

MSRB REPORTS

Volume 3, Number 7

Municipal Securities Rulemaking Board

December 1983

Automated Clearance Rules Approved

The Board's recent rule amendments on automated clearance, approved by the Securities and Exchange Commission on November 14, contain provisions which will require, when effective, that many inter-dealer and dealer-customer municipal securities transactions be confirmed or compared, cleared, and settled through automated clearance systems. This issue of *MSRB Reports* is devoted to explaining this rule amendment. The notice of approval, on pages 3-6, reviews the details of the amendments and sets forth the text of the rule change. The Commission's approval order, which follows the Board's notice, further explains the rationale for the Commission's approval and support. Interpretive letters on pages 15-16 discuss the application of the amendments to specific fact situations.

In September, the Board requested that the Public Securities Association establish a committee to assist the industry in the implementation of these rule changes. The PSA, expressing strong support of industry use of automated clearance systems, agreed to help in this transition period and appointed an Ad Hoc Committee on Municipal Securities Automation. The correspondence between the Board and the PSA is printed on pages 13-14.

- **PSA and Board Correspondence on Implementation of Rule Change** p. 13
- **Letters of Interpretation** p. 15

December-January

- **December 12**—Effective date of G-12 and G-15 transactions in zero coupon, compound interest and multiplier securities
- December 28**—Effective date of G-12 and G-15 confirmation information for book-entry securities
- January 1**—Effective date of certain G-33 provisions
- Pending**—Effective dates of G-12 and G-15 for automated comparison, clearance and settlement (G-12 (f)(i) and G-15 (d)(ii) August 1, 1984)
(G-12 (f)(ii) and G-15 (d)(iii) February 1, 1985)
—SEC approval of amendment to:
 - G-12 CUSIP number discrepancies

In This Issue

Rules G-12 and G-15: Automated Clearance Systems Amendment Approved

- **Notice of Approval on Use of Automated Clearance Systems** p. 3
- **Commission Order of Approval** p. 7



Route To:

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

Rules G-12 and G-15

Amendments Approved on Use of Automated Clearance Systems

On November 14, 1983, the Securities and Exchange Commission approved certain amendments to the provisions of Board rules G-12 and G-15 on the confirmation, clearance and settlement of inter-dealer and customer transactions, respectively. The amendments generally are intended to foster the municipal securities industry's adoption and use of automated mechanisms in the processing and clearance of municipal securities transactions, most significantly by mandating, on a "phased-in" basis, the use of such mechanisms for the confirmation, comparison, and settlement of a substantial portion of such transactions. Certain provisions of the amendments, effective immediately, impose several procedural requirements with respect to certain customer transactions, and accomplish other technical changes in the rules. Other provisions of the amendments, scheduled for delayed effectiveness, will require, when effective, (1) that certain transactions between municipal securities brokers and dealers be compared and, where eligible, settled via book-entry through the facilities of a registered clearing agency, and (2) that certain transactions between municipal securities brokers and dealers and customers be confirmed, acknowledged, and, where eligible, settled via book-entry through the facilities of a registered securities depository. At the request of the Board, the Commission has approved these latter amendments for a "phased-in" implementation; therefore, the requirements relating to the automated comparison or confirmation of transactions are scheduled to become effective as of August 1, 1984, and the requirements relating to the book-entry settlement of transactions will become effective as of February 1, 1985.

Background

Board rule G-12 sets forth certain standards governing the confirmation, comparison, clearance and settlement of transactions between municipal securities brokers and municipal securities dealers. Rule G-15 sets forth standards,

substantially similar to those of rule G-12(c), regarding confirmations of transactions sent by municipal securities brokers and dealers to customers; prior to the amendments the rule did not set forth standards concerning the clearance and settlement of such transactions.¹

Since its inception the Board has viewed the promotion of efficiency in the clearance and settlement of municipal securities transactions as an important objective of its rule-making. The Board has taken a variety of actions to achieve this end, including actions to facilitate the clearance of physical securities and also, in certain cases, actions to remove obstacles to the development and use of automated clearance systems. As the Board has been implementing these changes to industry practices, several organizations have been putting into place programs for the automated clearance of municipal securities transactions. Experience with these programs has demonstrated that automated clearance techniques can be successfully adopted for use in the clearance of municipal securities transactions. The Board has actively monitored the development of and experience with these systems, and has sought to encourage their use through its participation in industry educational meetings and otherwise. The Board has recently concluded that it would be appropriate at this time to take regulatory action that would significantly increase the usage of automated systems for the clearance and settlement of municipal securities transactions, and, accordingly, adopted the amendments described in this notice.²

The Amendments

For Immediate Effectiveness

Paragraph (i) of new section (d) of rule G-15, approved by the Commission for immediate effectiveness, establishes several procedural requirements with respect to those transactions with customers which are effected on a delivery-vs.-

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

¹The amendments recently approved by the Commission establish certain requirements for the automated clearance and settlement of certain customer transactions; other requirements for the clearance and settlement of customer transactions not settled by automated means were recently proposed by the Board in an exposure draft dated August 15, 1983. See *MSRB Reports*, vol. 3, no. 5 (September 1983) at 21-24; *CCH Municipal Securities Rulemaking Board Manual*, ¶10,261 at 10,768-73.

²The Board's conclusions are discussed in detail in the September 9, 1983 notice of filing of the amendments. See *MSRB Reports*, vol. 3, no. 6 (November 1983) at 19-26; *CCH Municipal Securities Rulemaking Board Manual*, ¶10,271 at 10,785-92.

payment ("DVP") or receipt-vs.-payment ("RVP") basis. Paragraph (d)(i) specifies that a municipal securities broker or municipal securities dealer executing a transaction for a customer on a DVP or RVP basis must send or otherwise furnish the confirmation of the transaction to the customer not later than the close of business on the business day following the trade date, and must mark or otherwise indicate the fact that the transaction was effected on a DVP or RVP basis on the trading ticket. The municipal securities broker or dealer must also have obtained from the customer the name and address of the customer's clearing agent and the customer's name and clearing account number as known to the agent, as well as a representation that the customer will transmit information regarding the transaction to the agent within certain time limits specified in the rule.

The Board believes that these requirements will facilitate the clearance of customer DVP/RVP transactions generally, by ensuring that information necessary for the clearance of such transactions is transmitted or known by all interested parties in sufficient time before the settlement date of the transaction. The adoption of these requirements also will assist municipal securities brokers' and dealers' preparation for the implementation of the more extensive requirements for the use of automated clearance systems described below.

Other amendments which make technical changes to the texts of the rules—eliminating duplicative provisions and redesignating existing rule sections and paragraphs—also are effective immediately.

