MSRB REPORTS

Volume 10, Number 4 | Municipal Securities Rulemaking Board | October 1990

# In This Issue



## Beason and Brown Elected to Vacated Board Seats

The Board has elected Amos T. Beason and Robert C. Brown to fill the seats on the Board vacated by S. Ashton Stuckey and Donald J. Stuhldreher, respectively. The terms of Mssrs. Beason and Brown will expire on September 30, 1991.

Mr. Beason is Executive Vice President and Chief Investment Officer of First Commerce Corp. in New Orleans, which he joined in 1988. Prior to that, he was involved in Public Finance at Printon, Kane & Co. for three and a half years, and at First Boston Corp. for two years. Before that he was with Morgan Bank for 21 years, where he worked in all aspects of municipal finance. Mr. Beason was a founding director and President of the DBA and was a board member of the Citizens Budget Commission of New York City from 1979 to 1988, where he served as Chairman of its Economic Development Committee. He earned a B.A. in History from Vanderbilt University in 1961.

Since 1984, Mr. Brown has been Executive Vice President of Norwest Corp., President of Norwest Capital Markets, and Chairman of Norwest Investment Services, Inc. in Minneapolis. He has been at Norwest since 1981, where he has been Manager of the Bond Department, the Funds Management Group, Consumer Banking, Capital Management and Trust Groups. Priot to that, he was President of BancNorthwest, Chicago, which is now part of Norwest. Previously, he was in charge of the Municipal Bond Division of First National Bank of Chicago. Mr. Brown has served as Chairman of the PSA, President of the DBA, and Chairman of the MSRB. He received a M.B.A. in Finance *cum laude* from the University of Chicago in 1959 and an A.B. in History *cum laude* from the University of Illinois in 1953.

# Board Elects Hartley Chairman; Putman Vice Chairman

The Board has elected its Chairman and Vice Chairman for its 1991 fiscal year. Mr. David E. Hartley will serve as Chairman and Mr. R. Fenn Putman as Vice Chairman. They began their terms on October 1, 1990.

Mr. Hartley is Managing Partner at Stone & Youngberg in San Francisco. He has been with the firm for 38 years. Mr. Hartley has been active in numerous trade associations. In particular, he has served a leadership role in both the California and national Public Securities Associations. He has also been the Chairman of the Technical Advisory Committee of the California Debt Advisory Commission. He received a B.S. in Finance from the University of Washington.

Mr. Putman is Executive Vice President and Managing Director of the Municipal Securities Division at Dean Witter Reynolds, Inc. in New York City, where he is responsible for municipal finance. Prior to joining Dean Witter in 1987, he was Managing Director at Salomon Brothers, Inc. for ten years, Vice President at Dillon Read & Co. for three years, and Senior Vice President at W.H. Morton & Co. for ten years. Mr. Putman is President of the Municipal Forum of New York and a member of the Executive Committee of the Public Securities Association and the Municipal Analysts Society. He received a M.B.A. at the University of Missouri, Kansas City and a B.A. from Northwestern University.

## Also in This Issue



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# From the Chairman

I have always believed that it has been our responsibility as municipal securities dealers to *facilitate* the matching of issuers' needs for funds with the objectives of investors. In this role, the dealer community serves as an intermediary, seeking the best possible outcome for both parties. This role takes on greater meaning in these times of economic stress and the tremendous demand for improving this nation's infrastructure.

In the same vein, the MSRB has spent much effort in the last two years to establish the Municipal Securities Information Library™ system to facilitate the flow of information from issuers to investors. The MSIL™ system is only a *mechanism* to ensure that the market has ready access to the information necessary for making proper pricing and investment decisions. The MSIL system is only an intermediary for information flows. Just as it is the balancing of issuer and investor needs that determines the nature of the debt sold in the market, so, too, it must be the balancing of issuer abilities and investor needs that determines the information that should flow through the MSIL system.

In the coming year, the MSRB will also begin addressing the questions raised by the worldwide efforts to improve and standardize clearance and settlement procedures. Again, we hope to *facilitate* any transition to new procedures, not to impose unwarranted burdens on the industry. As is the case with disclosure issues, the process of facilitating change requires the active participation of everyone potentially affected by the change.

In closing, it is clear to me that '90s will be a period where new electronic technologies will have profound effects on the way we do business. We need to work together so that the process of adaptation produces benefits, not burdens. The MSRB welcomes the opportunity to be a partner with you in that effort.

Sincerely,

David E. Hartley
Chairman 1990-1991

## Calendar

| | | |
|---|---|---|
| **August 13** | — | Effective date of G-35 on arbitrator definitions |
| **August 30** | — | Effective date of G-36 on delivery of official statements to the Board |
| **January 10** | — | Comments due on G-23 on activities of financial advisors |
| **Pending** | — | MSIL CDI/ES system |
| | — | MSIL OS/ARD system |
| | — | G-36 on delivery of advance refunding documents to the Board |

# Board Members 1990–1991

## Bank Representatives

**Amos T. Beason**, *Executive Vice President*
*First Commerce Corp.* . . . . . New Orleans, Louisiana

**Robert C. Brown**, *Chairman*
*Norwest Investment Services, Inc.* .Minneapolis, Minnesota

**Peter T. Clarke**, *Managing Director*
*J.P. Morgan Securities, Inc.* . . . . . New York, New York

**Harry R. Larson**, *President*
*First Chicago Capital Markets, Inc.* . . . . . Chicago, Illinois

**Richard D. Thayer**, *President*
*C & S Securities* . . . . . Atlanta, Georgia

## Public Representatives

**J. Barry Cregan**, *Vice President*
*General Reinsurance Corp.* . . . . . Stamford, Connecticut

**Richard M. Evans**, *Director of Finance*
*City of Savannah* . . . . . Savannah, Georgia

**Charles W. Fish**, *Chairman*
*Fish & Lederer Investment Counsel, Inc.* Orange, California

**John M. Gunyou**, *City Finance Officer*
*City of Minneapolis* . . . . . Minneapolis, Minnesota

**Katherine C. Lyall**, *Executive Vice President*
*University of Wisconsin System* . . . . . Madison, Wisconsin

## Securities Firm Representatives

**Michael C. Delaney**, *General Partner*
*Goldman, Sachs & Co.* . . . . . New York, New York

**David E. Hartley**, *Managing Partner*
*Stone & Youngberg* . . . . . San Francisco, California

**John C. Merritt**, *Chairman & Chief Executive Officer*
*Van Kampen Merritt Inc.* . . . . . Philadelphia, Pennsylvania

**R. Fenn Putman**, *Executive Vice President & Managing Director*
*Dean Witter Reynolds, Inc.* . . . . . New York, New York

**Dean J. Torkelson**, *President*
*Seattle Northwest Securities Corp.* . . . Seattle, Washington

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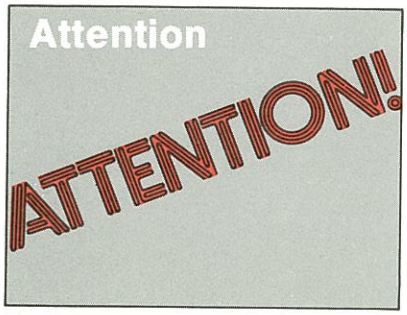


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- ☐ Other _____

# Delivery of Official Statements to the Board and the Board's Public Access Facility: Rule G-36

**Notice**

**Underwriters are required to send final official statements to the Board. In addition, the Board has opened its public access facility where interested persons may review or photocopy final official statements collected by the Board.**

On August 30, 1990, Board rule G-36 became fully effective. The rule requires underwriters to deliver final official statements to the Board for new issue municipal securities. If such municipal securities are underwritten by a syndicate, it is the responsibility of the syndicate manager to fulfil the requirements of rule G-36.

