MSRB REPORTS

Volume 5, Number 6 | Municipal Securities Rulemaking Board | November 1985

In This Issue

Ralph Horn Elected Board Chairman, Robert N. Downey Vice Chairman

Ralph Horn, senior vice president and manager of First Tennessee Bank, N.A. Memphis, Tennessee, has been elected Chairman of the Board, and Robert N. Downey, partner in Goldman, Sachs & Co. of New York, Vice Chairman. Mr. Horn and Mr. Downey began their one-year terms October 1, 1985.

Mr. Horn joined First Tennessee Bank in 1968 and since 1971 has managed the bank's municipal and government departments. Mr. Horn served on the Tennessee Municipal Securities Regulatory Board from 1972 to 1976 and while a member of the Board of Directors of the Dealer Bank Association headed its Federal Affairs Committee.

Mr. Downey, who joined Goldman, Sachs & Co. in 1969 and became a partner of the firm in 1977, is in charge of the firm's municipal department. He is a former member of the Board and Executive Committee of the Securities Industry Association and served as chairman of its Municipal Finance Committee.

Also in This Issue

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Route To:

- ☒ Manager, Muni. Dept.
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Publication

Principal's Examination Study Outline Updated

A September 1985 edition of the study outline for the Municipal Securities Principal Qualification Examination (Test Series 53) has been published. No substantive change in subject matter has been made to this edition; however, rule references have been revised to reflect rule amendments effective at the time of publication.

September 13, 1985

Questions concerning professional qualifications and requests for the study outline should be directed to Peter H. Murray, Assistant Executive Director.

Calendar

October 15—Effective date of amendments to G-12 and G-15 on interest payment claims

January 10—Comments due on G-11 draft amendments

Pending
—G-12 on settlement dates for transactions in WAII securities
—G-34 on timely CUSIP number assignment
—G-35 on arbitration

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FROM THE CHAIRMAN

The Municipal Securities Rulemaking Board has just completed its tenth year, a decade of tremendous changes in the industry. From the perspective of the MSRB, the first half of the decade witnessed the writing of the basic set of standards. The second half has largely been devoted to laying the groundwork for the automation of the clearance and settlement of transactions.

There were few in the industry in 1980 who envisioned that in 1985 bearer bonds would no longer be issued and a large proportion of confirmations would be sent electronically. This transition is not over and it has not been easy. All 15 members of the Board, the ten dealers and the five public members, are acutely aware of not only the promise but also the problems that have resulted from the automated clearance and settlement rules. These rules, like all the other rules written by the MSRB, are constantly reviewed to determine if they are functioning as intended.

Your involvement with the review process is a *necessity*. The Board needs to know if the rules are not effective and your views on needed changes. Board members bring their own experiences to the meetings, knowing that there are probably other perspectives on the issue. Without hearing those views, the Board and the industry place great reliance on those that do offer their thoughts.

During the coming year, I ask you to help us find better ways to put your views before the Board. We will continue to hold meetings with dealer groups and will be contacting bond clubs and individuals within each bond community to respond to specific proposals of the Board. We expect to be dealing with the automated clearance and settlement rules, syndicate practices, transaction reporting, and new financing features.

Only you know the impact of rule changes on your firm. Tell us what they are!

Sincerely,

Ralph Horn
Senior Vice President
First Tennessee Bank, N. A.
MSRB Chairman
1985–86

Board Members 1985–86

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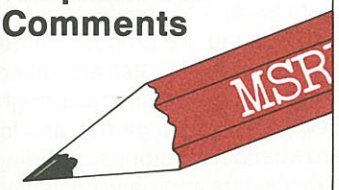
Request For Comments



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Syndicate Practices—Earlier Allocation Disclosure to Members: Rule G-11

Principal Changes Considered

The draft amendments would—

- **require syndicate managers, within two business days following the date of sale, to disclose in writing a summary of all allocations of securities accorded priority over members' take-down orders; and**
- **delete the current requirements that a manager provide specified written information pertaining to allocations within ten business days following the date of sale. The identities of certain orders would be disclosed at final settlement of the account.**

Action: Send comments.

Rule G-11, on sales of new issue municipal securities during the underwriting period, requires syndicates to establish priorities of orders and to make certain disclosures designed to provide new issue participants with information sufficient to understand and evaluate syndicate practices. Over the past several months the Board has been reviewing rule G-11 to determine whether the rule should be modified or withdrawn. In June 1985, the Board requested views of interested persons,[1] and on August 21, 1985, the Board met with industry members to discuss possible modifications of the rule. After considering various issues pertaining to syndicate practices, the Board is proposing to amend certain disclosure provisions of rule G-11 as summarized below. The Board is soliciting comments on the draft amendments from all interested persons; all comments received will be considered by the Board when it determines whether to adopt the draft amendments. In addition the Board wishes to reiterate its recent interpretation of rule G-17, on fair dealing, that syndicate expenses charged to members must be clearly identified and must be the actual expenses incurred on behalf of the syndicate.[2] The Board also intends to ask the enforcement agencies to ensure that the provisions of rules G-11 and of rule G-12(j) (on final settlement of syndicate accounts) are being followed by syndicate managers and members, and will monitor developments in this area to determine whether further modifications of rule G-11 would be appropriate.

Summary of Current Rule G-11

Rule G-11(e) requires syndicates to establish priorities for allocating securities to orders and the procedures, if any, by which the priorities can be modified.[3] The rule does not specify what priorities should be established[4] and expressly recognizes the right of a syndicate to authorize a manager to allocate securities in a manner other than that prescribed by the priority provisions if the manager determines that such allocations are in the best interests of the syndicate. The rule also expressly places responsibility on managers to justify that any such allocations were in the best interests of the syndicate.

Paragraph (f) of rule G-11 requires a manager to provide syndicate members with written information concerning the priority provisions prior to the first offer of any securities[5] and whether, and under what circumstances, the manager may allocate securities in a manner different from those priorities. Managers also are required to furnish this information promptly to others upon their request.