For Delayed Effectiveness

New section (f) of rule G-12 and paragraphs (ii) and (iii) of new section (d) of rule G-15 establish, for delayed effectiveness, requirements for the automated confirmation or comparison, clearance and settlement of certain inter-dealer and customer transactions, respectively. With respect to inter-dealer transactions, rule G-12(f) will provide, when effective, (1) that transactions must be compared through the automated facilities of a registered clearing corporation if the parties of the transaction are clearing corporation participants and the securities are eligible for comparison, and (2) that successfully compared transactions must be cleared and settled via book-entry through the facilities of a securities depository if the parties are depository participants and the securities are depository-eligible. With respect to customer DVP/RVP transactions, paragraph (ii) and (iii) of rule G-15(d) will provide, when effective, (1) that the transaction must be confirmed and acknowledged through the facilities of a securities depository if the securities involved in the transaction have been assigned a CUSIP number, and (2) that the transaction must be settled via book-entry if the securities are depository-eligible.³

As noted above, these requirements of the amendments are to be implemented on a "phased-in" basis, in order to permit time for all persons affected by the amendments to prepare for their effectiveness in an orderly fashion. Accord-

ingly, the provisions of rules G-12(f) and G-15(d)(ii) and (iii) specify that the requirements for the use of automated comparison or automated confirmation and acknowledgement systems shall become effective on August 1, 1984, and the requirements for the use of book-entry settlement systems shall become effective on February 1, 1985.

The Board has adopted these requirements due to its belief that the adoption of automated clearance and settlement systems for municipal securities transactions will provide substantial benefits to the municipal securities industry in increased efficiency in the clearance process and significant aggregate cost savings.

Texts of Amendments*

Rule G-12. Uniform Practice

(a) through (e) No change.

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

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

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

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

(g) through (k) No change.

³The rule makes the extension of the DVP/RVP privilege to a customer who is a depository participant contingent upon these requirements being met. If these requirements will not be met, the transaction cannot be effected on a DVP or RVP basis (although it could be effected on an alternative basis, such as, in the case of a DVP transaction, on a basis whereby the customer pays for the securities prior to settlement).

*Underlining indicates additions; deleted material has been omitted.

Rule G-15. Confirmation, Clearance and Settlement of Transactions with Customers**(a) Customer Confirmations.**

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

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

(B) name of customer;

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

(D) par value of the securities;

(E) description of the securities, including at a minimum the name of the issuer, interest rate, maturity date and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities, and in the case of any securities, if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligors" may be shown;

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

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

(H) settlement date;

(I) yield and dollar price as follows:

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

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

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

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

(J) amount of accrued interest;

(K) extended principal amount;

(L) total dollar amount of transaction;

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

(1) as a principal for its own account,

(2) as an agent for the customer,

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

or

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

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

(ii) If the broker, dealer or municipal securities dealer is effecting a transaction as agent for the customer or as agent for both the customer and another person, the confirmation shall set forth (A) either the name of the person from whom the securities were purchased or to whom the securities were sold for the customer or a statement that this information will be furnished upon request of the customer, and (B) the source and amount of any commission or other remuneration received or to be received by the broker, dealer or municipal securities dealer in connection with the transaction.

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

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

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

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

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

"Call features may exist which could affect yield; complete information will be provided upon request";

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

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

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

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

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

(iv) The confirmation for a transaction in securities traded on a discounted basis (other than discounted securities traded on a yield-equivalent basis) shall not be required to show the yield and dollar price information specified in

subparagraph (I) of paragraph (a)(i) nor the accrued interest specified in subparagraph (J) of paragraph (a)(i). Such confirmation shall, however, contain the rate of discount and resulting dollar price. Such confirmation may, in lieu of the resulting dollar price and the extended principal amount specified in subparagraph (K) of paragraph (a)(i), show the total dollar amount of the discount.

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

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

(vii) Information requested pursuant to this rule shall be given or sent to the customer within five business days following the date of receipt of a request for such information; provided however, that in the case of information relating to a transaction executed more than 30 calendar days prior to the date of receipt of a request, the information shall be given or sent to the customer within 15 business days following the date of receipt of the request.

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

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

(b) [reserved for future rulemaking]

(c) [reserved for future rulemaking]

(d) Delivery/Receipt vs. Payment Transactions.

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

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

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

(C) the broker, dealer or municipal securities dealer shall give or send to the customer a confirmation in accordance with the requirements of section (a) of this

rule with respect to the execution of the order not later than the close of business on the next business day after any such execution; and

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

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

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

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

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



Route To:

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

Rules G-12 and G-15

Commission Approval Order on Automated Clearance Rule Change

SECURITIES EXCHANGE ACT of 1934
Release No. 20365/November 14, 1983

I. Introduction

The Municipal Securities Rulemaking Board (the "MSRB") filed a proposed rule change on September 7, 1983,¹ under the Securities and Exchange Act of 1934 (the "Act"),² concerning clearance and settlement of municipal securities transactions. Generally, the proposed rule change would require use of clearing agency facilities to accomplish various tasks, including comparison of inter-dealer trades; confirmation and acknowledgement of customer trades; and settlement of related delivery and payment obligations by book-entry. The proposed rule change would apply to municipal securities brokers, dealers and their clearing agents, as well as municipal securities investors and their securities custodians.³

The proposed rule change would become effective in two stages. After August 1, 1984, for trades subject to the Rules, comparison of inter-dealer trades and confirmation and affirmation of customer trades through clearing agency facilities would be mandatory. After February 1, 1985, those trades would be required to be settled through the book-entry facilities of registered securities depositories.

The proposed rule change was developed through extensive public discussion of appropriate clearance and settlement procedures for municipal securities transactions. The specific dialogue concerning mandatory clearing agency use began when the MSRB published a draft of the proposed rule change in July 1982. That draft concerned only the settlement of dealer-customer obligations, but drew 24 comment letters.⁴ In March 1983, the MSRB solicited further comment on that proposal and on a proposal concerning

use of clearing agency facilities for comparison and settlement of inter-dealer trades. The MSRB received 27 comment letters on the March 1983 draft, as well as three comment letters after September 7, 1983. Those comments generally discussed the need to implement the proposed rule change in stages and the need for uniform clearing agency systems specifically tailored to municipal securities. All comments addressed to the MSRB were filed with and reviewed by the Commission. The Commission solicited written comment on the proposed rule change as filed on September 7, 1983, but received none.

As discussed below, the Commission has determined to approve the proposed rule change.