Underwriters must send to the Board by certified or registered mail, or some other equally prompt means that provides a record of sending, two completed Form G-36s and two final official statements. For issues subject to SEC rule 15c2-12, official statements must be sent within one business day of receipt from the issuer, and no later than 10 business days after the date of the final agreement to purchase, offer or sell the municipal securities. For issues not subject to SEC Rule 15c2-12, official statements must be sent within one business day of settlement or closing of the issue.[1]

Rule G-36 applies to all municipal securities issued on or after January 1, 1990. Underwriters that have not submitted Form G-36s and final official statements for such past issues should do so immediately. Dealers also should note that rule G-36 does not affect Board rule G-32 which, among other things, requires dealers to deliver official statements for new issues to customers purchasing new issue securities. Moreover, although dealers may, under certain circumstances, fulfil the requirements of rule G-32 by delivering preliminary official statements to customers purchasing new issue municipal securities if no final official statement will be prepared by or on behalf of the issuer, rule G-36 requires that underwriters deliver only *final* official statements to the Board.

In addition, on July 2, 1990, the Board opened a public access facility through which interested members of the public may review official statements collected by the Board. A photocopier also is available for visitors to copy official statements at a cost of $.20 per page. The facility is located at the Board's offices at 1818 N Street, N.W., Suite 800, Washington, D.C. 20036, and is open from 9:00 a.m. to 4:30 p.m., local time, when the Board's offices are open (generally business days other than federal holidays). Members of the public also may telephone the Board's offices at (202) 223-9347 to determine whether a particular official statement is available at the public access facility.

The Board also has filed with the Securities and Exchange Commission (Commission) its planned Municipal Securities Information Library™, or MSIL™, system.[2] Upon approval, the MSIL system will store, on optical disks, official statements and advance refunding documents provided to the Board pursuant to Board rule G-36. The electronic images will be sent to subscribers daily on a computer tape containing all documents imaged each day. The Continuing Disclosure Information/Electronic Submission (CDI/ES) part of the MSIL system will transmit, to news services and subscribers over telephone lines, notices affecting municipal securities in the secondary market that are voluntarily sent to the system by issuers or their agents. The MSIL system will also allow dealers and the public to call the Board and order paper copies of official statements printed from the electronic images. The deadline for comments to be sent to the Commission on these filings ended on September 24, 1990. [3]

**October 1, 1990**

**Questions about this notice may be directed to Thomas A. Hutton, Director of the MSIL system.**

[1] Issues for less than $1 million are not subject to SEC Rule 15c2-12. Rule G-36, however, requires underwriters to send final official statements for such issues only if a final official statement is prepared. Rule G-36 does not require underwriters to send final official statements to the Board, regardless of whether the issue is for below or above $1 million, if such issue is qualified for the exemption set forth in SEC Rule 15c2-12(c). Subsection (c) exempts from the rule issues in denominations of $100,000 or more if such securities: (1) are sold to no more than 35 financially sophisticated persons; or (2) have a maturity of nine months or less; or (3) at the option of the holder may be tendered to an issuer for redemption or purchase at least as frequently as every nine months until maturity, early redemption, or purchase by the buyer.

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

[3] *See MSRB Reports,* Vol. 10, No. 3 (July 1990) at 3-24.

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# Activities of Financial Advisors: Rule G-23

## Comments Requested

**The Board requests comments on draft amendments which would:**

- **treat placement agents the same as negotiated underwriters; and**
- **require disclosure by an underwriter to the issuer of its corporate affiliation with a non-dealer financial advisor.**

The Board requests comments on draft amendments to rule G-23, on the activities of financial advisors. The draft amendments would expand the situations in which the requirements of the rule would apply. The draft amendments would (i) treat placement agents the same as negotiated underwriters, and (ii) require disclosure by an underwriter to the issuer of its corporate affiliation with a non-dealer financial advisor. All interested parties are invited to submit comments on the draft amendments by January 10, 1991.

### Requirements of Rule G-23

Rule G-23 establishes disclosure and other requirements for dealers that act as financial advisors to issuers of municipal securities.[1] The rule is designed principally to minimize the *prima facie* conflict of interest that exists when a municipal securities dealer acts as both financial advisor and underwriter with respect to the same issue.

Among other things, rule G-23 prohibits a dealer acting as financial advisor from acquiring an issue as principal, either alone or in a syndicate, or arranging for such acquisition by a person controlling, controlled by, or under common control with such dealer, unless certain requirements are met. If the issue is to be sold on a negotiated basis, rule G-23(d)(i) requires the dealer (i) to terminate the financial advisory relationship with regard to the issue; (ii) at or before such termination, to disclose in writing to the issuer that there may be a conflict of interest in changing from the capacity of financial advisor to that of purchaser of the securities and the source and anticipated amount of all remuneration to the dealer with respect to the issue; (iii) at or after such termination, to obtain the express written consent of the issuer to the acquisition or participation in the purchase; and (iv) to obtain from the issuer a written acknowledgment of the receipt of these disclosures. With respect to issues sold by competitive bids, rule G-23(d)(ii) provides that a financial advisor must obtain the issuer's written consent prior to making a bid for the issue.

Rule G-23(e) requires an underwriter subject to section (d) to disclose its financial advisory relationship in writing to customers who purchase such securities from the dealer at or before completion of the transaction with the customer.[2]

### Summary of Draft Amendments and Request for Comments

**Financial Advisor and Placement Agent.**

Currently, rule G-23(d) does not apply to a dealer that acts as both financial advisor and placement agent for a new negotiated issue.[3] The draft amendments would require a dealer acting as financial advisor and placement agent to meet the same requirements, set forth in rule G-23(d), as a dealer acting as financial advisor and negotiating the underwriting. A dealer

**Comments on the draft amendments should be submitted no later than January 10, 1991, and may be directed to Ronald W. Smith, Legal Assistant. Written comments will be available for public inspection.**

[1] Rule G-23 does not apply to "independent" financial advisors, *i.e.*, those advisors that are not associated with a broker, dealer or municipal securities dealer. The rule also does not apply when, in the course of acting as an underwriter, a municipal securities dealer renders financial advice to an issuer, including advice with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.

[2] Rule G-23(c) also requires that all financial advisory agreements be in writing and specify the basis for compensation.

[3] As noted above, however, if the dealer places the bonds with a person controlling, controlled by, or under common control with the dealer, rule G-23(d) would apply.

acting as placement agent performs many of the same functions as an underwriter. In both instances, the dealer negotiates the best available rate for the issuer. The Board believes that the disclosure and other requirements of rule G-23(d) should apply to minimize the potential conflict of interest that exists when a dealer acts as both financial advisor and placement agent with respect to the same issue. The draft amendments also would make the customer disclosure provisions of rule G-23(e) applicable to these situations. The Board requests comment on the draft amendments and whether the rule should treat placement agents and negotiated underwriters identically.

