MSRB REPORTS

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Providing Information to Syndicate Co-Managers

Reminder: Rule G-11

Rule G-11, concerning syndicate practices, requires the senior syndicate manager, among other things, to disclose to other members of the syndicate the allocation of securities (rule G-11(g)) and syndicate expenses and other information (rule G-11(h)). The Board wishes to remind dealers that co-managers of syndicates, as syndicate members, also must receive this information from the senior syndicate manager within the time frames specified by rule G-11.

Calendar

June 18 —Effective date of G-35 on arbitration

June 27 —Short-Term Securities eligible for application for CUSIP numbers

July 7 —Effective date of G-12 and G-15 on confirmation disclosure for taxable securities

October 31—Comments due on
- G-8 concerning suitability recordkeeping requirements
- G-12 concerning open inter-dealer transactions
- G-15 concerning disclosure of call features

Pending —G-26 on customer account transfers

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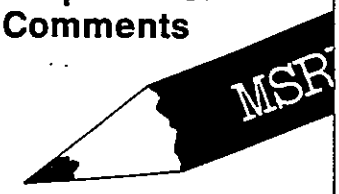
Request For Comments



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Recordkeeping Requirements for Suitability Information: Rule G-8

Comments Requested

Dealers would be required to maintain information concerning a customer's financial background, tax status and investment objectives.

The Board is publishing for comment a draft amendment to rule G-8(a)(xi) which would require municipal securities dealers to record suitability information on customer account records.

Rule G-19(b), on suitability, provides that before making a recommendation to a customer, a securities professional must determine that the transaction is a suitable investment for that customer. The rule specifies that a suitability determination shall be based upon, among other things, information furnished by the customer relating to the customer's "financial background, tax status and investment objectives. . . ." Rule G-8(a)(xi), on books and records, requires dealers to obtain and record certain information concerning each customer account. This rule does not, however, require dealers to document suitability information obtained pursuant to rule G-19(b).

The draft amendment to rule G-8(a)(xi) would require municipal securities dealers to record and maintain certain basic information obtained pursuant to rule G-19(b) on customer account records. The draft amendment specifies information concerning the customer's financial background, tax status and investment objectives, as well as any other similar information used or expected to be used by such municipal securities dealer in making recommendations to the customer.

In August 1980 the Board proposed a similar amendment to rule G-8(a)(xi). The Board suggested that a suitability recordkeeping requirement would be valuable to dealers in making recommendations and would assist municipal securities principals and regulatory examiners in reviewing transactions for compliance with rule G-19(b). Subsequently, the Board withdrew the proposed amendment because it understood that the corporate securities industry was not subject to a similar recordkeeping requirement and concluded that the amendment would unfairly increase the regulatory burden on municipal securities dealers.

The Board has reviewed its earlier assessment that a suitability recordkeeping requirement would be unfairly burdensome to municipal securities dealers. The Board has found that suitability recordkeeping generally is practiced by integrated firms, which represent a majority of municipal securities dealers. It therefore should not be unduly burdensome for sole municipal securities dealers and dealer banks also to follow this practice. Moreover, the Board believes that substantial benefits to customers and dealers would be derived from the draft amendment. Recording suitability information on customer account records would provide additional investor protection by facilitating a dealer's discharge of its suitability responsibilities. Also, suitability information recorded on the customer's account record would afford protection to dealers in the event the suitability of a recommendation subsequently is questioned. The information also would be useful to dealers when a customer continues to use the same dealer after the salesperson originating the account no longer is employed by the dealer. The customer's account form, containing the pertinent suitability information, could be forwarded to the new salesperson, thus providing continuity for the customer and the dealer.

It does not appear that maintaining suitability information would be burdensome since it could be recorded on the customer's account card via a checklist. The securities professional would simply mark the appropriate selection corresponding to the investor's financial background, tax status and investment objectives.

The Board requests comments from interested persons on the draft amendment and on current industry suitability recordkeeping practices. The Board also requests comments whether, if it adopts the draft amendment, it should delay the effective date to allow municipal securities dealers to implement the required recordkeeping procedures.

August 7, 1986

Comments on the matters discussed in this notice should be submitted not later than October 31, 1986, and may be directed to Angela Desmond, General Counsel. Written comments will be available for public inspection.