II. Background

Currently, the majority of the 15,000–20,000 transactions in municipal securities that occur daily are processed in much the same way the securities industry processed trades in corporate debt and equity securities issues during the 1950's and 60's.⁵ Dealer trade reports, customer confirmations and institutional settlement instructions are produced manually on paper and are sent by mail to the appropriate parties. Thereafter, settlement occurs in many different locations daily, through the physical exchange of securities certificates versus money.

Securities industry reliance on paper and manual processing techniques for corporate securities transactions led to paperwork crises in the late 1960's, which in turn caused the failure of many securities firms and significant investor losses.⁶ Problems for the municipal securities industry at that time, however, were much less apparent—for two reasons. First, significantly lower secondary market trading volume in municipal securities meant less pressure on the industry's municipal firms' back-offices. Second, historically, municipal securities certificates have been issued primarily in bearer-form, rather than registered-form. Thus, delivery of certificates to settle secondary market trades has been possible without the need to transfer record ownership, and efficient interest collection has not depended on transferring record ownership by record date.

¹See Securities Exchange Act Release No. 20189 (September 16, 1983), 48 FR 43470 (September 23, 1983).

²15 U.S.C. §78s(b)(1); 17 CFR 240.19b-4 (1983).

³The rule change, however, would apply to those entities only if they participate directly or indirectly in clearing agencies registered under the Act.

⁴Commenters, while supporting the MSRB's proposal, emphasized three areas of concern: 1) the limited number of municipal securities issues currently eligible for clearing agency services; 2) the difficulty of identifying customers as depository participants; and 3) the need to bring settlement of inter-dealer trades within the same time-frame as customer-side settlement.

⁵See Securities and Exchange Commission, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92nd Cong., 1st Sess. 28 (1971).

⁶*Id.*

The recent increase in the number of municipal securities issues in registered-form⁷ and in secondary market activity for all securities issues, necessarily increases the risk of back-office delays in processing municipal securities transactions. The municipal securities industry is unaccustomed, generally, to the use of registered instruments and to the recordkeeping and other functions of transfer agents and registrars. Increased secondary market activity, therefore, will likely aggravate the delays and inefficiencies inherent in the industry's physical securities processing systems for registered-form municipal bonds. The MSRB and many industry members recognize that the proposed rule change, by promoting efficient processing and timely settlement of certain municipal securities transactions through automated facilities,⁸ should help preclude crises.

III. Description of the Proposed Rule Change

The proposed rule change would amend MSRB Rule G-12 concerning comparison,⁹ clearance and settlement of inter-dealer trades; and MSRB Rule G-15 concerning confirmation affirmation¹⁰ and settlement of customer delivery and payment obligations. As explained below, the two rules together would require clearing agency participants to use clearing agency facilities for tasks associated with both street-side and customer-side settlement.

The rules define "participation" broadly to encompass both direct and indirect clearing agency participation. Neither rule mandates direct participation in a registered clearing agency nor do they require participation in any particular depository or clearing corporation. However, a non-participant dealer or institution whose clearing agent or securities custodian participates in a registered clearing agency generally would be subject to these rules.

Phase I: Comparison, Confirmation and Affirmation of Participant Trades

As of August 1, 1984, municipal securities dealers, brokers and customers that participate in registered clearing agencies will be required, in effect, to use the facilities of a registered clearing agency to compare, confirm and affirm

their municipal securities transactions. Trades covered by the rules include all transactions in municipal securities issues that are assigned CUSIP numbers.¹¹

MSRB Rule G-12 would require municipal securities brokers and dealers to use the automated facilities of a clearing agency for the comparison of their inter-dealer trades if they, or their agents, participate in a registered clearing agency that provides comparison services. The parties to such an inter-dealer trade would be required to submit trade data and other information to the clearing agency for comparison in accordance with the clearing agency's rules. Parties to an inter-dealer trade that participate in different clearing agencies would not be exempt from the rule if the clearing agencies are interfaced or linked with one another for comparison purposes. Similarly, parties to an inter-dealer trade that participate in a securities depository that is linked or interfaced with a clearing corporation that provides linked comparison services would be subject to the Rule.

MSRB Rule G-15 would prohibit participating municipal securities brokers or dealers from settling trades against payment ("COD/DVP")¹² with their customers, whenever the customers or their agents participate in a registered securities depository, unless certain conditions are met. First, the dealer must obtain from the customer prior to or at the time of accepting a COD/DVP trade order certain information necessary to identify the customer, its settlement agent or custodian, and the customer's account with the agent. Second, the dealer, customer, and settlement agent, as appropriate, must use the facilities of a securities depository to confirm and affirm transactions in municipal securities issues assigned CUSIP numbers.¹³ The MSRB would exempt from this Rule, however, internal trades of a dealer-bank department.¹⁴

Phase II: Book-entry Settlement

Effective February 1, 1985, the proposed rule change would require affected persons to settle by book-entry, through the facilities of a registered clearing agency, certain transactions in municipal securities issues that are depository-eligible. A "depository-eligible security" is an issue of secu-

⁷The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") requires that security issues with maturity dates of more than one year be in registered-form to retain federal income tax-exempt status. Thus, after July 1, 1983, virtually all long-term municipal securities issues are likely to be in registered-form.

⁸Recently, the National Association of Securities Dealers, Inc. (the "NASD") and various national stock exchanges adopted rules similar to that proposed by the MSRB requiring use of registered securities depositories for the processing and book-entry settlement of certain customer-side trades in corporate securities. Adoption of these rules was recommended by a Joint Committee of the Operations Committee of the Securities Industry Association (the "SIA") and the New York Stock Exchange, Inc. (the "NYSE") to insure efficient processing of securities transactions, particularly during periods of high volume trading. See Securities Exchange Act Release No. 19227 (November 9, 1982) 47 FR 51658 (November 16, 1982).

⁹"Comparison" is the process by which brokers and dealers match trades executed in the marketplace. Daily, each broker and dealer compares information about executed purchases and sales. If the relevant terms of the trade match, the two parties have a contract. If the parties report different information respecting a trade, the parties must resolve those differences before the trade can be settled.

¹⁰The "confirmation and affirmation" process is similar to the comparison process. In a typical institutional trade, an investment manager instructs a broker to execute a trade. After executing the trade, the broker sends the terms of the trade to the institutional customer or its investment manager. If the confirmation matches the customer's instructions to the broker, the customer will issue an affirmation to the custodian bank authorizing it to receive or deliver securities against payment to or by the executing broker.

¹¹The CUSIP Service Bureau automatically assigns CUSIP numbers to municipal securities issues with greater than one year to maturity and a total principal amount greater than \$500,000. (A CUSIP number may be assigned to an issue with a total principal amount less than \$500,000 upon request.) Currently, over one million long-term municipal securities issues have been assigned CUSIP numbers. This represents more than 20 times the number of corporate issues assigned CUSIP numbers. See *Prospects for Automation of Municipal Clearance and Settlement Procedures*, MSRB Reports (April 29, 1983), at 11, n.1.