**Affiliates or Subsidiaries of Dealer.**

The Board has been asked whether rule G-23 applies in two situations: (i) when a non-dealer bank acts as financial advisor and a broker-dealer affiliate of the bank wishes to underwrite the issue, or (ii) when a non-dealer subsidiary of a dealer bank acts as a financial advisor and the dealer bank wishes to underwrite the issue. Rule G-23(d) applies only when the financial advisor and underwriter for the issue are the same dealer or are two dealers subject to a control relationship.[4] Since the bank and the non-dealer affiliate are not dealers in these instances, they are not subject to this rule. The Board, however, has stated that disclosure by the dealer to the issuer of its affiliation with the financial advisor would be advisable in these circumstances.[5]

The Board seeks comment on draft amendments to rule G-23 that would require disclosure by an underwriter or placement agent of any corporate affiliation with the issue's non-dealer financial advisor. While the Board does not believe that it is necessary for the underwriter or placement agent to comply with all of the requirements of rule G-23(d) in this instance, it does believe that the issuer should be aware of any corporate affiliation between the financial advisor and the dealer, even if the financial advisor is not a dealer. The Board also requests comment whether rule G-23(e) should apply to require disclosure to customers of an underwriter's or placement agent's corporate affiliation with the financial advisor.

In addition to comments on the draft amendments, the Board welcomes all comments on the current provisions of rule G-23.

## Text of Draft Amendments*

**Rule G-23 Activities of Financial Advisors**

(a) through (c) no change.

(d) *Underwriting Activities*. No broker, dealer, or municipal securities dealer that has a financial advisory relationship with respect to a new issue of municipal securities shall acquire as principal either alone or as a participant in a syndicate or other similar account formed for the purpose of purchasing, directly or indirectly, from the issuer all or any portion of such issue, or act as agent for the issuer in arranging the placement of such issue ~~arrange for such acquisition or participation by a person controlling, controlled by, or under common control with such broker, dealer, or municipal securities dealer~~, unless

(i) if such issue is to be sold by the issuer on a negotiated basis,

(A) the financial advisory relationship with respect to such issue has been terminated in writing and at or after such termination the issuer has expressly consented in writing to such acquisition or participation in the purchase of the securities on a negotiated basis;

(B) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination that there may be a conflict of interest in changing from the capacity of financial advisor to purchaser of the securities with respect to which the financial advisory relationship exists and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; and

(C) the broker, dealer, or municipal securities dealer has expressly disclosed in writing to the issuer at or before such termination the source and anticipated amount of all remuneration to the broker, dealer, or municipal securities dealer with respect to such issue in addition to the compensation referred to in section (c) of this rule, and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure; or

(ii) if such issue is to be sold by the issuer at competitive bid, the issuer has expressly consented in writing prior to the bid to such acquisition or participation.

The limitations and requirements set forth in this section (d) shall also apply to any broker, dealer, or municipal securities dealer controlling, controlled by, or under common control with the broker, dealer, or municipal securities dealer having a financial advisory relationship. The use of the term "indirectly" in this section (d) shall not preclude a broker, dealer, or municipal securities dealer who has a financial advisory relationship with respect to a new issue of municipal securities from purchasing such securities from an underwriter, either for its own trading account or for the account of customers, except to the extent that such purchase is made to contravene the purpose and intent of this rule. ~~Each broker, dealer, and municipal~~

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[4] *See*, "Questions and Answers on Activities of Financial Advisors: Rule G-23," *MSRB Reports*, Vol. 9, No. 1 (March 1989), at 21-23.

[5] The Office of the Comptroller of the Currency has required certain subsidiaries of national banks that are not broker-dealers but engage in financial advisory activities to comply with the requirements of rule G-23 before the bank dealer may act as underwriter on the issue because of the potential conflict of interest.

* Underlining indicates new language; strike-through indicates deletions.

~~securities dealer subject to the provisions this section (d) shall maintain a copy of the written disclosures, acknowledgments and consents required by this section in a separate file and in accordance with the provisions of rule G-9.~~

(e) *Disclosure to Issuer of Corporate Affiliation*. If the financial advisor for the issue is not a broker, dealer or municipal securities dealer, and the broker, dealer or municipal securities dealer that acquires the issue or arranges for such acquisition is controlling, controlled by, or under common control with such financial advisor, the broker, dealer or municipal securities dealer must disclose this affiliation in writing to the issuer prior to the acquisition and the issuer has expressly acknowledged in writing to the broker, dealer, or municipal securities dealer receipt of such disclosure.

(f) Each broker, dealer, and municipal securities dealer subject to the provisions of sections (d) or (e) shall maintain a copy of the written disclosures, acknowledgments and consents required by these sections in a separate file and in accordance with the provisions of rule G-9.

(e) through (f) renumbered (g) through (h).

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**Notice of Approval**


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# Definitions of Industry and Public Arbitrators: Rule G-35

**Amendments Approved**

**The amendments define industry and public arbitrators.**

On August 13, 1990, the Securities and Exchange Commission (Commission) approved amendments to rule G-35, the Board's Arbitration Code.[1] The amendments pertain to the Board's definitions of public and industry arbitrators and related challenges for cause. The amendents became effective upon approval.

Pursuant to requests from the Commission, the Board revised the definitions of public and industry arbitrators to be consistent with the definitions used by other self-regulatory organizations. These definitions prohibit the use of retired industry persons and certain attorneys, accountants and other professionals as public arbitrators. Also, the amendments delete the provision granting customers a challenge for cause to the use of such persons as public arbitrators and the provision allowing the use of current public arbitrators, who will no longer come within the new public arbitrator definition, until September 1, 1991.

**August 13, 1990**

## Text of Amendments*

**Rule G-35. Arbitration**

Sections 1 through 7. No change.

Section 8. *Composition and Appointment of Panels*

(a) and (b) No change.

(c) Objections

~~(i)~~ No change.

~~(ii) Each party who is a person other than a broker, dealer, municipal securities dealer, government securities broker or government securities dealer, shall be granted a challenge for cause to a public arbitrator, as defined in Section 12(c), who: (i) has been retired from a broker, dealer, municipal securities dealer, government securities broker or government securities dealer for over three years, or (ii) is an attorney, accountant or other professional who devoted 30 percent or more of his professional work effort within the last two years to clients who are brokers, dealers or municipal securities dealers.~~

~~(iii) Until September 10, 1991, each party who is a person other than a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer, shall be granted a challenge for cause to a public arbitrator who served as a public arbitrator prior to [date of approval of SR-MSRB-88-5] but would not be able to serve as a public arbitrator pursuant to the definitions of industry and public arbitrators in Section 12(c). After September 10, 1991, these arbitrators will be reclassified as industry arbitrators.~~

Sections 9 through 11. No change.

Section 12. *Designation of Number of Arbitrators and Definitions of Industry and Public Arbitrators*

(a) and (b) No change.

(c) *Definitions of Industry and Public Arbitrators*

(1) An industry arbitrator:

(i) is a person associated with a broker, dealer, municipal securities dealer, government securities broker or government securities dealer, or

(ii) is a person who has been associated with a broker, dealer, municipal securities dealer, government securities broker or government securities dealer within the past three years, or

~~(iii) is an attorney or other professional who devoted 20 percent of more of his professional work effort within the last two years in either or both of the following areas: (A) as counsel to a broker, dealer or municipal securities dealer acting as the underwriter~~

**Questions about the amendments may be directed to James McCabe, Director of Arbitration.**

[1] SEC Release No. 34-28336.

