessment fees	$5,959,480	$3,350,957
Annual fees	265,200	264,200
Initial fees	18,600	22,600
Investment income	202,034	213,366
MSIL fees	19,679	22,822
Board manuals and other	103,886	93,840
	6,568,879	3,967,785
Expenses:		
Administration and operations	1,536,447	1,317,169
Board and committee	402,476	508,133
Professional qualifications	271,478	258,229
Arbitration	254,511	234,644
MSIL:		
Development (Note 6)	474,854	644,987
Operations (Note 6)	627,377	86,714
Education and communications	186,723	327,544
Rulemaking and policy development	446,034	394,688
	4,199,900	3,772,108
Excess of revenues over expenses	2,368,979	195,677
Fund balance, beginning of year	3,590,615	3,394,938
Fund balance, end of year	$5,959,594	$3,590,615

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

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.

STATEMENTS OF CASH FLOWS

for the years ended September 30, 1992 and 1991

	1992	1991
Cash flows from operating activities:		
Excess of revenues over expenses:	$ 2,368,979	$ 195,677
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation and amortization	136,216	107,694
Amortization of investment premium/discount	64,148	1,047
Gain on sale of fixed assets	(14,890)	(21,040)
Increase in accounts receivable	(117,400)	(270,701)
(Increase) decrease in interest receivable	(1,651)	16,691
(Increase) decrease in other assets	(249,572)	18,321
Increase (decrease) in accounts payable and accrued expenses	(33,118)	135,803
Decrease in deferred credit	(31,000)	(31,003)
Total adjustments	(247,267)	(43,188)
Net cash provided by operating activities	2,121,712	152,489
Cash flows from investing activities:		
Purchase of fixed assets	(536,263)	(137,025)
Proceeds from sale of office equipment	46,727	1,487
Purchases of U.S. Treasury Notes	(3,885,180)	(2,240,719)
Maturities of U.S. Treasury Notes	2,600,000	2,250,000
Net cash used by investing activities	(1,774,716)	(126,257)
Net increase in cash and cash equivalents	346,996	26,232
Cash and cash equivalents, beginning of year	212,618	186,386
Cash and cash equivalents, end of year	$ 559,614	$ 212,618

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

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.

NOTES TO FINANCIAL STATEMENTS

1. Accounting policies

The Municipal Securities Rulemaking Board (the Board) was established in 1975 pursuant to authority granted by the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975, as an independent, self-regulatory organization charged with rulemaking responsibility for the municipal securities industry. Effective May 17, 1989, the Board became incorporated as a nonprofit, nonstock corporation in the Commonwealth of Virginia.

Assessment fees

On March 10, 1992, the Board filed with the Securities and Exchange Commission an amendment to Rule A-13 on assessments relating to the underwriting of municipal securities offerings. The amendment relates to the Board's method of assessment, the scope of offerings which are assessed and assessment rates.

The underwriting assessment fee is equal to a percentage of the face amount of all municipal securities which are purchased from an issuer as part of a new issue. The fee charged ranges from .001% to .003% of the par value of the offerings.

Revenue from assessment fees is recognized when the underwriter files the offering statement with the Board.

Annual fees

Each municipal securities broker and municipal securities dealer is required to pay an annual fee of $100 with respect to each fiscal year of the Board in which the municipal securities broker or municipal securities dealer conducts business.

Initial fees

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

Continued

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.

NOTES TO FINANCIAL STATEMENTS

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

Investments

Investments in securities are stated at amortized cost, which approximates market value. Investments consist entirely of U.S. Treasury notes, maturing on various dates through May 1994. It is management's intention to hold each note through maturity.

Equipment, improvements, related depreciation and amortization

Furniture and equipment are recorded at cost and are depreciated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease period or the estimated useful life of the improvement.

When assets are retired or sold, the related cost and accumulated depreciation are removed from the accounts, and any gain or loss arising from such disposition is included in current operations.

Cash and cash equivalents

Cash and cash equivalents include cash on hand, time and demand deposits, and money market funds with maturities of three months or less. Cash and cash equivalents includes amounts held by banks and financial institutions in the United States.

2. Lease agreements

On November 16, 1984, the Board leased new office space under a lease agreement expiring in November 1994. This agreement calls for the Board to receive a rent credit equal to one-half of the base monthly rent for the first 30 months of the lease. As a result, the monthly rental payments were $9,350 through May 1987 and are $18,700 a month for the remainder of the lease term, subject to an annual escalation

Continued

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.
NOTES TO FINANCIAL STATEMENTS

based on the Consumer Price Index and a proportionate share of the increase in the costs of operating the building. For financial reporting purposes, the Board is recognizing rental expense evenly during the 10-year lease term at $16,105 a month. The Board is required to maintain an irrevocable letter of credit of $18,700, in lieu of a security deposit, payable to the lessor as part of the lease agreement. The lease may be renewed at the Board's option, for a period of five years, in accordance with the terms set forth in the lease agreement.

On October 1, 1992, the Board entered into a lease agreement for office space in Alexandria, VA. The rental payments are $15,870 each month for a term of sixty months commencing October 1, 1992.

