MSRB REPORTS

Volume 4, Number 3 | Municipal Securities Rulemaking Board | May 1984

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Board Reprints Rules in New Publication

The Board has just reprinted its rules separately in a volume entitled *MSRB Rules*. Besides the rules, the new publication, dated April 1, 1984, includes notices and letters interpreting the rules and samples of forms needed by municipal securities brokers and dealers and by municipal securities professionals. *MSRB Rules* is a reprint of the rules section as published in *MSRB Manual*. The Board hopes that the industry finds the rules volume convenient and simple to use.

The Board continues to publish as usual the softcover *MSRB Manual*. In addition to the Board rules, *MSRB Manual* contains law texts, pertinent regulations of other agencies, notices of recent decisions which affect the municipal securities industry, and indexes to those materials.

The new publication, *MSRB Rules*, costs $2.00; the updated and reprinted *MSRB Manual* (April 1, 1984) costs $5.00. Both may be ordered by calling ((202) 223-9347) or writing the Board offices.

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Notice of Approval

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Rule G-12

Amendments Approved on CUSIP Number Discrepancies

On March 28, 1984 the Securities and Exchange Commission approved certain amendments to the provisions of Board rule G-12 concerning CUSIP number discrepancies on deliveries. The amendments were effective upon approval by the Commission.

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

The amendments clarify that the exceptions stated in the rule to the provisions permitting rejection of a delivery do not apply to a delivery of new issue municipal securities made by an underwriter who is subject to the requirements of Board rule G-34 concerning the application for and imprinting of CUSIP numbers on new issues. Therefore the CUSIP number imprinted on the securities delivered by the underwriter must in all cases be the correct number; deliveries of securities with incorrect numbers imprinted on them may be rejected by the receiving dealer.

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

April 6, 1984

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

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

(i) No change.

(ii) Securities Delivered.

(A) No change.

(B) CUSIP Numbers

(1) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of subparagraph (c)(v)(F) of this rule; provided, however, that, for purposes of this item (1), a security shall be deemed to have the same CUSIP number as that specified on the confirmation (a) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (b) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security.

(2) A new issue security delivered by an underwriter who is subject to the provisions of rule G-34 shall have the CUSIP number assigned to the security imprinted on or otherwise affixed to the security.

(iii) through (xvi) No change.

(f) through (l) No change.

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

*Underlining indicates additions; deleted material has been omitted.

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Questions & Answers

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Rule G-12

Close-Out Procedures: Questions and Answers in New Edition of Close-Out Manual

The Board will shortly release for the industry's use a new edition (dated May 1984) of its *Manual on Close-Out Procedures*. The new edition of the *Manual* will contain, in addition to the previously published material, new sections reviewing the amendments to the close-out rules effective in June 1983 which—

- established an extension of time in the event the securities which are the subject of the close-out notice have been submitted for transfer, and
- made provision for the use of the close-out procedures in the event of certain types of reclamations. The new edition also contains other new material covering recent interpretations of the general close-out rules.

Reprinted below are the additions to the *Manual* covering material other than the provisions incorporated in the rule by the June 1983 amendments. The references are to the question numbers in the August 1981 edition of the *Manual*.

EXECUTING A CLOSE-OUT: THE PURCHASER'S OPTIONS

Q: **Suppose, in the case of a mandatory repurchase execution of a close-out in a down market, I am seeking to have the other dealer repurchase at the contract price securities that I bought from him at a yield price. Do I use the original dollar price on the trade, or do I use the original yield price figured to the new settlement date of the repurchase transaction?**

A: You can use the original yield price figured to the new settlement date. Note that in the case of a security trading at a premium the seller can force you to use the yield price figured to the new settlement date.[1]

EXECUTING A CLOSE-OUT: THE PROCEDURE

Q: **What happens if a dispute arises about the fairness of the close-out execution price? Am I still obliged to send out any moneys owed on the close-out execution within 10 business days?**

A: No. If the close-out execution price is disputed, the settlement of the money amounts due should be deferred until the dispute is resolved.[2]

CLOSE-OUT EXECUTIONS ON RETRANSMITTALS

Q: **What happens in the event that the ultimate seller challenges the fairness of the execution price? Are all the other parties still obliged to settle the money amounts they owe within the 10 business days?**

A: No. As in the case of the two-party close-out, if the execution price is disputed, completion of the money settlements should be delayed until the dispute is resolved.[3]

Q: **In these situations, though, some of the amounts owed will not be involved in the dispute—for instance, the profit amounts for the parties in the middle of the transaction chain. Shouldn't those parties settle up on the undisputed amounts, and just defer payment on the portion that is the subject of the dispute?**

A: Undisputed amounts can be paid right away, and sometimes it might be desirable that this be done. The rule does not require it, though.

Q: **Can I retransmit a close-out notice I receive to any dealer who owes me securities on a transaction that is 5 or more business days old? Suppose I receive a notice on a transaction for one settlement date, and my only open fail to receive is for a transaction for a later settlement date. Can I retransmit the notice to my contra-side on that second transaction?**

A: Yes, as long as that second transaction is 5 or more business days old.[4]

[1]This question and answer is being inserted in the forthcoming edition of the *Manual* after the question and answer currently numbered 46.
[2]This question and answer is being inserted in the forthcoming edition of the *Manual* after the question and answer currently numbered 66.
[3]This question and answer and the one immediately following are being inserted in the forthcoming edition of the *Manual* after the question and answer currently numbered 138.
[4]This question and answer is being inserted in the forthcoming edition of the *Manual* after the question-and-answer currently numbered 143.

Q: What would happen if the notice I am receiving is a second or subsequent notice (with the earlier delivery deadline and execution period dates) and I had never initiated or retransmitted a close-out on that second transaction, on which I am retransmitting the notice? In that case, the dealer to whom I retransmit the notice will be subject to a possible close-out five days earlier than he would have been if I were retransmitting a first notice. Can I still retransmit the notice to him?

A: Yes. Once a transaction is 5 or more business days old, it is subject to a possible close-out. The fact that the other dealer had not previously received a close-out notice on the transaction does not affect your right to retransmit a second or subsequent notice to him.[5]

Q: Can I retransmit one or more notices and issue my own notice on the same transaction? Suppose a dealer owes me 100 bonds that I have resold in two lots of 50. I can retransmit to him notices on each of my offsetting sale transactions. Can I initiate my own notice and send it to him on the same transaction?

A: Yes, you can issue your own notice. Since close-out notices are intended to be used to facilitate the completion of transactions, however, and not for the purpose of harassing another dealer, you should consider whether your issuing your own notice serves any purpose.

Q: Can I retransmit to another dealer notices for a total par value of securities greater than the amount of securities he owes me? For example, if he owes me 100 bonds, can I retransmit to him three notices for 50 bonds each?