¹²Federal credit regulations require customers to settle securities transactions with their brokers no later than seven business days following execution. Federal credit regulations extend this time limit to thirty-five days for those customers who establish special cash accounts and who agree to settle purchases against the delivery of securities (cash-on-delivery—"COD") or to settle sales upon payment (delivery-versus-payment—"DVP"). See 12 CFR 220.4(c) (1982).

¹³See note 11, *supra*. Under this rule, the municipal securities broker or dealer also must: (i) identify such transactions as DVP or RVP transactions on the trade ticket; (ii) send the confirmation to the customer not later than the first business day following trade date; and (iii) obtain a representation (written or oral) from the customer that instructions regarding the transaction will be transmitted to the customer's settlement agent.

¹⁴Thus, this Rule would not require a dealer-bank or its non-participant customer to use the automated facilities of a clearing agency for the confirmation, affirmation and book-entry settlement of any customer-dealer obligation when both parties use a department of the dealer-bank as their agent. See MSRB letter to Robert V. Slater, Second Vice President, The Northern Trust Company (September 21, 1983) in File No. SR-MSRB-83-13.

rities that is eligible for safekeeping and book-entry transfer services in a registered securities depository.¹⁵

Thus, MSRB Rule G-12 would require municipal securities dealers and brokers to settle, by book-entry movement, all inter-dealer transactions in depository-eligible municipal securities issues if those transactions are successfully compared through the facilities of a registered clearing agency. Although settlement must occur by book-entry movement, participants will not be required to settle trades through any particular clearing agency accounting operation.¹⁶ Accordingly, participants may provide standing instructions to settle on a trade-for-trade basis.¹⁷

MSRB Rule G-15 would require certain municipal securities brokers or dealers and their customers to settle, by book-entry, through the facilities of a registered securities depository,¹⁸ COD/DVP transactions in depository-eligible municipal securities issues. The proposed rule change, however, would not require securities to remain on deposit after settlement.¹⁹

IV. Discussion

A. Why Automate Processing And Immobilize Certificates?

All parties to a municipal securities transaction subject to the Rules should realize significant cost savings by clearing transactions electronically, settling obligations by book-entry, and immobilizing municipal securities certificates in depositories.²⁰ The savings inherent in automated trade processing should extend to bearer-form as well as registered-form instruments, although the benefits of immobilizing bearer-form certificates may be narrower. Moreover, safekeeping and processing economies and efficiencies should be enjoyed by all parties subject to the Rules.

Automated trade processing should assure timely settlement of securities transactions and reduce settlement financing costs by expediting the transmission of trade reports,

confirmations and affirmations.²¹ Moreover, by eliminating repetitive preparatory tasks, automated processing should enhance the accuracy of trade information and increase the number of trades settling in a timely and predictable manner. As a result, municipal securities industry members should realize significant cost savings as labor and research expenses decline, as dependence on the mail is reduced, and as delayed or lost trade documents are eliminated.

Similarly, book-entry settlement should reduce aggregate costs for the municipal securities industry by reducing the number of physical deliveries.²² Since book-entry movements only require physical deliveries of securities in connection with deposits in and withdrawals from the depository, investors, brokers and dealers subject to the Rules should be able to avoid repetitious physical movements of securities. In addition, clearing agency participants can share economies and efficiencies that result from depositories' bulk shipments and special arrangements between depositories and transfer agents for expedited turnaround of transfer requests. Savings in certificate-related expenses should be particularly significant for registered-form municipal securities issues. Moreover, reduced physical deliveries of registered and bearer-form municipal securities certificates should enhance certificate safety and reduce costs associated with certificate loss. Finally, book-entry settlement through the various interfaces should facilitate trading and settlement without regard to the parties' geographic location. One Account Settlement saves participants unnecessary fees for participation in and use of more than one depository and promotes timely and efficient clearance and settlement.²³

Increased use of book-entry settlement pursuant to the proposed rule change should encourage participants to immobilize municipal securities certificates in securities depositories. In the corporate area, depositories have pro-

¹⁵Currently, all registered securities depositories offer safekeeping and ancillary services for registered-form municipal securities. However, only some offer those services for bearer-form municipal securities. See note 36, *infra*.

¹⁶Several types of accounting systems are used by clearing corporations. The most sophisticated accounting system is the Continuous Net Settlement ("CNS") system, which generates a single, daily net "buy" or "sell" position for each securities issue in which a participant has compared trades scheduled to settle on the fifth day after trade date and nets accumulated settlement obligations on that issue. The system severs the link between the original parties to the compared trades and interposes the system as the *contra* party. Accordingly, the clearing corporation's CNS system, rather than the original parties to the trade, becomes the entity obligated to deliver or receive securities and money. Unlike CNS systems, daily balance order ("DBO") systems traditionally have not interposed clearing corporations between parties. Instead, a DBO system generates a daily net "buy" or "sell" position for each issue of securities in which a participant has a compared trade due to settle, and allocates among, and issues to, participants net daily settlement orders to deliver or receive. As a result of the netting cycle, a participant may be required to deliver securities to, or receive securities from, a participant with which it had no direct trades.

¹⁷Many municipal securities dealers attempt to preserve confidentiality about their trading activities through the use of "broker's brokers." In a traditional Balance Order System, however, broker's brokers can net to zero, leaving municipal securities dealers to deliver securities to and receive payments from securities dealers they, in effect, ultimately "traded with" through the brokers' broker. For that reason, among others, municipal securities dealers historically have settled "trade-for-trade" with their broker's broker when circumstances required. Currently, NSCC does not plan to provide DBO services for the settlement of municipal securities transactions. See *infra*, note 32.

¹⁸The Depository Trust Company ("DTC") operates an automated settlement system for institutional transactions (the "ID system") in corporate securities issues. The ID system coordinates among certain brokers, investment managers and custodian banks participating in the system all the tasks that must be accomplished to effect customer-side settlement of these corporate securities transactions. In cooperation with DTC, the Midwest Securities Trust Company ("MSTC"), Pacific Securities Depository Trust Company ("PSDTC") and Philadelphia Depository Trust Company ("Philadep") offer their participants similar services through the National Institutional Delivery Systems. See discussion *infra* concerning the expansion of this service to municipal securities brokers, dealers, customers, and their agents.

¹⁹This appears to be consistent with those state laws that are interpreted to require certain institutional investors, such as insurance companies, to maintain their assets within the state. See e.g., FLA. STAT. ANN. §628.281 (1978).