* Underlining indicates additions; strikethrough indicates deletions.

~~of an issue of municipal securities, or (B) as counsel to or expert witness for a broker, dealer, municipal securities dealer, government securities broker or government securities dealer in securities-related litigation or arbitration proceedings against a person other than a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer.~~

(iii) is a person who is retired from a broker, dealer, municipal securities dealer, government securities broker or government securities dealer, or

(iv) is an attorney, accountant, or other professional who has devoted 20 percent or more of his or her professional work effort to a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer within the last two years.

(2) A public arbitrator is a person other than an industry arbitrator.

(3) A person will not be classified as a public arbitrator if he or she has a spouse or other member of the household who is a person associated with a broker, dealer, municipal securities dealer, government securities broker, or government securities dealer.

Sections 13 through 36. No change.

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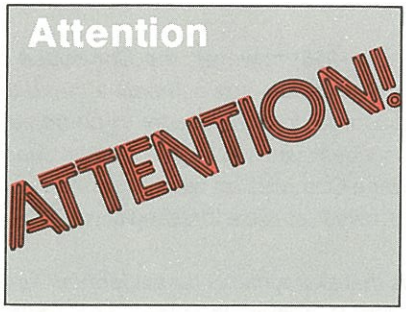


**Route to:**

- [X] Manager, Muni Dept.
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# Group of Thirty U.S. Working Committee Status Report & Request for Comment

**The following is a reprint of the Group of Thirty's U.S. Working Committee's status report and request for comments on achieving settlement on the third day after a trade is executed and requiring that payments for settlement, and issuer payments, be made in same-day funds.**

August 1990

## 1 STATEMENT OF PURPOSE

This report was commissioned by the U.S. Steering Committee, Group of Thirty Clearance and Settlement Project. It is intended to provide the reader with an overview of the current thinking of the U.S. Working Committee in regard to implementing in the United States two of the Group of Thirty's nine recommendations in the area of clearance and settlement of securities transactions. The Working Committee has examined the practicality of achieving settlement for corporate and municipal securities on the third day after a trade is executed (T+3) as well as the implications of requiring that payments for settlement, and issuer payments, be made in same-day funds (SDF). This report also provides the reader with insight into the deliberations of the two operational Subcommittees which have been examining each area and identifies issues that need further consideration.

The U.S. Working Committee hopes that the outcome of reading this report will be that your organization will participate by providing comments to the Committee in its effort to gather data from as broad a spectrum of the industry as possible on the effects of these changes. In addition to this report, the U.S. Working Committee has prepared a detailed questionnaire to be distributed to a broad base of broker/dealers, banks and other affected parties. "**THE NEXT STEP**" section at the end of this report tells you how to receive the extensive questionnaire. We hope you will take the time to help in this important effort.

## 2 EXECUTIVE SUMMARY

The U.S. Working Committee, together with a Subcommittee devoted to the review of T+3 and a Subcommittee dealing with same-day funds settlement, have developed an interim vision of what is both desirable and practical in terms of reducing risk and cost in clearance and settlement. The Committee looked at ways to reduce risk while recognizing the competitive challenge posed by other countries' efforts to implement the G30 recommendations. The Committee was also sensitive to what could be realistically achieved given the impact of the recommendations on various segments of the U.S. financial industry.

*On the G30 T+3 recommendation, the Committee has determined, subject to validation by data to be obtained from the industry, that T+3 settlement should be mandated for corporate equities, debt and municipal securities for implementation in 1992.* This recommendation would apply to transactions among financial intermediaries, as well as those between financial intermediaries and their institutional and retail customers. Just as most institutional assets are held at national depositories, the current trend among retail investors is to leave securities with financial intermediaries, the majority of which are in turn held in depositories. The Committee therefore believes that T+3 settlement can be achieved in 1992 and offers the potential for significant cost savings for the industry.

*The Committee recommends that by 1992 all settlements among financial intermediaries, and between financial intermediaries and their institutional customers, be accomplished only on a book-entry basis.* The statistical data available to the Committee shows this to be an achievable goal. *The Committee further recommends, given current retail trends, that settlements between financial*

*intermediaries and their retail customers should be on a book-entry-only (BEO) basis by 1995; however, the Committee also recognizes that practical alternatives to the use of physical certificates, such as a direct registration-type alternative, need to be developed.* This latter recommendation would accelerate an existing trend and provide a target for the industry to complete the immobilization process. *In addition, by the end of 1992, all new corporate or municipal securities issues brought to market must be eligible for depository processing.* The Committee believes that the Securities and Exchange Commission would be supportive of efforts aimed at achieving a book-entry-only environment as long as the interests of individual investors are addressed though a direct-registration-type approach.

*With respect to the G30 same-day funds recommendation, the Committee recommends that all payments for settlements among financial intermediaries, and between financial intermediaries and their institutional customers, should be made using same-day funds in 1992. This recommendation would also apply to payments associated with dividends, interest, redemptions and reorganizations.* It is the Committee's belief, subject to further industry comment, that this will not pose undue problems for the intermediaries, their institutional clients, or the banking system. *However, the Committee does not recommend. at this time, the use of same-day funds for settlement payments between financial intermediaries and their retail customers.* Despite a growing trend to hold funds in money market accounts, the Committee does not believe that retail payment systems are sufficiently well developed, in terms of being "user friendly," and accessible to the broad base of retail investors so as to permit imposing a requirement that the retail investor settle in same-day funds.

The respective Subcommittees have listed several key issues for specific focus. In addition to this request for review and comment, a detailed questionnaire will be distributed to a broad base of broker/dealers, banks, and other affected parties to further quantify the impact of T+3 and same-day funds for settlement of corporate and municipal securities. The questionnaire will be used to assist in measuring the impact that adopting the T+3 and same-day funds recommendations will have on U.S. financial institutions. The results will be presented at the Securities and Exchange Commission's Roundtable discussion on this subject which is currently projected to occur in late November 1990. This report and the detailed questionnaire offer the financial services industry an opportunity to participate in this policy-making effort to position the industry for the future. The leadership and vision of industry representatives are an important element in the success of this effort.

## 3 HISTORY OF THE GROUP OF THIRTY CLEARANCE AND SETTLEMENT RECOMMENDATIONS

The Group of Thirty (G30) is an independent, non-partisan, non-profit organization established in 1978 to "deepen understanding of international economic and financial issues, to explore the international repercussions of decisions taken in public and private sectors, and to examine the choices available to policymakers."

In 1988, more than 100 international financial leaders convened at a Group of Thirty symposium in London to discuss the state of clearance and settlement practices in the world's principal markets. At that symposium, it was concluded that the world's clearance and settlement practices require significant improvement in terms of risk, efficiency and cost. Attendees at the symposium determined that while the development of a single global clearing facility was not practicable, agreement on a set of practices and standards that could be embraced by each of the many markets that make up the world's securities systems was highly desirable.

The Group of Thirty then assembled a Steering Committee composed of distinguished members from eight countries. The Steering Committee chartered a Working Committee of experts, with a similar multinational composition, to formulate a set of specific recommendations for improving global clearing and settlement practices. The United States was represented on both the International Steering and Working Committees.