A: Yes. He would, of course, be subject only to an execution or executions for the amount of securities that he owes on the transaction. In your example, if you did retransmit the three notices for 50 bonds each, and all three were subsequently executed, the dealer to whom you retransmitted the notices would only be liable for moneys due on two of the notices, since he only sold you 100 bonds.

Q: If I pass on a "partial" retransmittal to another dealer, and he can deliver me the securities which are the subject of the retransmitted notice, although he still cannot make delivery of the full amount of the securities owed to me, am I obliged to accept his delivery of the smaller amount of securities, even though, for my purposes, that's a "partial" delivery?

A: You would be obliged to accept delivery of the smaller amount of securities that is the subject of the retransmittal if that was necessary to avert execution of the close-out on those securities. In this circumstance you would not have the discretion to choose to turn down the "partial" delivery.[6]

Q: Would I have to accept that partial delivery as soon as I retransmit the close-out notice?

A: It would seem reasonable to do so, since the originator of the notice is seeking to obtain delivery of the securities. You are obliged, however, only to accept the delivery if that is necessary to avert execution of the close-out; that means that you would have to accept the delivery in sufficient time to permit the securities to be redelivered to the originating dealer on or before the delivery deadline date.

Q: That seems pretty complete. Is there anything else to add?

A: Just that close-out should be taken seriously, not ignored, and not used to harass people. A close-out should really be issued only when there is a serious intention to close out the transaction, and not as a substitute for a phone call to check up on the status of a particular fail. As this booklet has made clear, the close-out procedures for municipal trades can be quite complex, due to the nature of the security. Issuing close-out notices automatically, then, without any real intent to execute the close-out, can really impose a burden on other dealers that will simply make the clearance process less efficient and may well slow down deliveries generally.[7]

[5]This question and answer and the two immediately following are being inserted in the forthcoming edition of the *Manual* after the question and answer currently numbered 144.

[6]This question and answer and the one immediately following are being inserted in the forthcoming edition of the *Manual* after the question-and-answer currently numbered 145.

[7]This question and answer is being substituted in the forthcoming edition of the *Manual* for the question-and-answer currently numbered 146.

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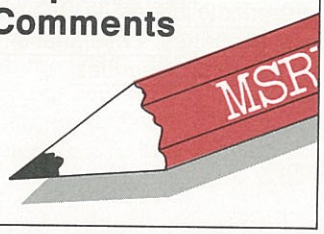
Request For Comments



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Rules G-12 and G-15

Comments Requested on Draft Amendments on Original Issue Discount Securities

Rules G-12(c) and G-15(a) prescribe certain items of information which must be contained on confirmations of transactions in municipal securities. The Board is considering adoption of amendments to those rules to require that transactions in certain tax-exempt securities that are sold at issuance at a discount from the par amount shall be designated as original issue discount securities in the description area of confirmations.

Background

An original issue discount security is a security sold at issuance at a discount from its par amount on which all or a portion of the return to be realized by the purchaser is in the accretion of the discount to par over the life of the security. A portion of the return from certain original issue discount securities is received as periodic interest payments at a stated interest rate, with the balance in accretion from the original issue discount to par. Others, such as "zero coupon" securities, pay no periodic interest, the entire return coming from the accretion of the discount to par.

The Board understands that the accretion of the discount of a tax-exempt original issue discount security, at least in part, generally is tax-exempt income to the holder. The Board believes that the fact that a security bears an original issue discount is material information (since it may affect the tax treatment of the security); therefore, this fact should be disclosed to a customer prior to or at the time of trade. As the Board previously has stated:

> the tax exemption of income received is a primary investment consideration for purchasers of municipal securities.[1]

In addition, the existence of an original issue discount should affect the price of the security.

Proposed Amendments

The Board has received inquiries from members of the industry and purchasers of tax-exempt original issue discount securities which suggest that it is often difficult to determine whether securities are original issue discount securities, especially when such securities subsequently are traded in the secondary market. Because of the importance of the information, the Board is considering requiring that confirmations of transactions in these securities contain the designation "OID" in the description field in order to make identification of these securities easier in the secondary market. The requirement would apply only to transactions in original issue discount securities on which periodic interest payments also are received, since these securities, unlike "zero coupon" securities, may be mistaken for traditional tax-exempt securities in which the periodic interest payment is the only form in which the investment return is received.[2] The Board is concerned that an investor might not be aware that all or a portion of the component of his investment return represented by accretion of the discount is tax-exempt, and therefore might sell the securities at an inappropriately low market price (*i.e.*, at a price not reflecting the tax-exempt portion of the discount) or pay capital gains tax on the accreted discount amount.

The proposed "OID" designation would be used only for issues which are identified by the underwriters as original issue discount securities.[3] Since dealers already are required to disclose orally to customers that securities are original

The Board welcomes comments on the draft amendments from all interested persons. In particular, the Board solicits the views of institutional and individual customers regarding the provisions of the draft amendments. Letters of comment should be received by the Board on or before May 1, 1984, and should be sent to the attention of Angela Desmond, General Counsel. Written comments will be available for public inspection.

[1]Exposure draft on zero coupon, compound interest and multiplier securities, *MSRB Reports*, vol. 2, no. 7 (October/November 1982) at 14; *MSRB Manual* (CCH) ¶10,225 at 10,706.

[2]The Board already has adopted requirements that confirmations in zero coupon, compound interest and multiplier securities state that the interest rate is "0%." In addition, Board rule G-15 requires customer confirmations of transactions in such securities to state, among other things, that there will be no periodic payments of interest.

[3]The Board believes that it is appropriate to limit the application of the proposed requirement to those issues because of certain open questions concerning the tax treatment of original issue discount securities. The Board has communicated with the appropriate tax policy-making authorities concerning the need to resolve these issues and anticipates that there will be action to address them in the near future.

issue discount securities, the draft amendments would apply to all existing original issue discount issues that were identified as such when initially offered as well as to new issues. The Board understands information concerning outstanding issues that were sold as original issue discount securities by the underwriters is available.

April 11, 1984

Text of Draft Amendments*

Rule G-12

(c) Dealer Confirmations

(i)–(v) No change.

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

(A)–(D) No change.

(E) if the securities pay periodic interest and are issued as original issue discount securities, a designation that they are "original issue discount" securities;

(E)–(F) renumbered (F)–(G)

Rule G-15

(a) Customer Confirmations

(i)–(ii) No change.

(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)–(E) No change.

(F) if the securities pay periodic interest and are issued as original issue discount securities, a designation that they are "original issue discount" securities;

(F)–(G) renumbered (G)–(H)

*Underlining indicates additions.