²⁰The Commission recognizes that there are, inevitably, costs associated with mandating more extensive use of computerized facilities for data processing and communication systems. Under the Act, any such costs to the industry must be reviewed in light of several statutory goals and may be balanced against industry cost savings. See §§15B and §17A of the Act and discussion *infra*.

²¹Mailing paper confirmations, affirmations and comparisons can delay receipt of documents necessary for settlement. In turn, such delays can cause settlement agents to reject tendered securities or withhold payment for securities ("DK's"), causing delayed settlement on the customer-side and unnecessary finance charges. The Joint Committee estimated that NYSE trades DK'd on the customer-side cost the corporate securities industry more than \$100 million in finance charges, in 1980.

²²To the extent municipal securities brokers and dealers use the CNS System, the netting process will reduce the number of actual deliveries necessary, thereby further reducing costs.

²³One Account Settlement—a basic feature of the National Clearance and Settlement System—permits a participant to settle all its trades through one clearing corporation or depository, regardless of the place of execution, recordation, and comparison of the trades.

vided cost-efficient vault facilities and ancillary services²⁴ for registered-form certificates. Such certificates can be handled efficiently in a fungible bulk, through the safekeeping of "jumbo" certificates²⁵ registered in nominee name.²⁶

B. Why should the MSRB facilitate automation in clearance and settlement?

The proposed rule change reflects an important step in the MSRB's continuing efforts to facilitate improvements in the industry's securities transaction processing. As discussed in a recent MSRB Report, *Prospects for Automation of Municipal Securities Clearance and Settlement Procedures*,²⁷ the MSRB during the last two years has used its rulemaking authority to advance the prospects for uniform national practices and procedures among disparate markets.²⁸ Furthermore, that Report notes that "major progress has been made in developing appropriate systems and preparing the industry for the transition to automated clearance The rule changes [under consideration here] will result in the inclusion of large numbers of transactions in such systems."²⁹

The Commission believes that the proposed rule change is a timely and appropriate exercise of the MSRB's rule-making responsibility.³⁰ Promoting back-office efficiency is an appropriate goal of Self-Regulatory Organization ("SRO") rule-making authority, particularly in light of traditional industry emphasis on front-office execution activities. The MSRB initiative in this area is in keeping with other recent SRO initiatives that the Commission encouraged and approved,³¹ and should generate important economies in both trade and certificate processing. As the MSRB noted in both its filing and its recent Report, the "registered-form" requirement of TEFRA creates a special need for automated processing of these securities.

In addition, the MSRB has provided ample time for industry education and preparation before the effective dates of the proposed rule change. Under the rules, for example, municipal securities brokers and dealers will need to develop or modify their internal operations to accommodate automated processing and book-entry settlement through clearing agencies. More importantly, the registered clearing agencies will need to complete system and interface enhancements promptly, so that the objectives of the proposed rule changes can be met. As discussed below, the Commission expects the MSRB to continue to monitor closely industry and clearing agency efforts under these amendments.

C. Current and prospective clearing agency systems provide a foundation for safe and efficient clearance and settlement under the rule change

Currently, only NSCC provides comparison services for registered and bearer-form municipal securities. The Commission understands that NSCC, in the next several months, will establish a national system for the comparison of municipal securities transactions in issues that have been assigned CUSIP numbers (the "National Trade Comparison System for Municipal Bonds").³² Initially, MCC and DTC plan to establish "links" to NSCC to access the comparison services of this national system for their respective participants. The Commission urges all other clearing agencies (directly or through NIDS, as appropriate) to establish effective links to NSCC for the national comparison system. Ideally, these arrangements should be concluded well in advance of the Phase I implementation date (August 1, 1984).

As noted above, all depositories currently offer confirmation and affirmation services through a National Institutional Delivery System ("NIDS"), for which DTC is the facil-

²⁴Income accounting (*i.e.*, the collection and processing of interest and maturity payments) is an important ancillary service for depository-eligible issues.

²⁵For reasons of safety and economy, depositories generally consolidate the certificates received in each issue by requesting from the transfer agent several large denomination certificates. The particular denominations maintained on deposit depends, primarily, on participant demand for certificates. (Depositories often elect to put interchangeable issues into registered-form for this reason).

²⁶The cost of immobilizing bearer-form certificates in securities depositories, of course, may be high relative to registered-form certificates and, at least initially, relative to other custodial alternatives. Higher depository fees result, in part, from the need to clip and present coupons to the paying agent prior to collecting interest payments and to provide more storage space for certificates with coupons attached. However, once the number of depository-eligible municipal securities issues in bearer-form grows, significant certificate immobilization by participants could help create certain economies at the depository that all participants can share. In any event, for municipal securities dealers with relatively small inventories and high transaction volume, depository immobilization would provide benefits and economies that likely exceed ex-clearing processing costs.

²⁷See note 11, *supra*.

²⁸See *e.g.*, MSRB Rule G-12 (uniform practice respecting: dealer confirmations; comparison and verification of confirmations; delivery of securities; payment; rejection and reclamation; close-out; good faith deposits; and settlement of syndicate accounts), MSRB Manual (CCH) ¶ 3556 (April 1983); MSRB Rules G-12(c)(v)(F), G-15(a)(vii) (mandatory use of CUSIP numbers on dealer confirmations), MSRB Manual (CCH) ¶¶ 3556, 3571 (April 1983).

²⁹MSRB Report, at 45.

³⁰In its filing, the MSRB notes that the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act, which directs the MSRB to propose and adopt "rules designed . . . to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest."

The MSRB further suggests that its proposed rule change is consistent with Section 17A of the Act and, in particular, with the Congressional finding set forth in Section 17A(a)(1) of the Act, which encourages "the linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement [because it] will reduce unnecessary costs and increase the protection of investors . . . on behalf of investors."

³¹See, *e.g.*, Securities Exchange Act Release No. 19227 (November 9, 1982), 47 FR 51658 (November 16, 1982) (approval of Exchange and NASD rules requiring depository participants to use depository facilities for customer-side settlement of certain institutional trades).

The SRO's have used their legislative authority to an even greater extent in other contexts. For example, the NASD has required certain NASDAQ market-makers to use the clearance and settlement facilities of registered clearing agencies. See NASD Manual (CCH) ¶1653A, Securities Exchange Act Release No. 19689 (April 26, 1982), 47 FR 19500 (May 5, 1982).

³²The National System will operate in a manner similar to the National OTC Equity Comparison System for corporate securities issues, for which NSCC is also the central processor. NSCC does not intend at the present time to offer its participants access to the NSCC balance order system because of the reluctance of municipal securities dealers to use netting systems. NSCC believes that municipal securities brokers and dealers would prefer to settle on a trade-for-trade basis to avoid (i) the netting of transactions, which can entail disclosing the parties actually trading, and (ii) partial deliveries of securities, which, under current MSRB Rules, is not mandated. See Participant Report, National Securities Clearing Corporation, No. 16 (October 30, 1983).