Rule G-11 also places certain disclosure responsibilities on syndicate members and other dealers when placing orders. Specifically, rule G-11(b) requires a syndicate member that submits an order to disclose whether the securities are being purchased for its dealer account, the account of a related portfolio, municipal securities investment trust or an accumulation account for an investment trust sponsored by the

Comments on the matters discussed in this notice should be submitted not later than January 10, 1986, and may be directed to Angela Desmond, General Counsel. Written comments will be available for public inspection.

[1] *See MSRB Reports*, vol. 5, no. 4, (June 1985). The comment letters may be reviewed by interested persons.
[2] *See MSRB Reports*, vol. 5, no. 5 (August 1985).
[3] In 1983 the Board adopted amendments which exempted "qualified note syndicates" as defined in section (a) of the rule from the provisions of rule G-11(d), (g)(ii) and (h)(ii).
[4] Of course, all priority provisions must be fair and consistent with just and equitable principles of trade as required by rule G-17 on fair dealing.
[5] Any subsequent change to those priorities must be furnished promptly to syndicate members.

dealer ("related portfolios"). Paragraph (d) of rule G-11 requires a dealer (whether or not it is a member of the syndicate) that submits a group order to disclose to the manager the identity of the person for whom the order is submitted at the time of giving the order.

Syndicate managers are required by rule G-11(g) to provide syndicate members within 10 business days following the date of sale written disclosures including: the identity of each person placing a group order for which securities have been allocated[6] and the identity of each related portfolio which received allocations (including the aggregate par value and maturity date of each maturity so allocated). The paragraph also requires a manager to provide a summary, by priority category, of all allocations of securities to orders which were entitled to a higher priority than the members' "take-down" orders (which summary must include the aggregate par value and maturity date of each maturity so allocated).

Finally, rule G-11(h) requires, a manager to provide at or before final settlement of the syndicate account, written information including (i) an itemized statement setting forth the nature and amounts of all expenses incurred on behalf of the syndicate and (ii) a summary showing the aggregate par values and prices (expressed in terms of dollar prices or yields) of all securities sold from the syndicate account.

It should be noted that rule G-12(j) requires final settlement of a syndicate account no later than 60 days following the date all securities have been delivered by the syndicate manager to the syndicate members.

Purpose of Rule G-11

Rule G-11 is designed to increase the scope of information available to syndicate managers and members, other municipal securities professionals and the investing public, in connection with the distribution of new issues of municipal securities without impinging upon the right of syndicates to establish their own procedures for the allocation of securities and other matters. The information required to be disclosed under rule G-11 is intended, in part, to enable prospective purchasers to frame their orders in a manner that enhances their ability to obtain the securities, to provide information to the syndicate manager so that it may allocate securities in the best interests of the syndicate, and to render syndicate managers accountable for the allocation of securities in accordance with their announced allocation procedures. Syndicate members are expected to follow and enforce their own syndicate agreements; disputes pertaining to the provisions of agreements among underwriters which cannot be resolved by the parties may be submitted to arbitration under Board rule G-35.

Other than requiring syndicates to establish priorities, rule G-11 does not address the content of agreements among underwriters. When the Board first adopted rule G-11, it considered whether to require syndicates to sell securities at a *bona fide* offering price during a mandatory *bona fide* offering period during which the new issue securities would be sold to the public. The Board also considered prohibiting any sales of new issue securities by underwriters to their investment or related portfolios during the proposed order period. In response to comments by the SEC staff and others that the offering period and related trading restrictions might not be consistent with the Securities Exchange Act, and for other policy reasons the Board abandoned proposed trading restrictions and adopted the disclosure approach contained in the current rule.

Comments on Rule G-11

The Board received nine written comments on rule G-11 and has met with and received comments from industry members at a meeting held in New York City on August 21, 1985, and at various dealer meetings held over the past year in various locations around the country. A number of commentators suggested that the priority and allocation requirements of rule G-11 are not being complied with. It was suggested that certain managers may allocate securities to orders with lower priority than those submitted by members, and that a new category of orders, "designated take-down," was being accorded priority even though that category often was not included in the priorities established by syndicates. At least one of the commentators stated that it was difficult for managers to enforce intra-syndicate pricing policies and suggested that the Board adopt a rule prohibiting the granting of concessions to customers.

Several commentators suggested that managers were not often asked to justify allocations which do not conform to a syndicate's priority provisions and sometimes were not responsive when they were asked. A number of regional dealers who act as managers on regional sales and participate as syndicate members in national issues stated that, while they were not always satisfied with allocations they received, they believed that most managers allocated securities in the best interests of the syndicate. In general, the commentators suggested that while some benefits might be derived from strengthening the rule, the interests of syndicate members, issuers and investors would be served better by preserving the flexibility of syndicates to establish their own procedures for underwriting a new issue of municipal securities. A number of dealers commented that rule G-11 has a prophylactic effect in that it suggests that syndicate activities should be subject to scrutiny by members and, to some extent, by investors. They believe that the rule embodies the principle that syndicate agreements should be adhered to and enforced by members. Others suggested that the rule has no notable effect on syndicate practices.

After considering these comments the Board concluded that many dealers do not realize that rule G-11 is primarily a disclosure rule and is not an allocation rule. As discussed earlier, the Board has declined to adopt provisions which place allocation or other pricing or trading restrictions on syndicates in part because, to do so, would require the Board to eliminate the flexibility currently enjoyed by syndicates and managers to respond to specific market con-

[6]Information required under paragraph (g) must cover all such orders submitted through the end of the order period or, if there is no order period, through the end of the first business day following the date of sale of the issue.

ditions in a way that facilitates the orderly distribution of securities and promotes the best interests of syndicates.[7] Given the success with which the industry underwrites large amounts of new issue municipal securities, the Board continues to believe that is appropriate to preserve the flexibility of syndicates to agree to individualized underwriting terms and to agree to deviate from these provisions when necessary and appropriate in the best interests of the synidcate. The Board wishes to point out that rule G-11(e) requires syndicates to establish priority provisions and states that this requirement shall not be satisfied by providing the manager with discretion to determine what priorities should be accorded to different types of orders. Moreover, the Board wishes to remind syndicate managers and members that managers have a responsibility to justify that any allocations not in accordance with the established priority provisions are in the best interests of the syndicate.