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Rule G-15

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

On March 2, 1984, the Securities and Exchange Commission approved the Board's amendment to rule G-15(a) on customer confirmation concerning the information to be set forth on confirmations of transactions in zero coupon, compound interest and multiplier securities. The amendment, which requires the inclusion of a statement calling attention to certain unusual features of these securities, becomes effective on September 1, 1984.[1]

The amendment applies to transactions with customers in municipal securities which mature in more than two years and pay investment return solely at redemption. It requires that municipal securities brokers and municipal securities dealers which sell these securities to customers include on the final customer confirmation the following information:

- that the customer will not receive periodic interest payments;
- if applicable, that the securities are callable at a price below maturity value; and
- if the securities are callable and available in bearer form, that unless the securities are in registered form, the absence of periodic payments may make it difficult for the customer to determine whether the securities have been called.

The amendment provides the following statement appearing in the description field of the confirmation will be deemed to satisfy these requirements: "No periodic payments—callable below maturity value without notice by mail to holder unless registered." The amendment also permits the statement to be contained as a legend on the reverse side of the confirmation provided that the presence of the legend is highlighted by a statement in the description field (*e.g.*, "Important—see legend __below").

The Board has delayed the effective date of these requirements until September 1, 1984, to give the industry an opportunity to take steps necessary to assure compliance.

March 2, 1984

Text of Proposed Amendment*

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

(a) Customer Confirmations

(i) through (iv) No change.

(v) The confirmation for a transaction in securities maturing in more than two years and paying investment return solely at redemption:

(A) shall not show the par value of the securities specified in subparagraph (D) of paragraph (a)(i) ~~and~~;

(B) shall not be required to show the amount of accrued interest specified in subparagraph (J) of paragraph (a)(i);

(C) ~~Such confirmation~~ shall, ~~however~~, show the maturity value of the securities and specify that the interest rate on the securities is "0%";

(D) shall indicate that the customer will not receive periodic payments;

(E) if applicable, shall indicate that the securities are callable at a price below the maturity value; and

(F) if the securities are callable and available in bearer form, shall indicate that unless the securities are registered it may be difficult for the customer to determine whether the securities have been called.

A statement in the description field of the confirmation or contained as a legend on the reverse side of the confirmation to the following effect will be deemed to satisfy the requirements of subparagraphs (D), (E) and (F) above: "No periodic payments—callable below maturity value without notice by mail to holder unless registered." Notwithstanding the foregoing, if the requisite information is set forth on the reverse side of the confirmation, its presence must be highlighted by a statement in the description field (*e.g.*, "Important—see legend __below").

(vi) through (ix) No change.

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

[1]The amendment supplements other amendments to rules G-12 and G-15 which relate to the disclosure of the maturity value of these securities, the description of the interest rate, transaction moneys and yield and dollar price calculations. *See MSRB Reports*, vol. 3, no. 6 (November 1983) at 17–18. These changes became effective December 12, 1983.

*Underlining indicates additions; broken line indicates deletions.

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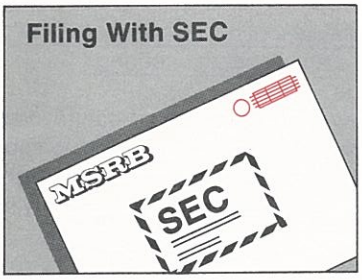

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Rules G-35 and A-16

Amendments Filed on Arbitration

On March 16, 1984, the Board filed with the Securities and Exchange Commission certain proposed technical amendments to rule G-35, the Board's code of arbitration, and rule A-16, arbitration fees and charges. These changes are intended to conform the provisions of the Board's arbitration code and arbitration fee schedule to recent amendments to the Uniform Arbitration Code developed by the Securities Industry Conference on Arbitration which is composed of the representatives of the Board, nine other self-regulatory organizations, four public members, and the Securities Industry Association. The Uniform Code, as implemented by the various self-regulatory organizations, has established throughout the securities industry a uniform system of arbitration procedures. The amendment will become effective upon approval by the Commission.

Provisions of Amendments

Jurisdiction.—The proposed amendments would permit a court which has jurisdiction over a claim to direct that the claim be resolved by arbitration. Currently, if a claim is six years old or more, it is no longer eligible for arbitration. The proposed language would make the code's time limitation coextensive with various state statutes of limitations and permit all securities-related disputes which are eligible for a judicial disposition to be resolved by arbitration.

Fees.—The proposed changes would increase the upper dollar limit on customer small claims arbitrations from $2,500 to $5,000. In addition, the proposed increases in certain arbitration fees are modest and are extended to help offset the effects of inflation since the code's adoption in 1978. However, fees for claims under $2,500 were lowered to match the new schedule of fees for customer small claims. The proposed amendments also would authorize arbitrators to assess costs in any dispute that was settled or withdrawn subsequent to the commencement of the first hearing.

Procedures.—The proposed amendments would describe the arbitrators' discretion to bar the presentation by the respondent of certain facts and defenses not included in responsive pleadings prior to hearing. This amendment should result in more complete answers filed by respondents.

Pleadings and Challenges to Arbitrators.—Other proposed amendments would expand the procedural rights afforded to all parties. The proposed amendments also provide that the Director of Arbitration may determine preliminarily whether multiple claimants, respondents and/or third party respondents are to proceed in the same or separate arbitrations. Also, claimants, respondents, and third party respondents would have the right to one peremptory challenge and unlimited challenges for cause. The Director of Arbitration would be given the discretion to extend the time period allowed for a party to challenge an arbitrator when necessary (*e.g.* when a party requires more time to investigate the background of an arbitrator prior to making a decision regarding the use of a peremptory challenge). Finally, the proposed amendments would allow parties to amend pleadings prior to the appointment of an arbitration panel.

March 16, 1984

Text of Proposed Amendments*

Rule A-16. Arbitration Fees and Deposits

(1) Except as provided in Section 34 of rule G-35, at the time of filing the Submission Agreement, the claimant shall deposit the amount indicated below unless such deposit is specifically waived by the Director of Arbitration.

Amount in Dispute (Exclusive of interest and expenses)	Deposit
~~$2,500~~ $1,000 or less	~~$50~~ $15
Above $1,000—but not exceeding $2,500	$25
Above $2,500—but ~~less than~~ not exceeding $5,000	$100
Above $5,000—but ~~less than~~ not exceeding $10,000	$200
Above $10,000—but ~~less than~~ not exceeding $20,000	~~$250~~ $300
Above $20,000—but ~~less than~~ not exceeding $100,000	~~$350~~ $500
Above $100,000 ~~and over~~	~~$550~~ $750

Questions concerning these proposed amendments may be directed to Diane G. Klinke, Deputy General Counsel.

*Underlining indicates new language; broken line indicates deletions.