In March of 1989, the Steering Committee released a report from the Working Committee which offered nine recommendations covering clearing and settlement systems in the world's corporate securities markets. The purpose of the report was to introduce standards for reducing risk and improving efficiency in these systems around the world, and included, for consideration in each country, the nine recommendations which are summarized below:

1 *All trade comparisons should be accomplished by T+1 no later than 1990.*

2 *Indirect market participants should be members of a confirmation/comparison system by 1992.*

3 *A central securities depository should be achieved in each country by 1992.*

4 *A review of a trade netting system to determine its appropriateness should be completed by 1992.*

5 *A Delivery-Versus-Payment (DVP) practice should be in place by 1992.*

6 *A Same-Day Funds (SDF) settlement convention should be adopted by 1992.*

7 *A rolling settlement system should be adopted with final settlement on T+3 by 1992.*

8 *Securities lending and borrowing should be encouraged.*

9 *Each country should adopt an international standard for securities numbering and messages by 1992.*

Following the release of the report, national efforts were initiated to study how existing home country systems compared with the recommendations. Status reports from the participating countries were collected in a single document and distributed at a meeting held in London in March 1990 which was attended by 150 individuals from 33 countries representing brokerage firms, banks, regulatory agencies and other industry organizations. At the London conference the progress of each of the National Working Committees was reviewed.

## 4 THE U.S. WORKING COMMITTEE

In the United States, a Steering and a Working Committee, structured along the lines of the original G30 effort, as well as a blue-ribbon Advisory Board, were established to study the existing systems in the United States. These committees consisted of representatives from brokers, banks, financial intermediaries and other major industry organizations. [*See MSRB Reports*, vol. 10, no. 1 (January 1990) at 23-25 for a listing of members of the committees.] The U.S. Working Committee, after reviewing the nine G30 recommendations, concluded that two of the recommendations—moving to a T+3 settlement period and adopting a same-day funds payment convention—required an in-depth study. Two operational Subcommittees, under the U.S. Working Committee, were established to focus on these areas.

What follows is a current summary of the conclusions and determinations reached by the T+3 and SDF Subcommittees. We encourage your organization's review and comments across a broad range of issues.

## 5 REPORT OF THE T+3 SUBCOMMITTEE

As stated in the original G30 report, Recommendation #7 provided that:

> "A 'Rolling Settlement' system should be adopted by all markets. Final settlement should occur on T+3 by 1992. As an interim target, final settlement should occur on T+5 by 1990 at the latest, save only where it hinders the achievement of T+3 by 1992."

### 5.1 ORIGINAL T+3 ASSUMPTIONS

To facilitate the Subcommittee review of the T+3 issue, several underlying assumptions were made:

(a) The focus should be limited to corporate and municipal securities transactions.

(b) The settlement period for institutional and retail customers should be kept the same.

(c) A book-entry-only environment should be achieved as soon as possible.

### 5.2 PRELIMINARY T+3 CONCLUSIONS

Based upon these assumptions, preliminary fact gathering and a significant degree of analysis took place. What follows are the T+3 Subcommittee's preliminary conclusions:

* T+3 settlement can be adopted industry-wide in the United States by 1992 for corporate and municipal securities transactions.
* Movement to a book-entry-only environment will bring significant efficiencies as well as cost and risk reduction to the industry although not without industry effort. The Subcommittee believes that the industry should migrate to book-entry-only, as rapidly as practical.

The Subcommittee recognizes that the movement to book-entry-only for the individual investor will be dependent upon the availability of practical and acceptable alternatives to the current methods of ownership: leaving securities with a financial intermediary or taking physical certificates. One alternative is a system for direct registration of shareholders with the issuer or its agent. This system, as envisioned, would create an electronic link between securities issuers and depositories, replacing certificates with an electronic format. Such a system may be available in pilot form by as early as 1992. This concept is being addressed by the T+3 Subgroup focusing on Direct Registration. Other private sector alternatives should also be identified and explored.

As part of the change to T+3, the Subcommittee is recommending, subject to additional industry comment, that:

* *By 1992, settlements and other movements of corporate and municipal securities must be effected only by book-entry movements within a depository for transactions among f inancial intermediaries (brokers, dealers, and banks) and between financial intermediaries and their institutional clients.*
* *By 1992, all new corporate or municipal securities issued must be eligible for depository processing, and procedures have to be developed to monitor inappropriate sale transactions during new issue stabilization periods.*

The T+3 Subcommittee believes that three major factors will determine the feasibility of converting the U.S. system to T+3

settlement:

(1) The benefits of moving to T+3 settlement for financial intermediaries and the investing public.

(2) The operational capabilities, implications, and costs to financial intermediaries and the investing public of moving to T+3.

(3) The overall business impact of the Subcommittee's recommendation mandating book-entry-only settlement among financial intermediaries and between financial intermediaries and their institutional clients.

These three factors are discussed in more detail as follows:

### (1) THE BENEFITS OF MOVING TO T+3 SETTLEMENT

Moving settlement closer to the time that an actual trade is executed ("T" or Trade Date) brings greater certainty and credibility to marketplaces. It is a widely held belief that T+3 will result in "fewer trades in the pipeline" with a concomitant reduction in overall risk to the system. The Subcommittee believes that global competitive pressures also give rise to concern that U.S. markets stay at the leading edge of safety and efficiency. Therefore the United States must, at a minimum, stay consistent with the growing trend toward harmonizing settlement processes as a matter of competitive advantage. This was confirmed at the G30 conference in London in March 1990 which revealed true global agreement to implement shorter settlement cycles. The T+3 Subcommittee recognized that the settlement period cannot be shortened beyond the operational capacity of the various market participants, without incurring additional risks and costs. Taking account of these factors, T+3 was thought to be operationally achievable in the United States by 1992.

It is generally viewed in the world markets, that as technology continues to advance, the ability to compress the settlement cycle even closer to the point of trade execution will be possible. Movement toward book-entry-only will enable the industry to evaluate the appropriateness of further compression of the settlement period. Book-entry-only is already a well established concept for other types of financial instruments such as U.S. treasury securities, money market mutual funds and options.

### (2) OPERATIONAL CONSIDERATIONS OF T+3

The compression to a T+3 settlement period will make securities and funds available to an investor sooner. Coordinated efforts between issuers, brokers, clearing agents, banks, depositories, transfer agents, and investors are required to facilitate this conversion. The Subcommittee has performed some research into these areas and found the following:

* The move to T+3 settlement for corporate securities for broker-to-broker transactions, i.e., the "street-side" of the business, should be achievable without detrimental effects on trade comparison or settlement. Statistics from National Securities Clearing Corporation (NSCC) confirm that nearly 99% of broker/dealer corporate equity transactions are compared by T+1. Even statistics for the peak volume period of October 1989 show the T+1 comparison rate to have approached 99% for broker/dealer trades. As new marketplace rules and practices become operational, this rate will further improve. The figures for municipal and corporate debt do, however, indicate need for improvement if T+3 for debt transactions is to be adopted.

* The confirmation/affirmation process between broker/dealers, institutional clients, and their agent banks requires changes to the present Institutional Delivery (ID) system of The Depository Trust Company (DTC) to accommodate the accelerated affirmation schedule for T+3 settlement. These changes will allow the maintenance, and ultimate enhancement, of the current level of trade affirmation and settlement efficiency. An interactive ID system which provides trade correction facilities is currently being proposed.