Based upon the comments received, the Board has concluded that certain amendments to rule G-11 may be advisable at this time and is considering adopting the amendments summarized below.

Summary of Draft Amendments

The draft amendments would require syndicate managers, within two business days following the date of sale, to disclose in writing a summary, by priority, of all allocations of securities which were accorded priority over members' take-down orders, indicating the price, aggregate maturity value and maturity date of each maturity so allocated. Several commentators stated that syndicate members do not receive sufficient order and allocation information early enough to help them frame orders or understand syndicate operations. These dealers asked to receive certain information concerning allocations to all orders receiving priority over member take-down orders. They also stated that they need to receive the information earlier than 10 business days after the date of sale for it to be of use. Accordingly, the Board is proposing to amend rule G-11 to require managers to provide, within two business days of the date of sale, a written summary, by priority, of all allocations of securities which are accorded priority over members' take-down orders indicating the aggregate maturity value, maturity date and the price of each maturity so allocated. These disclosures should include allocations of securities through the end of the order period or if the syndicate does not have an order period, through the first business day following the date of sale. These disclosures would not include the identity of persons placing priority orders.

The draft amendments would delete the current requirement that a manager provide certain written information pertaining to allocations within 10 business days following the date of sale. As noted above, rule G-11(g) requires a manager, within 10 days following the date of sale, to provide members with written information concening the identities of group and related portfolio orders to which securities were allocated. That section also requires a manager to provide a summary, by priority category, of all allocations of securities to orders which were entitled to a higher priority than the members' "take-down" orders (including the aggregate par value and maturity date of each maturity so allocated).

The commentators stated that they continue to believe that they have a right to know the identities of persons who place group and related portfolio orders since those orders are for the benefit of the whole syndicate. They stated that this information is not critical to their framing their orders and recognize that the premature disclosure of the identities of these orders might discourage investors who wish to maintain their anonymity from placing them. The Board is proposing to amend rule G-11 so that a manager would not be required to provide the identities of group and related portfolio orders to which securities were allocated (*i.e.*, rule G-11(g)(i) and (ii)) until it provides final accounting information to members under section (h) of the rule (*i.e.*, within 60 days of the date of sale) when it discloses the allocations of all securities sold from the account. Information concerning allocations to orders which received priority over member take-down orders (*i.e.*, that information currently provided under rule G-11(g)(iii)) would be provided effectively within two business days after the date of sale under the draft amendments.

Disclosure of Syndicate Expenses and Final Accounting

Rule G-12(j), the Board's uniform practice rule, requires final settlement of a syndicate account within 60 days following the date all securities were delivered by the manager to the members. Thus, a manager must provide the written final accounting and allocation disclosures required by rule G-11(h) as well as final payment of moneys owed to syndicate members by managers by that date.[8] The Board has received complaints that some managers do not settle syndicate accounts in a timely manner. The Board believes that the 60-day time limit provides sufficient time to enable managers to settle syndicate accounts. It urges all managers to take steps to assure that this provision is complied with.

In addition, in connection with providing the itemized statement required by rule G-11(h)(i) of all actual expenses incurred on behalf of the syndicate, the Board has stated that one of the purposes of this requirement is to assure the accountability of managers for syndicate funds. The Board wishes to caution managers to describe all expenditures clearly so as to make the expenditures readily understandable by members.[9] The Board also wishes to emphasize that syndicate managers should take care in determining the actual expenses involved in handling orders and may be acting in violation of rule G-17 if the expenses charged to syndicate members bear no relation to or otherwise overstate the actual expenses incurred on behalf of the syndicate.[10]

September 30, 1985

[7]In September 1981, the Board declined to adopt concession rules on the grounds that there was no evidence that syndicate flexibility should be circumscribed at that time. The Board based its determination upon the manner in which new issue municipal securities are distributed by syndicates; whether additional regulatory restraints on syndicate practices are necessary for the maintenance of the current distribution system, and, whether such additional regulation would have anticompetitive effects not necessary or appropriate. *See MSRB Reports*, vol. 1, no. 3 (September 1981).
[8]A member who must remit his share of losses to the syndicate manager must do so within a reasonable time period after receiving the syndicate accounting required by rule G-11(h)(i).
[9]*See MSRB Reports*, vol. 4, no. 1 (February 1984).
[10]*See MSRB Reports*, vol. 5, no. 5 (August 1985).

Text of Draft Amendments*

Rule G-11. Sales of New Issue Municipal Securities During the Underwriting Period.

(a) through (f) No change.