Text of Draft Amendment*

Rule G-8. Books and Records to be Made by Municipal Securities Brokers and Municipal Securities Dealers

(a) through (a)(x) No change.

(a)(xi) Customer Account Information. A record for each customer, other than an institutional account, setting forth the following information to the extent applicable to such customer:

(A) through (E) No change.

(F) information obtained pursuant to rule G-19(b) concerning the customer's financial background, tax status and investment objectives, as well as any other information used or expected to be used by such municipal securities dealer in making recommendations to the customer;

(~~F~~) through (~~J~~) renumbered (G) through (K).

For purposes of this subparagraph, the terms "general securities representative" and "general securities principal" shall mean such persons as so defined by the rules of a national securities exchange or registered securities association. For purposes of this subparagraph, the term "institutional account" shall mean the account of an investment company as defined in section 3(a) of the Investment Company Act of 1940, a bank, an insurance company, or any other institutional type account. Anything in this subparagraph to the contrary notwithstanding, every municipal securities broker and municipal securities dealer shall maintain a record of the information required by items (A), (C), (~~G~~) (H), (~~H~~) (I) and (~~J~~) (K) of this subparagraph with respect to each customer which is an institutional account.

(a)(xii) through (g) No change.

*Underlining indicates new language; broken rule indicates deletions

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Open Inter-Dealer Transactions: Rule G-12

Comments Requested

The Board requests comments whether substantial numbers of open inter-dealer transactions exist and, if so, suggestions as to possible actions the Board might take to address the problem.

The Board occasionally receives inquiries involving situations in which a dealer owing securities to another dealer recognizes that it will not be able to complete the transaction and wishes to have the transaction closed out. The dealer purchasing the securities in such a case, however, may choose not to exercise its right to close out the transaction under rule G-12(h). The Board is reviewing the application of its rules governing the resolution of such open transactions, and is seeking comment from interested persons whether substantial numbers of open transactions are a problem in the industry and suggestions for measures that could facilitate resolution of such transactions. If the Board is informed that a problem exists, it will consider rulemaking in the area.

Current Rules Governing Close-Outs

Rule G-12(h) specifies the procedure to be utilized by dealers in closing out open inter-dealer transactions. The rule allows the purchasing dealer to issue a notice of close-out to the selling dealer on any day[1] from five to 90 days after the scheduled settlement date.[2] If the selling dealer does not deliver the securities owed on the transaction within 10 days after the notice of close-out (15 days for retransmitted notices), the purchasing dealer may execute the close-out using one of three options: (i) "buy in" identical securities for the account and liability of the selling dealer; (ii) agree with the selling dealer to accept substitute securities; or (iii) require the selling dealer to repurchase the securities, the selling dealer paying any increase in the market value of the securities (a "mandatory repurchase"). The selling dealer must pay any monies owed on a close-out within 10 days of the execution of the close-out.

Rule G-12(h) does not require a purchasing dealer to use the close-out procedure to resolve open transactions or to execute notices of close-out that it has initiated. If the close-out procedure is not initiated within 90 days of the settlement date (and ultimately executed), the transaction remains open until it is resolved by the agreement of the parties or through the Board's arbitration procedure. During this period, the selling dealer is subject to market risk[3] and may be subject to adverse net capital treatment on the open transaction.[4]

Because of the concerns noted above, a selling dealer that cannot complete a transaction to a purchasing dealer may wish to have the trade resolved and its potential liability settled as quickly as possible. Rule G-12(h) currently does not provide a procedure for the selling dealer to close out the transaction if the purchasing dealer declines to do so.[5] The Board, however, previously has recognized that allowing a selling dealer to initiate a close-out of an open transaction may limit the flexibility of the purchasing dealer in resolving offsetting customer transactions and could result in the purchasing dealer assuming unanticipated market risks.[6] For these reasons, the Board has left the right to initiate close-outs exclusively with the purchasing dealer.

Comments Requested on Possible Board Actions

The Board is requesting comment on the nature and the extent of the problem of open inter-dealer transactions, especially those that remain open for more than 90 days. Specifically, the Board requests comment on the number of such open transactions in the industry, the reasons for their

Comments on the matters discussed in this notice should be submitted not later than October 31, 1986, and may be directed to Harold L. Johnson, Assistant General Counsel. Written comments will be available for public inspection.