Where the amount in dispute is less than $10,000 or less no additional deposits shall be required despite the number of sessions. Where the amount in dispute is above $10,000 or more and multiple sessions are required, the arbitrators may require any of the parties to make additional deposits for each additional session. In no event shall the aggregate amount deposited per session exceed the amount of the initial deposit at the rates above set forth.

(2) The arbitrators, in their awards, may determine the amount chargeable to the parties as forum fees (fees) and shall determine by whom such fees shall be borne. Where the amount in dispute is less than $10,000 or less, total fees to the parties shall not exceed the amount deposited. Where the amount in dispute is above $10,000 ~~or more but less than~~ but does not exceed $20,000, the maximum fee shall be ~~$250~~ $300 per session. Where the amount in dispute is above $20,000 ~~or more but less than~~ but does not exceed $100,000, the maximum fee shall be ~~$350~~ $500 per session. Where the amount in dispute is above $100,000 or more, the maximum fee shall be ~~$550~~ $750 per session. In no event shall the fees assessed by the arbitrators exceed ~~$550~~ $750 per session. Amounts deposited by a party shall be applied against fees, if any. If the fees are not assessed against a party who has made a deposit, the deposit will be refunded.

(3) If the dispute, claim or controversy does not involve or disclose a money claim, the amount to be deposited by the claimant shall be $100 or such amount as the Director of Arbitration or the panel of arbitrators may require but shall not exceed ~~$550~~ $750.

(4)–(5) No change.

(6) The arbitrators may assess costs in any matter settled or withdrawn subsequent to the commencement of the first session.

Rule G-35. Arbitration

Sections 1–4. No change.

Section 5. Initiation of Proceedings.

(a) No change.

(b) (1) The respondent or respondents shall, within 20 business days of receipt of service, file with the Director of Arbitration one executed Submission Agreement and one copy of the Answer. The Answer shall ~~contain all available defenses to the Statement of Claim~~ specify all available defenses and relevant facts that will be relied upon at hearing and may set forth any related counterclaim the respondent or respondents may have against the claimant and any third party claim against any other party or person upon any existing claim, dispute, or controversy to arbitration under this Arbitration Code.

(2)(i) A respondent, responding claimant, cross-claimant or third party respondent who pleads only a general denial as an Answer may, upon written objection by the adversary party to the Director of Arbitration before the hearing, in the discretion of the arbitrators, be barred from presenting any facts or defenses at the time of the hearing.

(ii) A respondent, responding claimant, cross-claimant or third party respondent who fails to specify all available defenses and relevant facts in such party's Answer, may, upon objection by the adversary party, in the discretion of the arbitrators, be barred from presenting the facts or defenses not included in such party's Answer at the hearing.

(c) through (e) No change.

(f)(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.

(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.

(3) All final determinations in respect of joining and, consolidation and multiple parties under this subsection shall be made by the arbitration panel.

Section 6. Time Limitations Upon Submission

(a) No claim, dispute or controversy shall be eligible for submission to arbitration under this Arbitration Code in any instance where six years shall have elapsed from the occurrence of the act or event giving rise to the claim, dispute or controversy. This section shall not extend applicable statutes of limitation, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction.

(b) The six year time limitation upon submission to arbitration shall not apply when the parties have submitted the dispute, claim or controversy to a court of competent jurisdiction. The six year time limitation shall not run for such period as the court shall retain jurisdiction upon the matter submitted.

Section 7. No change.

Section 8. Composition and Appointment of Panels.

(a) No change.

(b) Notice of Appointment; Objections. The Director of Arbitration shall inform the parties to the proceeding of the names and business affiliations of the persons appointed to the panel at least eight business days prior to the date fixed for the initial hearing session. In ~~an~~ any arbitration proceeding ~~being heard by a panel consisting of more than one arbitrator,~~ each party shall have the right to one peremptory challenge. In arbitration proceedings where there are multiple claimants, respondents and/or third party respondents, the claimants shall have one peremptory challenge, the respondents shall have one peremptory challenge and the third party respondents shall have one peremptory challenge, unless the Director of Arbitration determines that the interests of justice would best be served by awarding additional peremptory challenges. Each party shall also have the right to request that the Arbitration Committee remove other members of the panel which the Arbitration Committee shall be empowered to do in its sole discretion. Unless extended by the Director of Arbitration, a party wishing to

exercise a peremptory challenge or to request that the Arbitration Committee remove members of the panel must do so by notifying the Director of Arbitration in writing within five business days of notification of the identity of the persons named to the panel. There shall be unlimited challenges for cause.

Sections 9–10. No change.

Section 11. Tolling and Time Limitations for the Institution of Legal Proceedings.

Where permitted by law, the time limitations which would otherwise run or accrue for the institution of legal proceedings, shall be deemed tolled when ~~all the parties shall have filed duly executed submission agreements upon the claim, dispute or controversy submitted to arbitration~~ a duly executed Submission Agreement is filed by the claimant. The tolling shall continue for such period as the Board shall retain jurisdiction upon the matter submitted.

Sections 12–28. No change.

Section 29. Amendments of Pleadings.

~~No amendment to the pleadings shall be permitted after receipt of a responsive pleading except upon the consent of the arbitrators and upon such terms and conditions as they may direct~~.

(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. 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 the Director of Arbitration.

(b) After a panel has been appointed, no new or different pleading may be filed except for a responsive pleading as provided for in (a) above or with the panel's consent.

Sections 30–33. 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 municipal securities broker or municipal securities dealer, subject to arbitration under this Arbitration Code, which involves a dollar amount not exceeding ~~$2500.00~~ $5,000 (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) No change.

(c) The claimant shall pay the sum of $15.~~00~~ if the amount in controversy is $1,000 or less, $25 if the amount is more than $1,000 but $2,500 or less, or $100 if the amount in controversy is more than $2,500 but does not exceed $5,000 upon filing of the Submission Agreement. The final disposition of this sum shall be determined by the arbitrator.

(d) The Director of Arbitration shall endeavor to serve promptly by mail or otherwise on the respondent one copy of the Submission Agreement and Statement of Claim. The respondent shall within 20 calendar days from receipt of service file with the Director of Arbitration one executed copy of the Submission Agreement and one copy of an Answer, together with supporting documents. 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 may have against the claimant or any other person. The term "related counterclaim" for the purposes of this provision means a counterclaim related to a customer's account or accounts with a municipal securities broker or municipal securities dealer. If the respondent has interposed a third-party claim, the Director of Arbitration shall endeavor to serve promptly by mail or otherwise a copy of the third party claim together with a copy of the Submission Agreement on such third-party who shall respond in the manner herein provided for response to the claim. If the respondent files a related counterclaim exceeding ~~$2500.00~~ $5,000, the arbitrator may refer the claim, counterclaim and/or third-party claim, if any, to a panel of arbitrators, the size and composition of which shall be determined in accordance with section 12 hereof, or, he may dismiss the counterclaim and/or third-party claim without prejudice to the counter-claimant and/or third-party claimant in a separate proceeding. ~~The costs to the claimant under either alternative shall in no event exceed $15.00~~.