(g) *Disclosure of Allocation of Securities.* The senior syndicate manager shall, within ~~ten~~ two business days following the date of sale, disclose to the other members of the syndicate, in writing, ~~the following information~~ by priority category, a summary, by priority, of all allocations of securities which are accorded priority over members' take-down orders indicating the aggregate par value, maturity date and price of each maturity so allocated including any order confirmed at a price other than the original list price, securities allocated to each order ~~concerning the allocation of securities to orders submitted~~ through the end of the order period or, if the syndicate does not have an order period, through the first business day following the date of sale.~~:~~

~~(i) the identity of each related portfolio, municipal securities investment trust, or accumulation account referred to in section (b) above submitting an order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated;~~

~~(ii) the identity of each person submitting a group order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated except that this paragraph shall not apply to the senior syndicate manager of a qualified note syndicate as defined in paragraph (a)(x) above; and~~

~~(iii) a summary, by priority category, of the allocation of securities to other orders which, under the priority provisions, were entitled to a higher priority than a member's "take down" order, including any order confirmed at a price other than the original list price, indicating the aggregate par value and maturity date of each maturity so allocated.~~

(h) *Disclosure of Syndicate Expenses and Other Information.* At or before the final settlement of a syndicate account, the senior syndicate manager shall furnish to the other members of the syndicate:

(i) an itemized statement setting forth the nature and amounts of all actual expenses incurred on behalf of the syndicate. Notwithstanding the foregoing, any such statement may include an item for miscellaneous expenses, provided that the amount shown under such item is not disproportionately large in relation to other items of expense shown on the statement and includes only minor items of expense which cannot be easily categorized elsewhere in the statement. Discretionary fees for clearance costs to be imposed by a syndicate manager and management fees shall be disclosed to syndicate members prior to the submission of a bid, in the case of a competitive sale, or prior to the execution of a purchase contract with the issuer, in the case of a negotiated sale. For purposes of this section, the term "management fees" shall include, in addition to amounts categorized as management fees by the syndicate manager, any amount to be realized by a syndicate manager and not shared with the other members of the syndicate, which is attributable to the difference in price to be paid to an issuer for the purchase of a new issue of municipal securities and the price at which such securities are to be delivered by the syndicate manager to the members of the syndicate; and

(ii) a summary statement showing:

(A) the identity of each related portfolio, municipal securities investment trust, or accumulation account referred to in section (b) above submitting an order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated;

(B) the identity of each person submitting a group order to which securities have been allocated as well as the aggregate par value and maturity date of each maturity so allocated except that this paragraph shall not apply to the senior syndicate manager of a qualified note syndicate as defined in paragraph (a)(x) above; and

(C) the aggregate par values and prices (expressed in terms of dollar prices or yields) of all securities sold from the syndicate account. This paragraph shall not apply to a qualified note syndicate as defined in paragraph (a)(x) above.

*Underlining indicates new language; broken rule indicates deletions.

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Notice of Approval

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Processing of Interest Payment Claims: Rules G-12 and G-15

Principal Changes

The amendments provide that the parties filing interest payment claims—

- **direct them to the appropriate municipal securities broker or dealer,**
- **provide specified items of information, and**
- **receive a response in a specified time limit.**

On October 15, 1985, the Securities and Exchange Commission approved amendments to rule G-12 on uniform practice and rule G-15 on confirmation, clearance and settlement of transactions with customers. The amendments create a standard procedure for interest payment claims made between municipal securities brokers and dealers ("dealers") and set certain time limits for responding to these claims as well as interest payment claims made by customers. The amendments become effective on November 14, 1985, 30 days following the date of Commission approval.

Background

Prior to the amendments, Board rules did not provide dealers with a standard procedure for making claims for misdirected interest payments on municipal securities. In November 1984 the Board published for public comment draft amendments regarding the attachment of interest payment checks to deliveries of registered securities and requested comment whether it would be advisable to provide in Board rules a standard procedure for making interest payment claims.[1] After receiving favorable comment on the creation of a standard claim procedure from the commentators, the Board, in April 1985, circulated for comment draft amendments that created such a procedure.[2] The Board considered the comments received on April 1985 exposure draft at its July 1985 meeting and incorporated several of the suggestions received in the final amendments filed with the Commission.

Summary of Amendment to Rule G-12

The amendment to rule G-12 establishes a standard interest payment claim procedure that may be used by dealers to determine the party to which a claim should be directed, the information to be included in the notice of claim and the time limits for responding to claims made under the procedure.[3]

The procedure requires that parties making interest payment claims based on deliveries of registered securities must direct claims to the registered owner if the registered owner is a dealer and to the first signature guarantor that is a dealer if the registered owner is not a dealer. The Board recognizes that a dealer receiving a registered security on or immediately prior to the record date may not be able to reregister the security prior to the closing of the register for the security's next interest payment[4] and therefore may be required to file an interest payment claim on the security. The Board also notes that the dealer delivering the security in such a case may not be the registered owner of the security and may have obtained the security from another dealer in whose name the security is registered (or may have obtained the security as part of an even longer "chain" of transactions occuring after the record owner sold the security). In cases in which a dealer is the registered owner the Board believes that it would be most efficient for the dealer seeking the interest payment to make its claim directly with that dealer. If the registered owner is not a dealer, the procedure requires the claim to be directed to the dealer that guaranteed the signature of the registered owner. This dealer generally will have a dealer-customer relationship with the registered owner and therefore will be in the best position to obtain the misdirected interest payment from the registered owner.

In the relatively rare cases in which neither the registered owner nor the signature guarantor of the registered owner is a dealer, the procedure requires the claim to be directed to the first dealer whose signature guarantee appears on the security or accompanying transfer documents. The Board

Questions about the amendments may be directed to Harold L. Johnson, Assistant General Counsel.

[1] *MSRB Reports*, vol. 4, no. 6 (November 1984) at 7–8.
[2] *MSRB Reports*, vol. 5, no. 3 (April 1985) at 19–20.
[3] The amendments do not prohibit the use of other claim procedures. For example, several commentators indicated that members of National Securities Clearing Corporation ("NSCC") use a service known as Dividend Settlement Service to make interest payment claims against other members of NSCC.
[4] An inter-dealer delivery of a registered security occurring after record date would be required to be accompanied by an interest payment check pursuant to rule G-12(e)(xiv)(G).

recognizes that this dealer may not have a dealer-customer relationship with the registered owner in such a case and may have to initiate its own claim outside the procedure offered by the amendments. However, this dealer would be identifiable from the security (and any accompanying transfer documents) as being the dealer in the chain of transactions closest to the party that actually received the misdirected interest payment and therefore would be in the best position to locate and identify the registered owner and request the misdirected interest payment.