NSCC, however, will offer a "Comparison Only" mode for transactions in securities that are not depository-eligible. For these inter-dealer transactions successfully compared at NSCC, however, the resulting delivery obligation may be settled physically, through NSCC's "Envelope" services. (NSCC has a New York City envelope service that consists of a central location where participants can drop off envelopes containing securities and have those envelopes delivered to another participant; NSCC also provides an inter-city envelope service that ships envelopes, by courier, between New York City and several regional locations.)

ities manager. NIDS provides these services for corporate debt, equity, registered and bearer-form municipal securities issues. For those issues which are eligible for depository settlement, the depositories also provide, through interfaces, book-entry services nation-wide. Although use of NIDS, as it currently operates, would permit participants to satisfy the MSRB Rules, the Commission understands that limited modifications are being contemplated to accommodate more effectively the unique characteristics of municipal securities issues.³³

The registered securities depositories also provide a broad range of depository services for most registered-form municipal securities. Only DTC and MSTC, however, safekeep bearer-form municipal securities:³⁴ DTC at its central facility in New York and MSTC at a network of regional custodians. The Commission understands that MSTC and DTC anticipate extending their current depository interfaces to accommodate book-entry movements of both bearer and registered-form municipal securities issues. The Commission believes that effective interfacing is crucial if participants are to realize the benefits inherent in "One Account Settlement."³⁵ Therefore, the Commission urges DTC and MSTC to complete their arrangements promptly. The success of the MSRB rule change depends critically on earnest cooperation among clearing agencies and between the clearing agencies and the MSRB.³⁶

The Commission believes that current clearing agency systems provide a foundation for the proposed rule change and for safe, efficient clearance and settlement of municipal securities transactions. The Commission also believes that these systems, if modified and expanded by the clearing agencies and used by their participants, will remove the paper processing shackles that can constrict the municipal securities markets and will prepare active market participants for sustained high volume trading of the 1980's and beyond.

D. General Business Impact and Competitive Considerations

In light of the flexibility afforded municipal securities brokers, custodian banks, investment managers and most municipal securities dealers, the Commission believes that the proposed rule change does not impose any inappropriate or unnecessary costs on the parties to such trades. The Rules, as a general matter, do not require persons to join clearing agencies, but merely require existing clearing agency "participants" to use the most efficient industry means for clearance and settlement.

The Commission recognizes, however, that industry participants subject to the Rules may incur substantial start-up costs. For instance, municipal securities brokers and dealers will incur costs in connection with identifying accounts which are subject to Rule G-15 and devising procedures to capture and convey to the depository crucial data such as the identity of the customer and agent bank. Similarly, custodian banks and investment managers will incur new costs in connection with the distribution of confirmations.

The Commission believes that the benefits derived from widespread, uniform and safe automated processing of institutional and inter-dealer trades far outweigh the compliance-related expenses. As indicated, the expenses are, for the most part, one time implementation or start-up costs. The benefits, however, should be realized continuously over time. For instance, brokers, dealers and custodian banks ultimately should experience reduced aggregate transaction processing expenses.³⁷ Similarly, institutional customers or their investment managers will enjoy increased predictability and efficiency in clearance and settlement, and they may experience reduced commission expenses as a result of broker and dealer cost savings.³⁸

The Commission also believes the MSRB has provided appropriate and sufficient lead time for firms to make any needed systems and personnel changes. Indeed, prior to

³³For example, DTC contemplates establishing a separate, more extensive field on the computer-generated confirmation and affirmation forms to capture important descriptive information (i.e., maturity date, issue purpose).

³⁴DTC makes eligible for deposit over 40,000 municipal securities-issues, of which approximately 35,000 are in bearer-form. MSTC makes depository-eligible approximately 123,000 eligible municipal securities issues in bearer-form and approximately 35,000 in registered-form.

³⁵PSDTC recently initiated a pilot link to MSTC's bearer bond program to offer PSDTC participants the full range of MSTC services. See File No. SR-PSDTC-83-3, Securities Exchange Act Release No. 19802 (May 23, 1983), 48 FR 24504 (June 1, 1983).

³⁶See *supra*, note 23.

³⁷Many commenters noted that the current depository-eligibility standards should be made uniform by the Phase II implementation date (February 1, 1985). Currently, eligibility criteria vary substantially between MSTC and DTC: MSTC will accept for deposit, upon participant request, almost any municipal securities issue while DTC requires, among several other things, that the issue have a transfer agent whose performance is consistent with the Commission's 72 hour turnaround standard. (See 12 CFR 240.17Ad-2.)

The Commission understands that the rule will not require sole participants of different depositories to settle, by book-entry, transactions in securities issues that are not eligible for deposit at both depositories. Nonetheless, differing eligibility criteria could limit the value of the rule and the National Clearance and Settlement System by forcing settlement of such trades to occur outside clearing agencies. Differing eligibility criteria, coupled with the economic benefits of clearing agency participation, could pressure sole participants to join multiple depositories or to at least join the depository with the greatest number of eligible securities issues.

The Commission is reluctant to require depositories at this time to adopt uniform eligibility criteria. The Commission recognizes that eligibility requirements are important decisions reached by the depositories after extensive consultation with their participants. These decisions reflect a balancing of available resources, participant demand, operational preferences and system safeguards. The Commission also recognizes that eligibility determinations reflect a dynamic process and that the universe of dually-eligible securities issues should grow dramatically by February 1985 as a result of depository and participant experience. The Commission and the MSRB, of course, will monitor developments and, if necessary, will consider appropriate action.

³⁸As noted above, for customer-side processing of transactions in corporate securities issues alone, these savings aggregate annually to hundreds of millions of dollars. Moreover, with regard to municipal securities transactions, brokers and dealers face financing costs for fails on both the customer-side and the street-side.

³⁹At the present time, depositories recover the costs of confirmation and affirmation processing from participating broker-dealers and custodian banks. The depositories do not charge institutional customers for ID processing. The Commission, therefore, recognizes that those processing costs may well be passed through to institutional customers. Such a pass-through would offset, in some measure, reduced commission fees.