(e)–(l) No change.

Section 35. No change.

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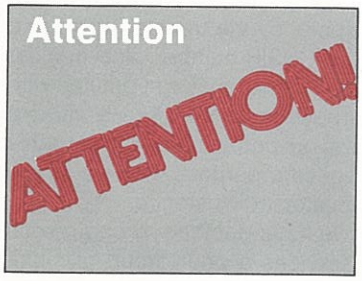

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Immobilization of Securities

Board and DTC Correspondence

November 7, 1983

Mr. William T. Dentzer, Jr.
Chairman and Chief Executive Officer
The Depository Trust Company
7 Hanover Square
New York, New York 10004

Dear Bill:

As you know, the Municipal Securities Rulemaking Board has recently been engaged in a lengthy review of the issue of the use of automated systems for the confirmation, comparison, clearance and settlement of transactions in municipal securities. As a result of this review, at its July 1983 meeting the Board adopted certain amendments to its rules which, when effective, will mandate the use of such systems to clear a substantial number of municipal securities transactions; copies of the notice of filing of these amendments have previously been provided to members of your staff. The adoption of these amendments reflects the Board's conclusion that the adoption of automated clearance and settlement systems, and the immobilization of the majority of outstanding issues of securities which is an integral part of such systems, are both important objectives which the municipal securities industry should accomplish in the near future.

It has recently come to the Board's attention that The Depository Trust Company has adopted a policy with respect to certain types of municipal issues which, in the Board's view, contravenes the objective of immobilizing municipal issues. The Board understands that DTC currently refuses to make eligible for its services (*i.e.*, to immobilize) certain general obligation issues of municipal securities in which portions of the issue are specifically designated as being for different "purposes."[1] Since the CUSIP numbering system does not recognize "purpose" distinctions in number assignments, a single interest rate and maturity date of such an issue (assuming all securities are subject to the same call provisions and have the same security and source of payment) would be assigned a single CUSIP number, regardless of any "purpose" distinctions among securities of that interest rate and maturity date. The Board understands that, due to the absence of CUSIP number differentiation among otherwise-identical general obligation securities of various "purposes," DTC has to date declined to immobilize securities from these types of issues in its facilities.

The Board strongly disagrees with DTC's decision on this matter. Securities which are distinct only as a "purpose," and are otherwise identical in all material respects, including the issue's security and source of payment, are, in the Board's view, fully fungible, and should correctly be assigned only one CUSIP number.[2] The Board, therefore, concurs with the CUSIP Agency's current practice with respect to the assignment of numbers to these types of securities, and would emphatically object to the assignment of CUSIP numbers in a manner which differentiates between the same securities with different "purposes." Given the fact that these securities should correctly be viewed as fully fungible, and that the general immobilization of municipal issues is a major goal of the municipal securities industry, the Board believes that DTC's policy with respect to these issues, which deems them not to be fungible and is not in accord with the goal of the general immobilization of municipal issues, is erroneous and undesirable.

The Board is aware that DTC has adopted this policy with respect to multi-"purpose" general obligation issues due to several considerations, most particularly the problems of handling interest payment coupons on bearer issues of this type and the possibility of a subsequent advance refunding of an issue of this type which would differentiate among the different "purposes" (*e.g.*, by refunding securities of a certain "purpose" to a particular call date and price, with securities of other "purposes" refunded to different call dates and prices, or to maturity[3]). While the Board understands the

[1]The Board uses the term "purpose" to refer only to the designation on an issue (or a portion of an issue) of the project, facility or other undertaking to which the proceeds received from the issuer's sale of the issue are to be applied. The term does not refer to any designation which reflects a distinction in the security or source(s) of payment for the issue.

[2]In contrast, the Board notes that, if portions of a general obligation issue are secured by separate sources of payment (even though all are secured by the same general obligation pledge), the various portions which are distinct as to source of payment are generally not deemed fungible and should be assigned separate CUSIP numbers. As a result of a specific request from the Board CUSIP numbers have been assigned in a manner which reflects this type of distinction on new municipal issues sold after January 1982.

[3]In such an eventuality, of course, the different "purpose" securities would no longer be fungible, and corrections to the assigned CUSIP numbers to reflect this distinction would have to be made.

difficulties these problems present to DTC, the Board does not believe that the exclusion of these types of issues from the depositories, and, consequently, from the benefits of immobilization and automated clearance, can in any way be considered an appropriate solution to these difficulties. Further, the Board notes that the first problem cited, the difficulty of depositing interest payment coupons from securities of different "purposes," is no longer of any concern with respect to new issue securities of this type, due to the July 1, 1983 effectiveness of the registration requirements of the Tax Equity and Fiscal Responsibility Act of 1982. While the possibility of an advance refunding by "purpose" which is the basis of the second problem does exist, the Board believes that this type of advance refunding is extremely rare, and cannot be viewed as sufficient justification for automatically deeming these issues ineligible for depository services.[4]

The Board strongly urges DTC to reconsider its current policy of automatically making all multi-"purpose" municipal issues ineligible for deposit in its facilities, and to revise such policy to permit such issues to be made eligible.

Sincerely,
[s] Arthur T. Cooke, Jr.
Chairman
Municipal Securities Rulemaking Board

December 8, 1983

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

Dear Art:

This responds to your letter of November 7 on the multi-purpose bond problem. DTC is in total agreement with the Board's view that multi-purpose (or multi-series) securities which are distinct only as to purpose (or series) and are otherwise identical in all material respects, including the issue's security and source of payment, should be regarded properly as fully fungible until the occurrence of any advance refunding which differentiates among the different purposes (or series).

While the Board and DTC agree, however, we understand that issuers and their agents often treat such issues as if they are not fully-fungible. Non-fungible examples reported to us are: issuance of a separate series of certificates for each purpose (frequently with duplicate numeric certificate serial numbers) within a single CUSIP number; issuance of separate interest payments for each purpose within a single CUSIP number; assignment of a separate security identification number for each purpose by the transfer agent and paying agent within a single CUSIP number; and transfer agents requiring that separate instructions be submitted with the certificates for each purpose to be transferred within a single CUSIP number. It is also our understanding that trades are sometimes made in a specific purpose within a single CUSIP number because of customer insistence.