[1] All references to "days" are business days.

[2] The purchaser also may initiate a close-out within 15 days after a reclamation made under rule G-12(g)(iii)(C) or rule G-12(g)(iii)(D), even though more than 90 days have elapsed since the original settlement date.

[3] If the purchasing dealer executes a buy-in or a mandatory repurchase in a rising market, the selling dealer is liable for the increase in the market value of the securities.

[4] Securities firms are subject to capital charges for municipal securities fail-to-deliver items over 20 days old.

[5] Rule G-12(h)(ii) does provide the selling dealer the right to close-out a transaction if the purchasing dealer refuses to accept a good delivery of securities made pursuant to a confirmed (or otherwise agreed upon) trade. This situation should be contrasted with one in which a seller cannot make a good delivery and desires that the close-out rules be used to resolve the trade.

[6] For example, a purchasing dealer may have an offsetting transaction with a customer who refuses to accept substitute securities or to otherwise resolve the open transaction. If securities are not available for a buy-in and the purchasing dealer must close out its open transaction with the selling dealer, it will continue to remain liable on its transaction with the customer. This effectively shifts the market risk of the open transaction from the selling dealer to the purchasing dealer.

existence and the extent of any operational, financial accounting or other problems that such transactions cause. The Board also requests comment on methods currently used by selling dealers to resolve open transactions, whether these methods generally are successful, and whether Board rulemaking is necessary. Finally, the Board would welcome suggestions on actions that it could take to provide selling dealers with a procedure to resolve open transactions, and that also would address fairly the concerns of purchasing dealers in such transactions.

August 14, 1986

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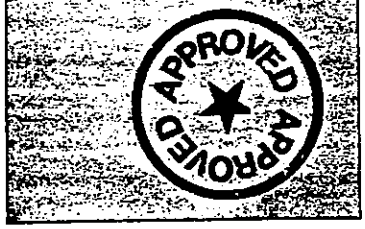
Notice of Approval



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Confirmation Disclosure Requirements for Taxable Securities: Rules G-12 and G-15

Amendments Approved

The amendments require that confirmations of transactions in municipal securities identified by the issuer or sold by the underwriter as subject to federal taxation contain a designation to that effect.

On July 7, 1986, the Securities and Exchange Commission approved amendments to rules G-12 and G-15 which require that confirmations of transactions involving municipal securities which have been identified by the issuer or sold by the underwriter as subject to federal taxation contain a designation to that effect.[1] The amendments became effective upon approval by the Commission.

Recently, there have been several "taxable" issues of municipal securities brought to market. Under Section 3(a)(29) of the Securities Exchange Act, the definition of a municipal security turns on whether the security is an obligation of a state or political subdivision of a state, and not whether income derived from the security is taxable. Board rules, therefore, apply to transactions in taxable municipal securities in the same way as they apply to other, more traditional municipal securities.

Although under rule G-17, on fair dealing, a dealer should advise customers of the taxable status of municipal securities at the time of or prior to execution of a transaction in such securities, the Board's confirmation rules previously had no disclosure requirements regarding transactions in such securities. The Board has determined that confirmation disclosure would be appropriate since the majority of municipal securities likely will continue to be tax-exempt and dealers and customers may find it necessary or appropriate to preserve a record of transactions in taxable municipal securities.

July 7, 1986

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (b) No change.

(c) Dealer Confirmations.

(i) through (v) No change.

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

(A) through (B) No change.

(C) if the securities are identified by the issuer or sold by the underwriter as subject to federal taxation, a designation to that effect;

(~~C~~) through (~~G~~) renumbered (D) through (H)

(d) through (l) No change.

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

(a) Customer Confirmations.

(i) through (ii) No change.

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

(A) through (B) No change.

(C) if the securities are identified by the issuer or sold by the underwriter as subject to federal taxation, a designation to that effect;

(~~C~~) through (~~H~~) renumbered (D) through (I)

(b) through (e) No change.

Questions about the amendments may be directed to Angela Desmond, General Counsel.

[1] SEC Release No. 34-23402.