August 1, 1984, many industry members should be able to draw upon their experience with automated customer-side processing of corporate equity and debt securities transactions.³⁹ Moreover, several compliance alternatives are available to persons subject to the Rules. For instance, a municipal securities broker or dealer may choose to establish a correspondent relationship with another participating broker-dealer, in lieu of direct clearing agency participation.⁴⁰ A participating broker or dealer, on the other hand, may avoid the expense of installing and operating an internal computer system by submitting "hard copy" trade data to a depository (*i.e.*, paper)—assuming that is a cost-effective alternative in light of that participant's settlement volume. Similarly, custodian banks may obtain from institutional customers standing instructions to affirm trades on behalf of a non-depository participant investment manager, thereby reducing such banks' ID expenses.

Finally, the Commission has considered the potential competitive burdens of the proposed rule change in light of the relevant benefits and costs, discussed above. In this regard, the Commission acknowledges that depositories compete to some extent with custodian banks and brokers

for the sale of custodial services. For the reasons discussed in Securities Exchange Act Release No. 19227, however, the Commission believes the proposed rule change will not impose any inappropriate burden on competition in the sale of custodial services.⁴¹ The Commission also believes that, as the MSRB stated in its filing, the proposed rule change does not impose any burdens on competition not necessary or appropriate in furtherance of the purposes of the Act.

Conclusion

For the reasons stated above, the Commission finds that the proposed rule change is consistent with the Act. The Commission also finds that the proposed rule change will not impose a burden on competition that is not necessary or appropriate under the Act.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is approved.

For the Commission, pursuant to delegated authority, by the Division of Market Regulation.

George A. Fitzsimmons
Secretary

³⁹See note 31, *supra*. Exchange and NASD rules requiring depository participants to use depository facilities for customer-side settlement took effect in January 1983. Many municipal securities brokers, dealers, and investment managers that effect transactions in both corporate and municipal securities issues are fully automated on the corporate side. These industry members may be able to rely on that experience during the transition to automated processing for municipal securities transactions, since some overlap in systems and personnel must exist. Also, municipal securities dealer-bank departments may be able to rely on the trust department, or other internal or bank subsidiary clearing operation for either the expertise in developing automated clearing and communication systems to interface with clearing agencies or the actual performance of the clearance function.

⁴⁰A non-participating dealer department in a bank that has a participating trust department, however, faces a special problem. In that instance, the trust department's participation is imputed to the dealer department under the Rules. If the trust department does not provide clearing services to the dealer department, the dealer department must use a participating clearing agent to be in compliance with the MSRB Rules.

Commenters suggested to the MSRB that, in this situation the dealer department may be "forced" to use clearing agency services. The Commission understands, however, that the vast majority of dealer-bank departments already employ participating broker or bank clearing agents. Nevertheless, should a dealer-bank department find that it must change its clearing arrangements under the Rule, it will face additional start-up costs. Over-time, however, as with all participating parties, the benefits should greatly exceed the costs.

⁴¹(November 9, 1982), 47 FR at 51662 (November 16, 1982). Those reasons included: the absence of a requirement that securities be maintained in a depository account after settlement; the ability of custodians that wish to perform a full service role for their non-participating institutional customers to operate independent, automated communications systems adequate to assure timely confirmation, affirmation and settlement through the institutional delivery systems; and the flexibility afforded participating custodian banks in choosing direct or indirect participation in a securities depository.



Route To:

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

Rules G-12 and G-15

PSA Appoints Committee, at Board Request, to Help in Transition to Automated Clearance Systems

September 22, 1983

Mr. Arch W. Roberts
Chairman
Public Securities Association
One World Trade Center
Suite 5271
New York, New York 10048

Dear Arch:

As you know, the Board filed with the Securities and Exchange Commission in September certain amendments to its rules which, when approved and effective, will mandate significantly increased use by municipal securities brokers and dealers of automated systems for the confirmation, comparison, clearance and settlement of transactions. An amendment to Board rule G-12 will require that transactions in eligible municipal securities between municipal securities brokers and dealers who are members of registered clearing corporations and depositories must be compared and settled via book-entry through the facilities of such entities. Similarly, an amendment to Board rule G-15 will require that transactions in eligible municipal securities between municipal securities brokers and dealers and customers effected on a delivery-vs.-payment basis must be confirmed, acknowledged and settled via book-entry through the facilities of a registered securities depository if the parties to a transaction are participants in a depository. The Board has requested that the Commission delay the effectiveness of these amendments, when approved, so that the requirements in both rules for the use of automated comparison or confirmation and acknowledgment systems become effective on August 1, 1984, and the requirements for book-entry clearance become effective on February 1, 1985.

I am writing on behalf of the Board to request that the Public Securities Association take the leading role in facil-

itating the industry's transition to an automated clearance environment during this period prior to the effectiveness of the proposed requirements. The changes mandated by these amendments are major ones for the municipal securities industry, and considerable effort will be needed, on the part of each firm, bank or institution individually as well as by the industry as a whole, to ensure that this transition is negotiated successfully and with a minimum of difficulty and disruption. The Board is of the view that these efforts will be greatly facilitated if a centralized committee is formed that will actively work toward the successful implementation of the amendments. The Board believes that the PSA is ideally placed to serve as the sponsor of and support for a committee of this type and urges that PSA establish such a group.

The Board perceives the following as areas in which such a committee could be active:

- (1) The committee could take steps to ensure that all persons who will be affected by the amendments are aware of them and of the need to accomplish any necessary changes by the effective dates;
- (2) The committee could arrange for the dissemination of material describing the basic workings of these automated systems and their operational requirements, or ensure that such material is distributed by others;
- (3) The committee could provide a means of coordinating the efforts of all affected persons toward implementation of the amendments;
- (4) The committee could provide a mechanism whereby persons working toward implementation of the amendments could share information and suggestions on appropriate and cost-effective ways of making any changes necessary to comply with the amendments;
- (5) The committee could take steps to inform industry members and others about appropriate methods of complying with the amendments and implementing necessary systems changes through the distribution of educational materials and/or the presentation of a series of educational seminars;²
- (6) The committee could identify and explore problems, if any, which arise in the course of the implementation of the amendments and possibly recommend Board action, if necessary, to address them.

In addition, as you know, PSA and others have expressed particular concern about the potential impact of the amend-

¹A copy of the notice of filing of the proposed amendments, which contains a more detailed discussion of their provisions, is enclosed for your reference.

²PSA's recent experience with the work of its Registered Securities Task Force would appear to be beneficial in this regard.

ments on smaller municipal securities brokers and dealers. The Board believes that it would be most helpful for this committee to devote special effort to monitoring the impact of the amendments on such firms and developing suggestions for ways in which such firms can comply with the amendments in the most cost-effective manner. The Board is most concerned with the effect of the amendments on such dealers and asks that it be kept apprised of the committee's views and efforts regarding this aspect of its work.