* Consideration of the impact of T+3 settlement on the retail market extends beyond the logistics of moving certificates, monies and instructions between the retail clients and their brokers. Consideration must also be given to the potential impact that such changes could have on investment decisions made by retail clients. There is support for the position that on the customer sell-side a move to T+3 would have minimal effect on settlement performance. Current available data seems to indicate that approximately 90% of securities sold by retail customers are in possession of their financial intermediaries by T+3. Data from a larger statistical base is needed before the Subcommittee can draw definitive conclusions.

* On the payment side, preliminary data indicates that even with the current T+5 settlement cycle, approximately 80% of funds due from retail clients for purchase transactions are available by T+3. Again, before conclusions can be drawn, statistical information from a broader base needs to be obtained along with information concerning what needs to be done to increase the rate of available funds on T+3.

* Retail customer preference indicates a trend toward leaving securities with financial intermediaries such as broker/dealers

and banks. For those members of the investing public who use physical certificates rather than leaving securities with financial intermediaries, alternatives need to be developed, for example, direct registration.

* Analysis regarding the impact of modifying current systems at broker/dealers, banks, transfer agents, service bureaus, and other organizations is required.

### (3) BOOK-ENTRY SETTLEMENT

The Subcommittee strongly believes that the delivery or receipt of securities between financial intermediaries and the associated monies should occur within a depository environment, and accordingly believes that, by 1992, book-entry settlement between financial intermediaries should be mandated. The extent to which financial intermediaries and institutional investors already use securities depositories is one reason this goal can be achieved by 1992.

From a cost-efficiency and risk perspective, the savings to financial intermediaries, and ultimately the investing public, appear significant if the certificate were either eliminated or fully immobilized in depositories. The T+3 Subcommittee has looked at various alternatives in this regard, both existing and some to which the corporate and municipal securities industry could begin to migrate. By example: (a) decertification of all issues with shareholders having their interest shown on the books of financial intermediaries or one national record-keeper, similar to U.S. treasury securities with the Treasury Direct Service for recording individual holdings; or (b) moving to either no certificate issuance or the use of a single global certificate held in a depository, with shareholders being on the books of a financial intermediary or on the books of an issuer/agent through a direct registration system.

Statistics suggest that the use of the physical certificate is declining and that a move to issuance of book-entry-only securities will evolve of its own accord. The experience in the new issue municipal market seems to bear this out. It has been further recognized that mandated movement to a certificateless environment by 1992 will encounter both legal and political hurdles. Customer preference aside, there are also some who suggest that it is more cost-effective for the industry to have infrequent retail securities purchasers hold their own securities.

*It is the preliminary view of the U.S. Working Committee that it is both desirable and achievable to eliminate the use of the physical certificate by 1995 for settlement of securities transactions.*

Accordingly, the Working Committee has commissioned various studies by its Subcommittees to achieve a broader consensus relative to the feasibility of moving retail-side activity to a book-entry-only environment within this time frame.

### 5.3 T+3 SUBCOMMITTEE ISSUES FOR COMMENT

The conversion to T+3 settlement will affect every firm to some degree depending upon the mix and character of its corporate and municipal business. In order to take this significant step forward in securities processing, the T+3 Subcommittee needs your evaluation of the impact of this proposal on your firm. In particular, please focus your attention on:

(1) The benefits, costs, timing, operational changes, data processing requirements and revenue impact of moving to T+3 settlement in 1992.

(2) The benefits, costs, timing, operational changes, data processing requirements and revenue impact of implementing the recommendation of moving to a book-entry-only environment for financial intermediaries and their institutional clients by 1992 and for the entire industry by 1995.

(3) The anticipated impact on your mix of business, client perception and investment behavior of moving toward T+3 and book-entry-only environments.

We would appreciate your bringing any issues surrounding T+3 which you believe have not been addressed in this report to our attention. Any statistical or financial data supporting your comments would be welcome.

## 6 REPORT OF THE SAME-DAY FUNDS OPERATIONS SUBCOMMITTEE

As stated in the original G30 report, Recommendation #6 provided that:

"Payments associated with the settlement of securities transactions and the servicing of securities portfolios should be made consistent across all instruments and markets by adopting the 'same-day' funds (SDF) convention."

Implementation of the same-day funds recommendation will be a significant task. However, it is not without precedent in this country. In the early 1980s, the Clearing House Interbank Payment System (CHIPS) was converted from next-day to same-day funds. The Options Clearing Corporation converted from next-day to same-day funds in 1988. To provide perspective, total U.S. funds settlement related to securities transactions in 1988 averaged $469 billion per day. Securities transactions settling in next-day funds averaged

$59 billion which represented 13% of this total.

### 6.1 ASSUMPTIONS

To facilitate the Subcommittee review of the same-day funds issue, several underlying assumptions were made. They are:

(a) The financial system will achieve significant benefits through adoption of this change in terms of reduced risks and increased efficiency over the short and long term.

(b) Uniformity in the funds settlement of all financial instruments is a desirable goal. (The government securities markets, as well as the derivative markets, currently settle in same-day funds.)

(c) The Securities and Exchange Commission (SEC) and the Federal Reserve Bank of New York (FRBNY) have supported the same-day funds recommendation to reduce the window of risk. It is in the best interests of the private sector to lead the way for change.

(d) The evolution of more automated and efficient payment and processing systems will facilitate a conversion to a same-day funds environment and provide increased volume capacity.

(e) The focus of the recommendation is on the settlement of corporate and municipal securities transactions between broker/dealers. banks, and institutional investors. **It does not apply to retail investors.** After much discussion, it was determined that settlement between financial intermediaries and their retail clients should not be addressed by the Subcommittee. This does not imply that there will not be significant issues in this area. Market forces should decide how financial intermediaries will deal with their clients.

(f) The same-day funds recommendation will apply to all settlement transactions and issuer payments (dividends, interest, redemptions, maturities, reorganizations, etc.).

The Subcommittee determined that three major factors will decide the best approach for converting the U.S. system to a full same-day funds environment:

(1) The operational implications and costs that will affect depositories, clearing corporations, broker/dealers, banks, issuers, and institutional investors currently settling in Next Day Funds (NDF).

(2) The intra-day/end-of-day liquidity position of banks maintaining an account at a Federal Reserve Bank.

(3) The impact of the reduction of float from settlements and issuer payments.

In addition, the extent to which firms can anticipate settlement requirements may also have significant impact on the design of the new system.

As the new system is designed, it must conform to legal and regulatory standards. The Board of Governors of the Federal Reserve System has published guidelines for private sector book-entry systems that wish to adopt a same-day funds convention. Federal Reserve staff have attended SDF Subcommittee meetings to keep current on the thinking of the private sector as plans for implementation of same-day funds proceed. Once the private sector has developed a plan for implementation, Federal Reserve staff will work with the private sector to ensure that the plan meets the requirements of the Federal Reserve System's policy on private book-entry systems that utilize the Fedwire.

### (1) OPERATIONAL IMPLICATIONS

The next-day settlement systems operated by clearing agencies currently provide for participant settlement by delivery of certified checks which are next-day available funds ("NDF Systems").