The procedure requires that claims made based on deliveries of bearer securities received without an appropriate interest payment check be directed to the dealer that delivered the security and that claims based on an erroneous attachment of an interest payment check be directed to the dealer that received the delivery. In situations in which the dealer making the claim realizes after a delivery that a mistake has been made with regard to the interest payment check normally attached to such a delivery, the dealer must direct its claim to the party that failed to include the interest payment with the delivery or to the party that received the interest payment that was erroneously attached.

The procedure requires a written notice of claim to be sent to the dealer against which the claim is made, including certain standard information. The items required to be included in the notice of claim include information identifying the parties involved in the claim, the securities and the interest payment which are the subject of the claim, a statement of the basis on which the claim is made, and, if the claim is based on a delivery of a registered security, a photocopy of the security on which the claim is based or a written statement from the paying agent for the security identifying the party that received the interest payment that is the subject of the claim. For claims made against dealers that delivered the security to, or received the security from, the claimant, the notice of claim also must include the delivery date or the settlement date of the transaction. The Board believes that this information is necessary for the dealer receiving a claim to research the validity of the claim and respond within the time frame required by the procedure.

The amendment requires prompt responses to claims made under the procedure and sets definite time limits for such responses. The amendment requires a dealer receiving a claim made under the procedure to send a check or bank draft in the amount of the interest payment, or a statement containing the reasons that the claim is denied, to the claimant within 10 business days of receipt of the written notice of claim. If the claim is based on an interest payment which occurred more than 60 days prior to the date of the claim, 20 business days are allowed for such response. The Board believes that dealers receiving interest payment claims including the information required by the procedure should be able to determine the validity of the claims and respond within these time limits. The additional 10 days for responses to older claims is provided since additional research time might be needed to locate records and other data pertaining to these interest payments and associated securities transactions.

Summary of Amendment to Rule G-15

The amendment to rule G-15 requires prompt response to interest payment claims made by customers. The amendment sets the same time limits for responding to interest payment claims made by customers as exist for responding to inter-dealer claims—10 business days for claims not more than 60 days old and 20 business days for claims older than 60 days. This requirement to respond promptly is not contingent upon the customer's use of any standard interest claim procedure.

October 15, 1985

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (k) No change.

(l) Interest Payment Claims. A broker, dealer or municipal securities dealer seeking to claim an interest payment on a municipal security from another broker, dealer or municipal securities dealer may claim such interest payment in accordance with this section. A broker, dealer or municipal securities dealer receiving a claim made under this section shall send to the claimant a draft or bank check for the amount of the interest payment or a statement of its basis for denying the claim no later than 10 business days after the date of receipt of the written notice of the claim or 20 business days in the case of a claim involving an interest payment scheduled to be made more than 60 days prior to the date of the claim.

(i) Determining Party to Receive Claim. A claimant making an interest payment claim under this section shall direct such claim to the party described in this paragraph (i).

(A) Previously Delivered Registered Securities. An interest payment claim made with respect to a registered security previously delivered to the claimant which is registered in the name of a broker, dealer or municipal securities dealer at the time of delivery shall be directed to such broker, dealer, or municipal securities dealer. A claim made with respect to a previously delivered registered security not registered in the name of a broker, dealer or municipal securities dealer shall be directed to the broker, dealer or municipal securities dealer guaranteeing the signature of the registered owner or, if neither the registered owner nor its signature guarantor is a broker, dealer or municipal securities dealer, to the broker, dealer or municipal securities dealer that first placed a signature guarantee on any assignment or power of substitution accompanying the security.

(B) Previously Delivered Bearer Securities. An interest payment claim made with respect to a bearer security previously delivered to the claimant shall be directed to the broker, dealer or municipal securities dealer that previously delivered the security.

(C) Securities Delivered by Claimant. An interest payment claim made with respect to a security previously delivered by the claimant shall be directed to the broker,

*Underlining indicates new language.

dealer or municipal securities dealer that received the securities.

(ii) Content of Claim Notice. A claimant seeking to claim an interest payment under this section shall send to the broker, dealer or municipal securities dealer against which the claim is made a written notice of claim including, at minimum:

(A) the name and address of the broker, dealer or municipal securities dealer making the claim;

(B) the name of the broker, dealer or municipal securities dealer against which the claim is made;

(C) the amount of the interest payment which is the subject of the claim;

(D) the date on which such interest payment was scheduled to be made (and, in the case of an interest payment on securities which are in default, the original interest payment date);

(E) a description of the security (including any CUSIP number assigned) on which such interest payment was made;

(F) a statement of the basis of the claim for the interest payment;

(G) if the claim is based on the delivery of a registered security, the certificate numbers of each security on which the claim is based and a photocopy of the certificate(s) on which the claim is based or (in lieu of such a photocopy) a written statement from the paying agent identifying the party that received the interest payment which is the subject of the claim; and,

(H) if the claim is made against the broker, dealer or municipal securities dealer that previously delivered the security on which the claim is based, or the broker, dealer or municipal securities dealer that received such security, the delivery date or settlement date of the transaction.

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

(a) through (d) No change.

(e) Interest Payment Claims. A broker, dealer or municipal securities dealer that receives from a customer a claim for the payment of interest due the customer on securities previously delivered to (or by) the customer shall respond to the claim no later than 10 business days following the date of the receipt of the claim or 20 business days in the case of a claim involving an interest payment scheduled to be made more than 60 days prior to the date of the claim.