Despite such problems, we have decided to begin soon to make eligible for DTC services a pilot group of multi-purpose bonds to learn more about related processing problems and to try to develop appropriate solutions. Our inclination is to focus the pilot on fully-registered issues because of their gradually-increasing importance relative to bearer issues. It is our intention to treat the multi-purpose bonds in the pilot as fully fungible as far as our Participants are concerned; i.e., we will not honor Participant requests to withdraw specific purpose bonds within the one CUSIP number even though we might happen to have certificate inventory in those bonds.

As we proceed with our pilot program, it would be helpful for us to know more about the market: What portion of outstanding bearer bonds are multi-purpose or multi-series? What portion of the new issues of fully registered bonds are multi-purpose or multi-series? What percentage of bonds are advance refunded and what percentage of those refundings are partial by purpose, series or certificate numbers? Such information, or even educated estimates, would help us to anticipate the order of magnitude of exception processing costs which we might incur.

As you are aware, the multi-purpose bond problem is one of long standing. Making or not making these bonds eligible for DTC services would not solve the fundamental problem that some segments of the industry treat them as fully fungible while others do not. Consequently the Board may wish to address this problem by considering the following actions:

1) Put teeth in the Board's strong view the multi-purpose bonds are fully fungible by adopting an interpretation to the effect that the seller of bonds by a specific purpose within one CUSIP number, having a duty to deliver those bonds promptly, violates that duty if it knows that it cannot obtain such bonds for delivery and fails to disclose that fact to the purchaser. Under such an interpretation,if a Participant has deposited multi-purpose bonds in DTC and is on notice of our policy not to honor withdrawal requests by specific purpose, it may constitute a violation of MSRB rules for that Participant to sell bonds by specific purpose without disclosing its inability to deliver them promptly.
2) Petition the CUSIP Agency to make the corrections the Board indicates would have to be made to the one CUSIP number assigned to multi-purpose bonds (or any other bonds) when a partial advance refunding occurs by purpose (or by series or certificate number).

[4]The Board notes also that it is equally possible that an issue of securities may be advance refunded by designating certain specific certificate numbers, with securities of a certain range of certificate numbers prerefunded to one call date and price, and securities of a different range of certificate numbers prerefunded to a different call date and price. Since DTC has not chosen to exclude issues because of the possibility of advance refundings by certificate numbers, it seems inconsistent to exclude multi-"purpose" issues because of the equally rare occurrence of advance refundings by "purpose."

We believe a new CUSIP number should be assigned to each of the portion of the issues advance refunded and the portion not advance refunded, with the old CUSIP number and the two new ones cross-referenced in the CUSIP Directory. Also, banknote companies and transfer agents, depending on the circumstances, could be asked or required to imprint the new CUSIP numbers on blank certificates in their possession.

3) Determine to endorse action by DTC requesting the Securities and Exchange Commission to adopt rules prohibiting registered transfer agents from issuing multiple interest payments within the one CUSIP number and rejecting transfer instructions solely for the reason of their not being submitted by purpose (or series) within the one CUSIP number. Non-SEC registered transfer agents could be asked to comply voluntarily with such prohibition.
4) Take part in or express interest in monitoring industry efforts to resolve the problem at its source. The Board may wish to have a staff member join the Task Force organized by the Financial Industry Securities Council specifically to address the problem of multi-purpose bonds. DTC's representative on the Task Force is James Reilly, Vice President.

We appreciate the spirit which led to your letter and hope that by working together, the Board, DTC and others can develop cost-effective solutions to this long-standing problem. Our approach to it and others is not to accept and absorb unnecessary and expensive processing problems while suffering in silence, but to highlight them, as we have in this case, and work with like-minded groups to moderate or eliminate them.

Sincerely,
[s] William T. Dentzer, Jr.
Chairman of the Board
The Depository Trust Company

March 5, 1984

Mr. William T. Dentzer, Jr.
Chairman and Chief Executive Officer
The Depository Trust Company
7 Hanover Square
New York, New York 10004

Dear Bill:

I am writing on behalf of the Municipal Securities Rulemaking Board to acknowledge with thanks receipt of your letter of December 8, 1983 responding to our previous letter concerning the eligibility for depository services of multi-"purpose" general obligation municipal securities. The Board was pleased to note DTC's clear commitment to the development of a solution to the problems in the clearance of multi-"purpose" issues through depository facilities. We view with interest DTC's "pilot" program for the inclusion of certain of such issues in the depository, and hope that the program succeeds in demonstrating the manner in which such issues can be made eligible for DTC's depository processing.

In your letter you inquire concerning the application of a previous Board interpretation requiring prompt deliveries of securities to customers to certain types of transactions in multi-"purpose" securities. You indicate that, consistent with the Board's view, DTC's present policies treat all securities of a given issue as fully fungible, regardless of any "purpose" distinctions; therefore, a participant's request for withdrawal of securities of a specified "purpose" would not be honored, and the participant might be delivered securities of any one of the several "purposes" held in the depository's vaults. You inquire whether in light of this policy, a DTC-participant dealer would violate the requirement for prompt delivery of securities to a customer if it sold securities of a specific "purpose" to the customer, knowing that it would be unable to obtain securities of that "purpose" to deliver to the customer since it would be unable to withdraw securities of that specific "purpose" from positions held in the depository.

As you are aware, the Board has previously stated that a dealer selling securities to a customer is obligated under the Board's "fair dealing" rule to make prompt delivery of such securities to the customer; if the dealer is unable to do so and fails to disclose that fact to the customer, the dealer may be acting in violation of the provisions of rule G-17. The Board is of the view that a dealer selling to a customer securities of a specified "purpose" when it knows that it may be unable to deliver such securities promptly to the customer (whether due to DTC's policy or otherwise) may be acting in violation of the "fair dealing" provisions of rule G-17.

You also suggest that the Board communicate to the CUSIP Agency its view concerning the need for correction of existing CUSIP numbers when, as the result of an advance refunding or for some other reason, such numbers no longer uniquely identify a single fungible issue of municipal securities but rather designate two or more no longer fungible issues. The Board has previously expressed this view to the CUSIP Service Bureau, and plans to send a letter to the CUSIP Agency's Board of Trustees in the near future to reiterate its strong opinion on this subject.

The Board also shares your view on the desirability of a change in the practices of transfer agents with respect to the treatment of multi-"purpose" securities. We believe that an effort, which we understand is under consideration by the Financial Industry Securities Council, to eliminate legal impediments to the issuance of "general purpose" securities is the most appropriate way in which to deal with this problem, and intend, should such an effort be undertaken, to make clear our support for it.