> *The Subcommittee envisions that in the new same-day funds environment, final funds settlement will be performed over the Fedwire System. The current thinking is that all participants in a clearing system will settle the cash side of their activity through banks or depository institutions with an account at a Federal Reserve Bank at the end of the day. Instead of exchanging checks, depositories and clearing agencies would initiate a same-day funds payment (or instruct a participant to do so) for the net of all settlements.*[1]

Much discussion has taken place on the requirements for change that would need to be implemented by organizations such as DTC and NSCC. DTC has a Same-Day Funds Settlement System (SDFS) in place for certain instruments representing a small percentage of DTC's total transaction volume. The system will begin processing commercial paper in the near future, which will increase volume

[1] Net settlement payments reduce the magnitude of gross settlement debits significantly. In May of 1990 the average daily percentage of net payments at NSCC, as compared to the original gross obligations, was 4.21%. For the same period the net payment obligations of DTC were 6.09% of gross obligations.

significantly. However, it does not have the capacity to handle the large transaction volumes currently processed by the existing Next-Day Funds System (NDFS). SDFS, which has a number of special control features (e.g., net debit caps, collateralization, net-net settlement, and provisions to allow receiving parties to pre-approve deliveries), would need to be significantly modified to prevent gridlock due to increased volumes.

The conclusion, therefore, is that consideration should be given to modifying somewhat the current NDF process to support a same-day funds environment. The system would likely include features of both the current SDFS and NDFS systems, and include adequate controls. The following elements might be included in the design of the new system:

i. Net settlement of activity in each participant account.

ii. Settlement in Fed Funds through a bank maintaining an account at a Federal Reserve Bank.

iii. Control of collateral in the system to ensure that each participant's settlement obligation to the system is collateralized.

iv. The ability to limit how much a participant can owe to the system, as per the Fed guidelines. This may imply the need to inject liquidity intra-day, or take other mitigating action in times of stress.

v. A clearing fund to which all participants would contribute to be used to finance settlement failures.

Another key factor to be considered in the conversion to same-day funds is the ability of clearing participants, the clearing corporations, and depositories to anticipate upcoming settlements. The higher the percentage of anticipated transactions, the easier it will be for operational issues to be assessed and addressed in advance of settlement. Transactions which can be anticipated with reasonable certainty might be subject to a different set of controls than those that are unknown until settlement day.

The Subcommittee has analyzed extensive statistical data to measure the level of transactions which can be anticipated. CNS (the NSCC system to settle broker-to-broker trades) and ID (the DTC's confirmation/affirmation system which stages settlements between brokers and their institutional customers) account for approximately 70% of total transaction volume, and approximately 50-60% of total dollar volume. These trades can be anticipated.

Non-CNS, non-ID volume is largely composed of securities lending transactions. Preliminary analysis shows that a large percentage of securities lending transactions are "iffy borrows". "Iffy borrows" are securities borrowing effected to anticipate non-receipt of securities and are returned the same day if the securities are received. Two mitigating factors may reduce the impact of "iffy borrows" on the ability to anticipate transactions:

* A possible modification to SEC Rule 15c3-3 that would allow broker/dealers to anticipate delivery of confirmed ID trades, thereby negating the need to borrow for these potential deliveries on an "iffy" basis.

* The assumption that while most of the transaction volume of securities lending is "iffy," in dollar terms a significant percentage can be anticipated to be returned.

### (2) LIQUIDITY IMPLICATIONS

The change to a same-day funds convention for settlement could have an impact on the liquidity positions of banks with an account at a Federal Reserve Bank, particularly if the banks were not able to anticipate the end-of-day net balances to be moved between participants and the clearing corporations and depositories. Thus the availability of such information and the financial resources of the clearing corporations and depositories are key to successful implementation of same-day funds.

In addition to banks managing their liquidity, sufficient liquidity would also need to be maintained by the settlement systems to assure that a final settlement would occur by the end of the day. How much liquidity is needed and the form in which it is held require further study.

Once again, it is clear that the percentage of transactions that can be anticipated will help settlement systems and participants to monitor and meet liquidity needs in advance.

### (3) FLOAT IMPLICATIONS

The previous discussion mainly concerns the effect upon liquidity of modified payment practices. Another consideration is the revenue impact of the loss of float to agents who service issuers. If paying agents were to credit investors in same-day funds, the loss of overnight float may impact the pricing and availability of these services to issuers, since revenues from this float may already be factored into the pricing structures. The impact of this on the marketplace is another concern of the Subcommittee.

## 6.2 SDF SUBCOMMITTEE ISSUES FOR COMMENT

The conversion to same-day funds will affect every firm to some degree depending upon the mix and character of its corporate and municipal business. We would like your comments on the impact of this change to your firm with particular attention directed to:

(1) The benefits, costs and/or difficulty in effecting the transition within your firm (e.g. systems, practice, operational procedures, etc.) in terms of the operational, liquidity, and float issues discussed above.

(2) How the change in settlement and issuer float might affect the way you currently price services to issuers and investors.

We would appreciate your bringing any issues surrounding same-day funds which you believe have not been addressed in this report to our attention. Any statistical or financial data supporting your comments would be welcome.

## 7 THE NEXT STEP

A detailed questionnaire is being prepared to collect more quantitative data regarding the impact of T+3, book-entry-only and same-day funds environments and will be distributed at the beginning of September to a broad base of broker/dealers, banks, and other affected parties. You are invited to participate and contribute your input to the overall assessment. If you wish to participate, and did not receive a questionnaire, please call the Group of Thirty U.S. Working Committee at (212) 510-0426. Or write to:

Dennis M. Earle
Executive Director
U.S. Working Committee
Group of Thirty
Clearance and Settlement Project
55 Water Street
22nd Floor
New York, N.Y. 10041

The questionnaire is being administered for the Working Committee by Nolan, Norton & Company. All questionnaires will be reviewed in confidence by Nolan, Norton which will report results to the Committee in summary fashion only.

Alternatively, if you wish to respond to the questions posed by this Status Report without responding to the questionnaire, please address you comments in writing to the Executive Director at the address above.

## U.S. Working Committee

*Group of Thirty*

*Clearance & Settlement Project*

### Summary of Recommendations

| INSTRUMENT | COUNTER-PARTY | T+3 | BOOK-ENTRY | SDF |
|---|---|---|---|---|
| *Corporate Equity* | Financial Intermediary | 1992 | 1992 | 1992 |
| | Institutional Client | 1992 | 1992 | 1992 |
| | Retail Client | 1992 | 1995[1] | Not Recommended |
| *Corporate Debt* | Financial Intermediary | 1992 | 1992 | 1992 |
| | Institutional Client | 1992 | 1992 | 1992 |
| | Retail Client | 1992 | 1995[1] | Not Recommended |
| *Municipal Debt* | Financial Intermediary | 1992 | 1992 | 1992 |
| | Institutional Client | 1992 | 1992 | 1992 |
| | Retail Client | 1992 | 1995[1] | Not Recommended |

[1] Subject to subsequent review for earlier implementation.