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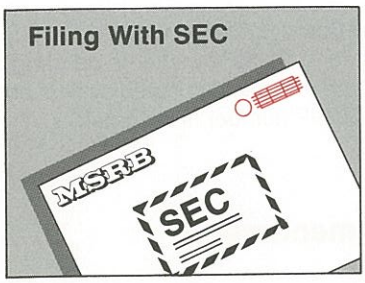

Route To:

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

CUSIP Numbers—Timely Assignment: Rule G-34

Principal Changes Proposed

The amendments would require a dealer—

- **serving as underwriter in a negotiated issue to apply for CUSIP numbers in sufficient time to ensure assignment of the numbers on or before the business day that the contract to purchase the issue is executed, and**
- **serving as a financial advisor to an issuer in connection with a competitive sale to ensure that application for CUSIP numbers for the issue is made in sufficient time to permit assignment of numbers prior to the award.**

On October 8, 1985, the Municipal Securities Rulemaking Board filed with the Securities and Exchange Commission a proposed amendment to the provisions of Board rule G-34 concerning the requirement that underwriters obtain CUSIP numbers for new issues of municipal securities. The proposed amendment is designed to facilitate the use of the automated system for comparison of when-issued transactions, which is scheduled to become operational in early 1986, by ensuring timely assignment of CUSIP numbers for new issues. The Board also wishes to clarify the application of its inter-dealer confirmation rules to a when-issued transaction that takes place during the time that an application for CUSIP numbers for a new issue is pending. The proposed amendment will become effective upon approval by the Commission.

Background

Rule G-34 requires a municipal securities dealer acting as an underwriter of a new issue of municipal securities to apply to the Board or its designee (currently the CUSIP Service Bureau) for CUSIP numbers for the issue no later than the business day after the date of the contract to purchase the issue (for negotiated issues) or the business day after the award of the issue (for competitive issues). The Board understands that CUSIP number assignments for a competitive issue generally are obtained by the issuer prior to the award of the issue. For negotiated issues, however, the underwriter, rather than the issuer, most often is responsible for obtaining CUSIP numbers. The Board also understands that, in some cases, the underwriter for a negotiated issue may not apply for CUSIP numbers until after the contract to purchase the issue is executed. Although this is consistent with the current language of rule G-34, such a late application may result in CUSIP numbers not being assigned when an issue begins trading on a when-issued basis.

The automated comparison system for municipal securities transactions is based upon comparison of CUSIP numbers and National Securities Clearing Corporation ("NSCC"), the central processor for municipal securities comparisons, plans to expand the system to include when-issued trades in early 1986. In order for when-issued transactions to be submitted for comparison in the automated system, CUSIP numbers first must be assigned to an issue. Therefore, unless CUSIP numbers are available on the day that when-issued trading begins in a new issue, dealers will be unable to submit such trades into the automated system in a timely manner on the business day after trade date.

Summary of Amendment

The proposed amendment to rule G-34 would require a dealer serving as underwriter in a negotiated issue to apply for CUSIP numbers in sufficient time to ensure assignment of the numbers on or before the business day that the contract to purchase the issue is executed. In cases in which a contract to purchase a negotiated issue is executed after the normal business hours of the CUSIP Service Bureau, the dealer should apply for a CUSIP number as soon as possible on the business day following the date of the execution of the contract. An underwriter for a competitive issue would be required to apply for CUSIP numbers on the date of the award of the issue. The proposed amendment also would require that a dealer serving as a financial advisor to an issuer in connection with a competitive sale ensure that application for CUSIP numbers for the issue is made in sufficient time to permit assignment of numbers prior to the award.[1]

The Board believes that the use of the automated comparison system for when-issued trades ultimately will pro-

Questions concerning this notice may be directed to Harold L. Johnson, Assistant General Counsel.

[1]Rule G-34 provides that any dealer that would otherwise be required to apply for CUSIP numbers on a new issue is under no obligation to do so if the issuer previously has applied to obtain numbers for the issue.

vide considerable cost savings and bring greater efficiency to the clearance of when-issued transactions in municipal securities. The proposed amendment will promote the use of the automated system of comparison for when-issued securities by helping to ensure the availability of CUSIP numbers for new issues prior to the beginning of when-issued trading in the issues. The Board encourages dealers that are responsible for applying for CUSIP numbers on a negotiated issue to do so as early in the underwriting process as possible to ensure assignment of numbers prior to the execution of the purchase contract for the issue and the beginning of when-issued trading. The Board understands that, in some negotiated issues, the underwriter may not know all the details of the issue necessary to obtain assignment of numbers until just prior to the execution of the purchase contract. The Board encourages underwriters in such cases to supply preliminary information to the CUSIP Service Bureau as early as possible so that the CUSIP number assignment can be made quickly when final and complete information on the issue becomes available.

When-Issued Transaction Must Be Submitted to Automated System If Application for CUSIP Number is Pending

Rule G-12(c) requires that physical confirmations of when-issued transactions be sent out within two business days of trade date. Rule G-12(f) requires trades to be submitted for comparison in an automated comparison system operated by a registered securities clearing agency if certain conditions are met.[2] Rule G-12(a) provides that trades submitted for comparison in the automated system need not be confirmed physically under rule G-12(c).

The Board has received some inquiries from dealers concerning the requirements of rules G-12(c) and (f) once the automated comparison system for when-issued trades becomes operational. These dealers have asked whether when-issued trades should be compared using the physical confirmation process set forth in rule G-12(c) if the trades cannot be submitted immediately into the automated comparison system due to the lack of CUSIP numbers. The Board notes that a when-issued transaction in a new issue for which no CUSIP number will be assigned is not eligible for automated comparison and must be compared by the use of physical confirmations. The Board is interpreting rule G-12(f) to require that, if a request for a CUSIP number is pending, the trade should be submitted into the automated system on an "as of" basis once the CUSIP number is assigned.

October 9, 1985

Text of Proposed Amendments*

Rule G-34.

(a) New Issue Securities.

(i) Assignment of Numbers.