Sincerely,
[s] Arthur T. Cooke, Jr.
Chairman
Municipal Securities Rulemaking Board

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CUSIP Numbering System

Board Letters to CUSIP

March 14, 1984

Mr. Walter N. Cushman
Chairman
CUSIP Board of Trustees
% Bank of New York
48 Wall Street
New York, New York 10015

Dear Mr. Cushman:

I am writing on behalf of the Municipal Securities Rulemaking Board to request that the CUSIP Agency take action on two matters of great concern to the municipal securities industry involving the use of the CUSIP numbering system on transactions in municipal securities. The two areas of concern are (1) the correction of previously assigned CUSIP numbers which no longer uniquely identify a single fungible issue of municipal securities, whether as a result of an advance refunding by issue "purpose" or otherwise, and (2) the development of a means of modifying an existing CUSIP number when part of the issue designated by such number is the subject of a secondary market credit enhancement or other similar device. Both of these concerns cause or may cause difficulties for persons active in the municipal securities markets in using the CUSIP numbering system to accurately identify the issues which are the subject of transactions. The Board believes that timely action to correct or modify the system to resolve these problems is essential.

The first of these difficulties arises in situations where distinctions between parts of an issue of securities which were correctly deemed at the time of issuance to be immaterial to the CUSIP assignment process subsequently, as a result of an advance refunding of the issue, become the sole means of distinguishing among the different refunded securities. The most common example of this occurrence is the case of general obligation securities of different "purposes"[1] which have subsequently been advance refunded by "purpose" with securities of different "purposes" refunded to different redemption dates and prices.[2] Other issues of securities have subsequently been advance refunded by certificate number, with securities of certain designated certificate numbers refunded to one redemption date and price, and securities of other designated certificate numbers refunded to a different redemption date and price.[3] In each of these cases, the originally assigned CUSIP numbers, which did not distinguish between securities of different "purposes" or different certificate numbers, no longer uniquely identify a single, fully fungible issue of securities, since the securities refunded to different dates and prices are no longer fungible. Some procedure must be established to ensure that new numbers are assigned in such an eventuality which correctly distinguish among the now non-fungible parts of the previous issue.

The second concern relates to various devices which have recently been developed to assist in the marketing of outstanding secondary market securities. Several of the entities offering insurance for new issues of municipal securities have recently announced that they will insure whole issues or whole maturities of eligible municipal securities being offered in the secondary market; the Board expects that such insurance will shortly be made available for parts of a single maturity of an outstanding municipal security. Additionally, other organizations have developed programs for selling municipal securities in the secondary market with a put option attached (substantially shortening the maturity), or with an irrevocable bank letter of credit in favor of the bondholder provided; the Board believes that it is likely that these devices also will be used with respect to parts of a single maturity of an issue. Since all of these devices of which the Board is aware are fully transferrable (*i.e.*, securities with insurance, a put option or a letter of credit can be sold to a new owner with the attached device remaining valid), the Board anticipates that such instruments will be traded in the municipal secondary market. Therefore, in the event that these devices come into use for parts of a single maturity of

[1]The Board uses the term "purpose" to refer only to the designation on an issue (or a portion of an issue) of the project, facility or other undertaking to which the proceeds received from the issuer's sale of the issue are to be applied. The term does not refer to any designation which reflects a distinction in the security or source(s) of payment for the issue.

[2]*E.g.*, an issue of Washington Suburban Sanitary District, Md., securities, paying interest at 5.80% and with a stated maturity of May 1, 1988, was advance refunded by "purpose," with the General Construction bonds prerefunded to a call date of May 1, 1982 at a price of 104 and the Water bonds escrowed to the May 1, 1988 maturity at par. These securities were correctly assigned a single CUSIP number at issuance (CUSIP no. 940152C33); to the Board's knowledge, this number was never altered as a result of the advance refunding.

[3]*E.g.*, an issue of Owensboro, Ky., Electric Light and Power Revenue securities, paying interest at 7.10% and with a stated maturity of January 1, 2001 (CUSIP no. 691021CQ0), was advance refunded by certificate number, with securities of various designated certificate numbers refunded (at the same redemption price) to redemption dates ranging from January 1, 1982 to January 1, 1995.

securities[4] it seems likely that the situation would develop that several securities will be traded in the market, all having the same description and the same CUSIP number, which will not be fungible, since one may be insured, one may have a put option attached, and one may be the original issue with no credit enhancement or other similar device provided.

The Board believes that it will be necessary to make provision in the CUSIP system for the trading of these types of instruments. Any procedure for the reassignment of numbers on outstanding issues developed with respect to the advance refundings by "purpose" or certificate number discussed above might also be appropriate for the reassignment of numbers on securities for which an insurance policy has been purchased or a bank letter of credit obtained. In the case of a security sold with a put option attached, an alternative solution may be needed, since the option will expire well before the maturity date of the security; the CUSIP Agency's recent consideration of the means of using the CUSIP system on options on corporate securities may suggest an appropriate alternative course of action on these instruments. The Board would appreciate the CUSIP Agency's consideration of this problem and development of a proposed solution to it.

As you are aware, certain changes to Board rules which will mandate substantially increased use of automated confirmation and clearance systems on municipal securities transactions are scheduled to become effective over the course of the next year. Since such systems rely heavily on the use of the CUSIP numbering system as the primary means of securities identification, the Board believes that it is essential that these two problems be resolved prior to the effectiveness of these rule changes.[5] The Board asks that the CUSIP Agency take expeditious action to address these concerns.

Should you wish to discuss these matters further, please do not hesitate to contact me or Donald F. Donahue of the Board's staff.

Sincerely,
[s] Arthur T. Cooke, Jr.
Chairman
Municipal Securities Rulemaking Board

March 6, 1984

Mr. Joseph Siegel
Vice President
CUSIP Service Bureau
25 Broadway
New York, New York 10004

Dear Joe:

I am writing in response to your letter of December 21, 1983 concerning an inquiry you have received regarding the assignment of CUSIP numbers to certain general obligation securities issued by cities, towns and districts located in Massachusetts. In your letter you noted that the Massachusetts Municipal Finance law[1] permits cities, towns, and districts to issue securities for certain "purposes" outside the otherwise-applicable debt limit.[2] You indicated that the CUSIP Service Bureau has received a suggestion that CUSIP numbers be assigned in a manner which distinguishes between securities issued within the debt limit. In order to facilitate the CUSIP Agency's consideration of this suggestion, you inquired whether two otherwise-identical securities, one issued within and the other outside the debt limit, would be considered to be fungible for purposes of the requirements of Board rules.

The Board has reviewed the relevant provisions of the Massachusetts Municipal Finance law, and, in addition, has discussed your inquiry with Massachusetts public finance professionals and certain bond counsel. Based on these actions the Board has concluded that the distinction between issuance within and issuance outside the debt limit is not, in itself, sufficient to render two otherwise-identical Massachusetts general obligation securities non-fungible. The Board would consider two Massachusetts general obligation securities which are distinct only in this respect to be fungible for purposes of its rules, and would disagree strongly with any decision to assign separate CUSIP numbers based solely on this distinction.