Total lease expense for office space and equipment for the years ended September 30, 1992 and 1991, was $415,730 and $374,257, respectively.

3. Retirement plans

The Board has a defined-contribution retirement plan. All employees are eligible to participate upon attaining a minimum length of service. The Board makes contributions to an insurance company based on a percentage of the salaries of covered employees and their lengths of service. Retirement plan costs are funded as they accrue. Employees may also make voluntary contributions. Cost of the plan was approximately $86,500 and $84,000 for the years ended September 30, 1992 and 1991, respectively.

The Board also has a deferred compensation plan which covers all employees. The Board contributes $.50 for every $1 contributed by an employee, with a maximum Board contribution of 2% of the employee's annual salary. The cost of this plan was approximately $16,000 and $14,000 for the years ended September 30, 1992 and 1991, respectively.

4. Income taxes

Under provisions of the Internal Revenue Code and applicable income tax regulations of the District of Columbia, the Board is exempt from taxes on income other than unrelated business income. No provision for income taxes has been made

Continued

MUNICIPAL SECURITIES RULEMAKING BOARD, INC.
NOTES TO FINANCIAL STATEMENTS

as of September 30, 1992 and 1991, since the Board believes that any unrelated business income is not significant.

5. Fixed assets

Fixed assets consist of the following as of September 30, 1992 and 1991:

	1992	1991
Leasehold improvements	$ 71,834	$ 48,235
Office equipment	782,997	370,775
Furniture and fixtures	252,485	248,605
	1,107,316	667,615
Accumulated depreciation and amortization	(468,877)	(399,441)
	$ 638,439	$ 268,174

6. MSIL

During 1991, the Board developed and established MSIL (Municipal Securities Information Library), an information storage and retrieval process which collects, stores and disseminates official statements and advance refunding documents.

The Board charges users of the MSIL system for information retrieval and copy. The fees for these services are recognized when rendered.

The Board expenses in the current period all development costs incurred in establishing MSIL, except for computer equipment which is capitalized and depreciation over the life of the asset. Costs of operating MSIL are expensed as incurred.

Publications List

Manuals and Rule Texts

MSRB Manual
Soft-cover edition containing the text of MSRB rules, interpretive notices and letters, samples of forms, texts of the Securities Exchange Act of 1934 and of the Securities Investor Protection Act of 1970, as amended, and other applicable rules and regulations affecting the industry. Reprinted semi-annually.
April 1, 1993 ..... $5.00

Glossary of Municipal Securities Terms
Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.
1985 ..... $1.50

Instructions for Filing Forms G-36
This publication is available to assist underwriters in submitting official statements, advance refunding documents and complete and correct Forms G-36.
1992 ..... no charge

Professional Qualification Handbook
A guide to the requirements for qualification as a municipal securities representative, principal, sales principal and financial and operations principal, with questions and answers on each category. Includes sections on examination procedures, waivers, disqualification and lapse of qualification, the text of MSRB qualification rules and a glossary of terms.
1990 ..... 5 copies per order ..... no charge
Each additional copy $1.50

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

Arbitration Information and Rules
Based on SICA's *Arbitration Procedures* and edited to conform to the Board's arbitration rules, this pamphlet includes the text of rules G-35 and A-16, a glossary of terms and list of other sponsoring organizations.
1991 ..... no charge

Instructions for Beginning an Arbitration
Step-by-step instructions and forms necessary for filing an arbitration claim.
1991 ..... no charge

The MSRB Arbitrator's Manual
The Board's guide for arbitrators. Based on SICA's *The Arbitrator's Manual*, it has been edited to conform to the Board's arbitration rules. It also contains relevant portions of the *Code of Ethics for Arbitrators in Commercial Disputes.*
1991 ..... $1.00

Reporter and Newsletter

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

Examination Study Outlines

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

Study Outline: Municipal Securities Representative Qualification Examination
Outline for Test Series 52
July 1992 ..... no charge

Study Outline: Municipal Securities Principal Qualification Examination
Outline for Test Series 53
July 1990 ..... no charge

Brochure

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

Publications Order Form

Description	Price	Quantity	Amount Due
MSRB Manual (soft-cover edition)	$5.00		
Glossary of Municipal Securities Terms	$1.50		
Professional Qualification Handbook	5 copies per order no charge Each additional copy $1.50		
Manual on Close-Out Procedures	$3.00		
Instructions for Filing Forms G-36	no charge		
Arbitration Information and Rules	no charge		
Instructions for Beginning an Arbitration	no charge		
The MSRB Arbitrator's Manual	$1.00		
Study Outline: Municipal Securities Representative Qualification Examination	no charge		
Study Outline: Municipal Securities Principal Qualification Examination	no charge		
MSRB Information for Municipal Securities Investors (investor Brochure)	1 to 500 copies no charge Over 500 copies $.01 per copy		
		Subtotal	
		D.C. residents add 6% sales tax; Virginia residents add 4.5% sales tax	
		Total amount due	

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