(A) Except as otherwise provided in this section (a), each municipal securities broker or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall apply in writing to the Board or its designee for assignment of a CUSIP number or numbers to such new issue. The municipal securities broker or municipal securities dealer shall make such application as promptly as possible, but in no event later than, ~~in the case of competitive sales, the business day following the date of award, or, in the case of negotiated sales, the business day following the date on which the contract to purchase the securities from the issuer is executed.~~ : in the case of negotiated sales, a time sufficient to ensure assignment of a CUSIP number or numbers on or prior to the business day on which the contract to purchase the securities from the issuer is executed; or, in the case of competitive sales, the date of award. A municipal securities broker or dealer acting as a financial advisor to an issuer in connection with a competitive sale of an issue shall ensure that application for a CUSIP number or numbers is made in sufficient time to permit assignment of CUSIP numbers prior to the date of award. The municipal securities broker or municipal securities dealer shall provide to the Board or its designee the following information:

(1) through (8) No change.

(B) through (D) No change.

(ii) through (iii) No change.

(b) through (c) No change.

[2]Rule G-12(f) requires eligible inter-dealer transactions between participants in a registered securities clearing agency to be submitted for comparison through the automated comparison system. For transactions in which a dealer uses a clearing agent that is a member of a registered securities clearing agency, the dealer is considered to be a participant in the registered securities clearing agency.

*Underlining indicates new language; broken rule indicates deletions.

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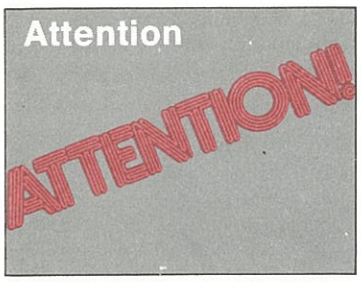

Route To:

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Sending Confirmations to Customers Who Utilize Dealers to Tender Put Option Bonds

Summary of Interpretation

The Board concludes that a dealer which the customer instructs to tender bonds pursuant to a put option must send a confirmation to the customer if the dealer has an interest in the put option bond.

The Board has received inquiries whether a municipal securities dealer must send a confirmation to a customer when the customer utilizes the dealer to tender bonds pursuant to a put option. Board rule G-15(a)(i) requires dealers to send confirmations to customers at or before the completion of a transaction in municipal securities. The Board believes that whether a dealer that accepts for tender put bonds from a customer is engaging in "transactions in municipal securities" depends on whether the dealer has some interest in the put option bond.

In the situation in which a customer puts back a bond through a municipal securities dealer either because he purchased the bond from the dealer or he has an account with the dealer, and the dealer does not have an interest in the put option and has not been designated as the remarketing agent for the issue, there seems to be no "transaction in municipal securities" between the dealer and the tendering bondholder and no confirmation needs to be sent. The Board suggests, however, that it would be good industry practice to obtain written approval of the tender from the customer, give the customer a receipt for his bonds and promptly credit the customer's account. Of course, if the dealer actually purchases the security and places it in its trading account, even for an instant, prior to tendering the bond, a confirmation of this sale transaction should be sent.[1]

If a dealer has some interest in a put option bond which its customer has delivered to it for tendering, a confirmation must be sent to the customer. A dealer that is the issuer of a secondary market put option on a bond has an interest in the security and is deemed to be engaging in a municipal securities transaction if the bond is put back to it.

In addition, a remarketing agent (*i.e.*, a dealer which, pursuant to an agreement with an issuer, is obligated to use its best efforts to resell bonds tendered by their owners pursuant to put options) who accepts put option bonds tendered by customers also is deemed to be engaging in a "transaction in municipal securities" with the customer for purposes of sending a confirmation to the customer because of the remarketing agent's interest in the bonds.[2] The Board's position on remarketing agents is based upon its understanding that remarketing agents sell the bonds that their customers submit for tendering, as well as other bonds tendered directly to the trustee or tender agent, pursuant to the put option. The customers and other bondholders, pursuant to the terms of the issue, usually are paid from the proceeds of the remarketing agents' sales activities.[3]

September 30, 1985

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

[1]This would apply equally in circumstances in which the dealer has an interest in the put option bond.
[2]Of course, remarketing agents also must send confirmations to those to whom they resell the bonds.
[3]If these funds are not sufficient to pay tendering bondholders, such bondholders usually are paid from certain funds set up under the issue's indenture or from advances under the letter of credit that usually backs the put option.

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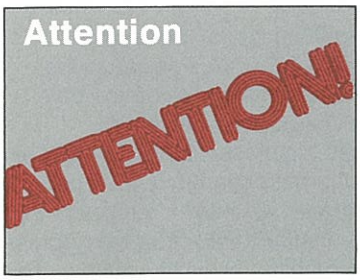

Route To:

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Put Option Bonds—Application of Board Rules: Rules G-12, G-15, G-17, G-25 and G-30

Summary of Interpretations

- **discusses fair practice principles (fair dealing, guarantees against loss, and pricing) applied in several situations;**
- **reviews customer and inter-dealer confirmation disclosure requirements pertaining to description of securities and yield; and**
- **summarizes recent interpretations concerning delivery requirements.**

The Board has received a number of inquiries from municipal securities brokers and dealers regarding the application of the Board's rules to transactions in put option bonds. Put option or tender option bonds on new issue securities are obligations which grant the bondholder the right to require the issuer (or a specified third party acting as agent for the issuer), after giving required notice, to purchase the bonds, usually at par (the "strike price"), at a certain time or times prior to maturity (the "expiration date(s)") or upon the occurrence of specified events or conditions. Put options on secondary market securities also are coming into prominence. These instruments are issued by financial institutions and permit the purchaser to sell, after giving required notice, a specified amount of securities from a specified issue to the financial institution on certain expiration dates at the strike price. Put options generally are backed by letters of credit. Secondary market put options often are sold as an attachment to the security, and subsequently are transferred with that security. Frequently, however, the put option may be sold separately from that security and re-attached to other securities from the same issue.

Of course, the Board's rules apply to put option bonds just as they apply to all other municipal securities. The Board, however, has issued a number of interpretive letters on the specific application of its rules to these types of bonds. These interpretive positions are reviewed below.