The Board believes that it would be appropriate for such a committee also to include representatives of other industry organizations as participants in its work, and requests that PSA, should it decide to form such a group, undertake to provide for such representation. In this regard the Board notes that representatives of the Securities Industry Association and committees of the American Bankers Association have been active in similar efforts in connection with the January 1, 1983 effective date of comparable amendments to New York Stock Exchange rule 387, Section 64 of the Uniform Practice Code of the National Association of Securities Dealers, Inc., and similar rules of other exchanges. The Board believes that such persons could provide extremely helpful guidance to the committee on the preparation for implementation of the amendments to the Board's rules. The Board notes also that representatives of other organizations, such as the Dealer Bank Association and the Municipal Dealers Association, might assist the committee by providing information and suggestions from the perspectives of their specialized constituencies.

The Board believes that PSA can provide a service of great value to the municipal securities industry by undertaking such an effort. We hope that you will view this request favorably, and look forward to your response. Should PSA determine to sponsor such an effort, the Board would, of course, appreciate being kept informed about the committee's activities.

Sincerely,
[s]Anthony M. Mandolini
Chairman
Municipal Securities Rulemaking Board

November 18, 1983

Mr. Arthur T. Cooke, Jr.
Chairman
Municipal Securities Rulemaking Board
1150 Connecticut Avenue, N.W., Suite 507
Washington, D.C. 20036

Dear Art:

The Public Securities Association strongly supports amendments to Municipal Securities Rulemaking Board rules G-12 and G-15 which will bring to the municipal securities industry the efficiencies and economies of automated systems of securities clearance and processing. The PSA Board of Directors has carefully considered the request of the MSRB that our Association take the leading role in assuring that the transition from a manual to an automated clearance environment be accompanied with the least possible disruption to the industry. I am pleased to inform you that the PSA Board has directed the formation of an Ad Hoc Committee on Municipal Securities Automation.

The Ad Hoc Committee will be co-chaired by William J. White, President and Chief Executive Officer of Kirchner, Moore & Co., and F. Paul Wisniewski, Senior Vice President of J.J. Kenny Co. Inc. Due to the importance of this issue to the future efficiency of the market for municipal securities membership in the Committee will not be limited to PSA members. As suggested by Tony Mandolini's letter of September 22, 1983 our Committee will include individuals who have been active in the implementation of comparable rules (e.g., New York Stock Exchange Rule 387). In addition, we will ask members of the MSRB staff to participate in the Ad Hoc Committee and will keep the MSRB informed of the committee's activities.

We welcome the opportunity to serve the industry in this manner and trust that our efforts will benefit all market participants.

Sincerely,
[s]Arch W. Roberts
Chairman
Public Securities Association



Route To:

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

Rules G-12 and G-15

Letters of Interpretation

Designation of "DVP" or "RVP" Transactions

I am writing in response to a point made in your letter of May 5, 1983 commenting on the March 14, 1983 exposure draft of an amendment to Board rules regarding the confirmation and clearance of customer delivery-vs.-payment or receipt-vs.-payment transactions in municipal securities. In that exposure draft, you may recall, the Board proposed to require, among other matters, that

the memorandum of [a delivery-vs.-payment or receipt-vs.-payment] order made in accordance with the requirements of paragraph (a)(vi) or (a)(vii) of rule G-8 shall have noted thereon the fact that it is a delivery-vs.-payment (DVP) or receipt-vs.-payment (RVP) transaction. . . .

In your comment letter you indicated that [your firm] has established a system whereby all delivery-vs.-payment and receipt-vs.-payment transactions for a particular customer are designated by a specific account number, with transactions for the same customer effected on an alternative basis, if any, being designated by a different account number. You suggested that this should suffice to meet the purpose of the cited proposed requirement, and that a separate "notation" should not be necessary.

On September 7, 1983 the Board filed with the Securities and Exchange Commission certain proposed amendments to its rule G-15 which are substantially similar to the March 1983 proposals; a copy of the notice of filing is enclosed for your information. In the amendment as filed with the Commission the provision cited above has been revised to require that the trading memorandum include a "designation" that a transaction is a delivery-vs.-payment or receipt-vs.-payment transaction. In adopting the provision in this form the Board intended that types of "designations" other than the "DVP" or "RVP" notation be contemplated in the exposure draft proposal should be acceptable for purposes of this requirement, including a designation by means of the use of an account number specifically limited to these types of transactions, as was suggested in your letter. —MSRB interpretation of September 14, 1983, by Donald F. Donahue, Deputy Executive Director.

Application of Automated Systems Requirement to "Internal" Transactions

As you are aware, the Board has been considering for the past year the adoption of amendments to Board rules to mandate the use of automated confirmation/comparison and book-entry settlement systems in connection with the clearance of certain inter-dealer and customer transactions in municipal securities. In connection with its consideration of this matter, the Board released, in July 1982, an exposure draft of a proposal to apply such requirements to customer transactions, and, in March 1983, two exposure drafts of comparable proposals with respect to customer transactions and inter-dealer transactions. The Board has recently taken action on these proposals, and adopted amendments to its rules, substantially along the lines of the March 1983 proposals, for filing with the Securities and Exchange Commission; a copy of the notice of filing of these amendments is enclosed for your information.

[The bank] commented to the Board on both the July 1982 exposure draft, by letter dated October 15, 1982 from [a member] of the bank's Operation's Department, and on the March 1983 exposure drafts, by letter dated June 1, 1983 from yourself. In these letters, among other comments, the bank suggested that the proposed requirement for the use of automated confirmation and book-entry settlement systems on certain customer transactions should not apply in circumstances where the transaction is between the bank's dealer department and a customer who clears or safekeeps securities through the dealer department or through the bank's custodian or safekeeping department. Your June 1983 letter, for example, commented as follows:

Internal trades [with] customers of a dealer bank are not exempt from the amendment. This seems inconsistent with operating efficiency and the objectives of the amendment. Technically, a bank dealer would have to submit to [an automated confirmation and book-entry settlement system] trades made with customers who clear or safekeep through another department in the bank. If adopted, the amendment should allow for such an exemption.

I am writing to advise you that, in reviewing the comments on the July 1982 and March 1983 proposals, the Board concurred with this suggestion. The Board is of the view that the proposed requirement for the automated confirmation

and book-entry settlement of certain customer transactions does not apply to a purchase or sale of municipal securities effected by a broker, dealer, or municipal securities dealer for the account of a customer in circumstances where the securities are to be delivered to or received from a clearance or safekeeping account maintained by the customer with the

broker, dealer or municipal securities dealer itself, or with a clearance or safekeeping department of an organization of which the broker, dealer, or municipal securities dealer is a division or department.—*MSRB interpretation of September 21, 1983, by Donald F. Donahue, Deputy Executive Director.*