In its review of the Massachusetts Municipal Finance law, however, the Board noted that certain of the securities issued outside the debt limit are secured by payments to be received from a county or state authority, in addition to the full faith and credit of the issuing entity;[3] others are secured simply by the full faith and credit of the issuer. As the Board has previously stated,[4] any distinction in the security or source(s) of payment for an issue is a material element which should be observed in the assignment of CUSIP numbers to such issue.[5] Consequently, two otherwise-identical Massachusetts general obligation securities, one of which is secured solely by the full faith and credit of the issuer and the other secured both by the full faith and credit of the issuer and (pursuant to §6A of the Municipal Finance law) by a specific source of payment, should be assigned separate CUSIP numbers.

With best regards,

Sincerely,
[s] Donald F. Donahue
Deputy Executive Director
Municipal Securities Rulemaking Board

[4]The Board does not believe that the same problem would arise in the case where the device applies to the whole issue or a whole maturity, since all of the securities designated by the previously assigned CUSIP numbers will be subject to the credit enhancement or other similar device and, hence, remain fungible.

[5]The first of these rule changes is scheduled to become effective on August 1, 1984.

[1]MASS. ANN. LAWS, ch. 44 (Michie/Law. Co-op).

[2]The debt limit is specified in §10 of the Massachusetts Municipal Finance law; §§6A and 8 list those purposes for which debt may be incurred outside the statutory debt limit.

[3]MASS. ANN. LAWS, ch. 44, §6A.

[4]*See, e.g.*, December 14, 1981 letter from Jean J. Rousseau, Chairman, M.S.R.B., to the CUSIP Service Bureau.

[5]As you know, the CUSIP Service Bureau subsequently agreed with this view and began assigning numbers in this fashion as of February 1, 1982.

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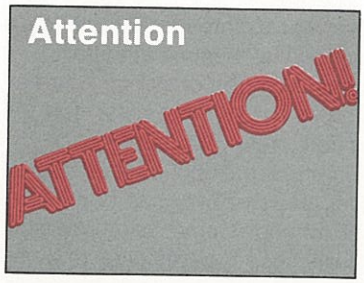

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Letter of Interpretation

G-15—Callable Securities: Pricing to Call and Extraordinary Mandatory Redemption Features

This is in response to your November 16, 1983, letter concerning the application of the Board's rules to sales of municipal securities that are subject to extraordinary redemption features.

As a general matter, rule G-17 of the Board's rules of fair practice requires municipal securities brokers and dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require, in connection with the purchase from or sale of a municipal security to a customer, that a dealer must disclose, at or before the time the transaction occurs, all material facts concerning the transaction and not omit any material facts which would render other statements misleading. The fact that a security may be redeemed "in whole," "in part," or in extraordinary circumstances prior to maturity is essential to a customer's investment decision about the security and is one of the facts a dealer must disclose prior to the transaction. It should be noted that the Board has determined that certain items of information must, because of their materiality, be disclosed on confirmations of transactions. However, a confirmation is not received by a customer until after a transaction is effected and is not meant to take the place of oral disclosure prior to the time the trade occurs.

You ask whether, for an issue which has more than one call feature, the disclosure requirements of MSRB rule G-15 would be better served by merely stating on the confirmation that the bonds are callable, instead of disclosing the terms of one call feature and not another. Board rule G-15, among other things, prescribes what items of information must be disclosed on confirmations of transactions with customers.[1] Rule G-15(a)(i)(E) requires that customer confirmations contain a materially complete description of the securities and specifically identifies the fact that securities are subject to redemption prior to maturity as one item that must be specified. The Board is of the view that the fact that a security may be subject to an "in whole" or "in part" call is a material fact for an individual making an investment decision about the securities and has further required in rule G-15(a)(iii)(D) that confirmations of transactions in callable securities must state that the resulting yield may be affected by the exercise of a call provision, and that information relating to call provisions is available upon request.[2]

With respect to the computation of yields and dollar prices, rule G-15(a)(i)(I) requires that the yield and dollar price for the transaction be disclosed as the price (if the transaction is done on a yield basis) or yield (if the transaction is done on the basis of a dollar price) calculated to the lowest price or yield to call, to par option, or to maturity. The provision also requires, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in whole" calls should be used.[3] This requirement reflects the longstanding practice of the municipal securities industry and advises a purchaser what amount of return he can expect to realize from the investment and the terms under which such return would be realized.

You also ask whether it is reasonable to infer from the disclosure of one call feature that no other call features exist. As discussed above, the Board requires a customer confirmation to disclose, when applicable, that a security is subject to redemption prior to maturity and that the call feature may affect the security's yield. This requirement applies to securities subject to either "in whole" or "in part" calls. Moreover, as noted earlier, because information concerning call features is material information, principles of fair dealing embodied by rule G-17 require that these details be disclosed orally at the time of trade.

[1]Similar requirements are specified in rule G-12 for confirmations of inter-dealer transactions.

[2]The rule states that this requirement will be satisfied by placing in footnote or otherwise the statement: "call features may exist which could affect yield; complete information will be provided upon request."

[3]A copy of the Board's December 10, 1980 notice on this issue is attached for your convenience. [Ed. Note: *MSRB Manual* (CCH) ¶3571 at 3567–4.]

By contrast, identification of the first "in-whole" call date and its price must be made only when they are used to compute the yield or resulting dollar price for a transaction. This disclosure is designed only to advise an investor what information was used in computing the lowest of yield or price to call, to par option, or to maturity and is not meant to describe the only call features of the municipal security.

In addition, in the case of the sale of new issue securities during the underwriting period, Board rule G-32 requires that at or prior to sending the final confirmation of the transaction a copy of the final official statement, if any, must be provided to the customer.[4] While the official statement would describe all call features of an issue, it must be emphasized that delivery of this document does not relieve a dealer of its obligation to advise a customer of material characteristics and facts concerning the security at the time of trade.

Finally, you ask whether the omission of this or other call features on the confirmation is a material omission of the kind which would be actionable under SEC Rule 10b-5. The Board is not empowered to interpret the Securities Exchange Act or rules thereunder; that responsibility has been delegated to the Securities and Exchange Commission. We note, however, that the failure to disclose the existence of a call feature would violate rule G-15 and, in egregious situations, also may violate rule G-17, the Board's fair dealing rule.—*MSRB interpretation of February 10, 1984, by Angela Desmond, General Counsel.*

[4]The term "underwriting period" is defined in rule G-11 as:
the period commencing with the first submission to a syndicate of an order for the purchase of new issue municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending at such time as the issuer delivers the securities to the syndicate or the syndicate no longer retains an unsold balance of securities, whichever last occurs.