Fair Practice Rules

Rule G-17.—Board rule G-17, regarding fair dealing, imposes an obligation on persons selling put option bonds to customers to disclose adequately all material information concerning these securities and the put features at the time of trade. In an interpretive letter on this issue,[1] the Board responded to the question whether a dealer who had previously sold put option securities to a customer would be obligated to contact that customer around the time the put option comes into effect to remind the customer that the put option is available. The Board stated that no Board rule would impose such an obligation on the dealer.

In addition, the Board was asked whether a dealer who purchased from a customer securities with a put option feature at the time of the put option exercise date at a price significantly below the put exercise price would be in violation of any Board rules. The Board responded that such dealer may well be deemed to be in violation of Board rules G-17 on fair dealing and G-30 on prices and commissions.

Rule G-25(b).—Board rule G-25(b) prohibits brokers, dealers, and municipal securities dealers from guaranteeing or offering to guarantee a customer against loss in municipal securities transactions. Under the rule, put options are not deemed to be guarantees against loss if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v).[2] Thus, when a municipal securities dealer is the issuer of a secondary market put option on a municipal security, the terms of the put option must be included with or on customer confirmations of transactions in the underlying security. Dealers that sell bonds subject to put options issued by an entity other than the dealer would not be subject to this disclosure requirement.

Confirmation Disclosure Rules

Description of Security.—Rules G-12(c)(v)(E) and G-15(a)(i)(E) require inter-dealer and customer confirmations to set forth

> a description of the securities, including . . . if the securities are . . . subject to redemption prior to maturity. . . , an indication to such effect . . . .

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

[1] *See* MSRB Interpretation of February 18, 1983, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3581 at 3569-6.
[2] Rule G-8(a)(v) requires dealers to record, among other things, oral or written put options with respect to municipal securities in which such municipal securities broker or dealer has any direct or indirect interest, showing the description and aggregate par value of the securities and the terms and conditions of the option.

Confirmations of transactions in put option securities, therefore, would have to indicate the existence of the put option (*e.g.,* by including the designation "puttable" on the confirmation), much as confirmations concerning callable securities must indicate the existence of the call feature. The confirmation need not set forth the specific details of the put option feature.[3]

Rules G-12(c)(v)(E) and G-15(a)(i)(E) also require confirmations to contain

> a description of the securities including at a minimum . . . if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service . . . .

The Board has stated that a bank issuing a letter of credit which secures a put option feature on an issue is "obligated . . . with respect to debt service" on such issue. Thus, the identity of the bank issuing the letter of credit securing the put option also must be indicated on the confirmation.[4]

Finally, rules G-12(c)(v)(E) and G-15(a)(i)(E) require that dealer and customer confirmations contain a description of the securities including, among other things, the interest rate on the bonds. The Board has interpreted this provision as it pertains to certain tender option bonds with adjustable tender fees to require that the net interest rate (*i.e.,* the current effective interest rate taking into account the tender fee) be disclosed in the interest rate field and that dealers include elsewhere in the description field of the confirmation the stated interest rate with the phrase "less fee for put."[5]

Yield Disclosure.—Board rule G-12(c)(v)(I) requires that inter-dealer confirmations include the

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

Rule G-15(a)(i)(I) requires that customer confirmations include information on

> yield and dollar price as follows:
>
> (1) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity.
>
> (2) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown.
>
> (3) for transactions at par, the dollar price shall be shown.
>
> In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated, and the call or option date and price used in the calculation must be shown.

Neither of these rules requires the presentation of a yield or a dollar price computed to the put option date as a part of the standard confirmation process. In many circumstances, however, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to the put option date, and that the dollar price will be computed in this fashion. If that is the case, the yield to the put date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to the put date, together with a statement that it is a "yield to the [date] put option" and an indication of the date the option first becomes available to the holder.[6] The requirement for transactions effected on a yield basis of pricing to the lowest of price to call, price to par option or price to maturity, applies only when the parties have not specified the yield on which the transaction is based.

In addition, in regard to transactions in tender option bonds with adjustable tender fees, even if the transaction is not effected on the basis of a yield to the tender date, dealers must include the yield to the tender date since an accurate yield to maturity cannot be calculated for these securities because of the yearly adjustment in tender fees.[7]

Delivery Requirements

In a recent interpretive letter, the Board responded to an inquiry whether, in three situations, the delivery of securities subject to put options could be rejected.[8] The Board responded that, in the first situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date but delivered after the option expiration date, such delivery could be rejected since the securities delivered were no longer "puttable" securities. In the second situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date and delivered prior to that date, but too late to permit the recipient to satisfy the conditions under which it could exercise the option (*e.g.,* the trustee is located too far away for the recipient to be able to present the physical securities by the expiration date), the Board stated that there might not be a basis for rejecting delivery, since the bonds delivered were "puttable" bonds, depending on the facts and circumstances of the delivery. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

Finally, in the third situation, securities which were the subject of a put option exercisable on a stated periodic basis (*e.g.,* annually) were purchased for settlement prior to the annual exercise date of the option but not delivered until after the annual exercise date so that the recipient was unable to exercise the option at the time it anticipated being

[3]*See* MSRB Interpretation of April 24, 1981, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3556 at 3559-8.
[4]*See* MSRB Interpretation of December 2, 1982, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3571 at 3567-15.
[5]*See* MSRB Interpretation of March 5, 1985, by Diane G. Klinke, Deputy General Counsel, *MSRB Manual* (CCH) ¶3556 at 3559-12.
[6]*See* MSRB Interpretation of April 24, 1981, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3556 at 3559-10.
[7]*See* fn. 5.
[8]*See* MSRB Interpretation of February 27, 1985, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3556 at 3559-5.

able to do so. The Board stated that this delivery could not be rejected since "puttable" bonds were delivered. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

The Board welcomes the views of all interested persons on the application of current Board rules to transactions in put option bonds.

September 30, 1985