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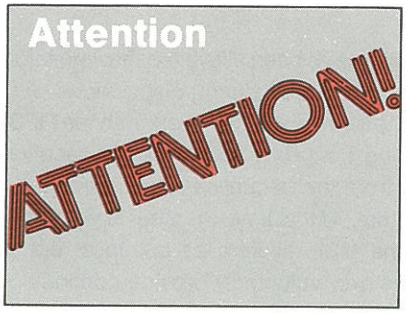


**Route to:**

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

# Letter to GFOA on its Draft Disclosure Guidelines

September 24, 1990

John Petersen
Disclosure Guidelines Project
Government Finance Officers Association
1750 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Petersen:

The Municipal Securities Rulemaking Board appreciates the opportunity to comment on the July 18 Draft Revisions to the GFOA's *Disclosure Guidelines for State and Local Government Securities*. The Board strongly supports the *Guidelines* and believes that the Draft Revisions will help to ensure that disclosure documents are complete, are produced in a timely manner and are useful to investors and other market participants. The Draft Revisions appropriately accommodate the requirements placed on underwriters by SEC Rule 15c2-12 and the accompanying interpretive Release. Of importance in this regard are the new procedural statements in the *Guidelines* on conduit issuers, credit enhancements, and notices of sale and bid forms. The Board also welcomes the *Guidelines*' strengthened recommendations on continuing disclosure documents. These recommendations reflect the increased market interest in continuing disclosures and the commensurate need for more detailed guidance to issuers. In addition, the Board is pleased that the Draft Revisions place greater emphasis on standardizing the cover page and introduction sections of official statements. We believe that this revision will help to make important disclosure information more readily accessible to readers of the documents.

Although Procedural Statement No. 1 of the *Guidelines* is not new, the Board believes that it deserves special attention and wishes to endorse it strongly. The GFOA's commitment to a continuing review of the *Guidelines* is particularly appropriate given the ongoing efforts on voluntary disclosure standards, new market products and changing disclosure practices. The Board commends the GFOA for utilizing in the *Guidelines* the disclosure initiatives of other groups such as the National Federation of Municipal Analysts, the National Council of State Housing Agencies and the American Bankers Association's Corporate Trust Committee. Obtaining the perspectives of all market participants in reviewing standards for disclosure documents will ensure that the *Guidelines* continue their important role in shaping disclosure practices.

The Board notes that the Procedural Statements recommend that issuers send disclosure documents to "one or more public or private repositories."[1] The Board strongly supports issuer involvement and interest in ensuring long-term access to their disclosure documents. The Board encourages issuers, as well as underwriters, to disseminate disclosure documents as widely as possible. Although the Board cannot determine, and does not seek to determine, the content of disclosure documents, the Board does have a role in ensuring that there is meaningful access in the market to those disclosure documents that are produced. The Board, as the primary regulator of the industry, has long known that material information in disclosure documents often is not reaching the secondary market in the manner necessary for dealers (1) to disclose all material facts to customers; (2) to recommend only suitable transactions; and (3) to price securities transactions accurately. These requirements are placed on municipal securities dealers by Board rules for the purpose of investor protection.

As you know, the Board has undertaken several initiatives to help ensure greater market access to disclosure documents. Under rule G-36, the Board now collects from underwriters copies of substantially all official statements produced for new issues. The Board currently stores paper copies of the documents and makes them available for review and copying in its public access facility.[2] The Board has proposed to collect advance refunding documents in a similar manner under rule G-36 and has proposed to make available electronic and paper

[1] Procedural Statement No. 8, at page 92.

[2] The Board also requires underwriters to supply any supplements or amendments to the documents which may be made by issuers during the underwriting period. The GFOA may wish to consider a similar explicit recommendation for issuers to submit supplements to repositories.

copies of the documents to interested parties through the Municipal Securities Information Library,™ or MSIL,™ system.[3] The MSIL system would ensure that any interested party can obtain a comprehensive and timely stream of new issue disclosure documents. In addition, the Board is planning a facility within the MSIL system to accept the voluntary submission of continuing disclosure documents from issuers or trustees who wish to provide the market with such disclosures through this system.

As a public repository operated by the Board, the MSIL system would ensure that new issue and continuing disclosure documents are available to all interested parties on equal terms, in a fair manner and in a manner that will not confer special or unfair benefit to any party. It has been designed to facilitate the use of its documents by private sector information vendors. Vendors will be encouraged to redistribute the documents to their customers and to use the documents to produce value-added information products such as summaries, extracts, evaluations, etc.

As noted previously, the Procedural Statements recommend that issuers send disclosure documents to "one or more public or private repositories." If issuers follow this suggestion, there will be no assurance that any one or all of these repositories will have a complete collection of this information. Investors and dealers may have to contact each of the repositories to find a particular document or to subscribe to all repositories to ensure the completeness of their own document collections. In addition, there is the possibility of unequal access to information and resulting trading and pricing problems. The Board recommends that the *Guidelines* be revised in one of two ways—either to ask issuers to send documents voluntarily to all public and private repositories, or, if this would be too onerous for issuers, to provide a copy to the Board's public repository, when operational, so that all market participants, as well as all private information vendors and repositories, have equal access to a complete set of public documents.[4]

Although the Board is aware that the GFOA has expressed reservations about the MSIL system in the past, it hopes that many of these concerns have been alleviated through information that the Board has provided during discussions with the GFOA and others. The Board wishes to work with the GFOA to address any remaining concerns and hopes to receive approval for the facility from the Securities and Exchange Commission in the near future. At that time, the Board hopes that the *Guidelines* will list the MSIL system as a public repository through which issuers may voluntarily provide continuing disclosure information to the market.

The Board also recommends a few minor language changes in the *Guidelines*. The language referencing Board rule G-32, found on page 58 and on page 83 in footnote 37, should be revised to indicate that rule G-32 applies to *all dealers* selling "new issue securities" as defined in the rule and is not limited in its application to the underwriters of the issue.[5] In addition, the Board suggests that item (i) in the last paragraph of procedural statement No. 7 be revised to state that issuers may wish to consider mailing redemption notices to all registered owners *by secure means such as registered mail*.[6]

* * *

The municipal securities market has made substantial progress in the area of disclosure during the last few years and the Board believes that progress continues to be made. Particularly important are the efforts by issuer, analysts and dealer groups to establish meaningful, voluntary guidelines on the content and format of disclosure documents. The Board believes that the serious and widespread efforts which are now taking place on disclosure obviate any need for legislative measures in this area. The Board considers the work of the GFOA on the *Guidelines* vital to this process and wishes to offer its assistance in publicizing the *Guidelines* as well as in other educational efforts which may be appropriate.

Sincerely,

Thomas Sexton
Chairman

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

[4] As noted previously, Board rule G-36 requires underwriters to provide official statements to the Board. Thus, it would not be necessary for issuers voluntarily to provide such documents to the Board.

[5] Language in the penultimate paragraph of Procedural Statement No. 3 refers to the official statement delivery requirements of Board rules discussed in Procedural Statement No. 2. As Procedural Statement No. 2 does not refer to rule G-32, we believe that the reference should probably be to footnote 37 on page 83.

[6] This suggestion is consistent with the 1986 recommendations of the SEC regarding call notification. Release on Call Notification, Securities Exchange Act Release No. 34-23856 (Dec. 3, 1986).

# New Issue of *MSRB Manual*

The updated soft-cover edition of the *MSRB Manual* , dated October 1, 1990, now is available.

The *MSRB Manual*, published by Commerce Clearing House, includes the Securities Exchange Act of 1934, the Securities Investor Protection Act of 1970, Board rules and interpretations, pertinent regulations of other agencies and samples of forms.

Copies of the updated *Manual* may be obtained from the Board's offices by submitting a completed order form along with payment in full for the amount due. An order form is located on page 15 of this issue. The cost of the *Manual* is $5.00.

# Publications List

## Manuals and Rule Texts

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