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CUSIP Service Bureau Notice on Eligibility of Short-Term Securities

Rule G-34 requires a dealer serving as an underwriter for a competitive issue of municipal securities or as a financial advisor for a negotiated issue of municipal securities to ensure that CUSIP numbers are applied for and assigned to the issue by the date of sale. Until recently, municipal securities issues under one year in maturity were not eligible for CUSIP number assignment and thus were not subject to the requirements of the rule. The CUSIP Service Bureau announced on June 27, 1986, that it would make eligible, on a pilot basis, certain short-term municipal securities that mature in less than one year. Dealers serving as underwriters and financial advisors for such short-term issues should be aware that rule G-34 requires that they ensure that CUSIP numbers are applied for and assigned to the issues.

The CUSIP Service Bureau announced the new eligibility of short-term municipal securities issues in the following notice.

June 27, 1986

TO: OPERATIONS MANAGERS
[FROM: CUSIP SERVICE BUREAU]

RE: SHORT TERM MUNICIPAL SECURITIES

To meet the needs of the securities industry over a period of time, the CUSIP Service Bureau has modified the eligibility rules regarding Short Term Securities.

To further expand the benefits of the System, the CUSIP Board of Trustees has authorized the CUSIP Service Bureau, on a pilot basis, to assign new CUSIP numbers to BANS, TANS, TRANS, RANS and other similar type securities that mature in less than one year.

The new rules will apply to all these short term securities of issuers which previously met the usual CUSIP eligibility requirements and have other securities outstanding. Numbers will be assigned automatically on issues over $1,000,000 upon receipt of appropriate documents by the Service Bureau. Issues of smaller size, which are depository eligible, will also be eligible for number assignment upon request.

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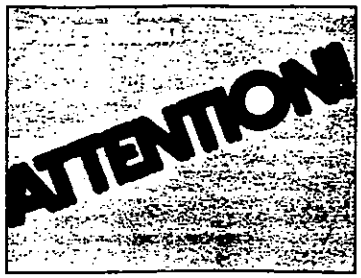

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Price Calculation for Securities with an Initial Non-Interest Paying Period: Rule G-33

Summary of Interpretation

The Board adopts a method for calculating the price of securities with periodic interest payments, but with an initial non-interest paying period.

The Board has adopted a method for calculating the price of securities for which there are no scheduled interest payments for an initial period, generally for several years, after which periodic interest payments are scheduled. These securities, known by such names as "Growth and Income Securities," and "Capital Appreciation/Future Income Securities," function essentially as "zero coupon" securities for a period of time after issuance, accruing interest which is payable only upon redemption.[1] On a certain date after issuance (the "interest commencement date"), the securities begin to accrue interest for semi-annual payment.

In March 1986, the Board published for comment a proposed method of calculating price from yield for such securities.[2] The Board received five comments on the proposed method, four expressing support for the method and one expressing no opinion.[3] The commentators generally noted that the proposed method appeared to be accurate and could be used on bond calculators commonly available in the industry. The Board has adopted the proposed method of calculation, set forth below, as an interpretation of rule G-33 on calculations.

The general formula for calculating the price of securities with periodic interest payments is contained in rule G-33(b)(i)(B)(2). For securities with periodic payments, but with an initial non-interest paying period, this formula also is used. For settlement dates occurring prior to the interest commencement date the price is computed by means of the following two-step process. First, a hypothetical price of the securities at the interest commencement date is calculated using the interest commencement date as the hypothetical settlement date,[4] the interest rate ("R" in the formula) for the securities during the interest payment period and the yield ("Y" in the formula) at which the securities are sold. This hypothetical price is computed to not less than six decimal places, and then is used as the redemption value ("RV" in the formula) in a second calculation using the G-33(b)(i)(B)(2)formula, with the interest commencement date as the redemption date, the actual settlement date for the transaction as the settlement date, and a value of zero for R, the interest rate. The resultant price, using the formula in G-33(b)(i)(B)(2), is the correct price of the securities.[5]

The price of such securities for settlement dates occurring after the interest commencement date, of course, should be calculated as for any other securities with periodic interest payments.[6]

August 25, 1986

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

[1]This interpretation is not meant to apply to securities which have a long first coupon period, but which otherwise are periodic interest paying securities.
[2]*MSRB Reports*, vol. 6, no. 2 (March 1986) at 13
[3]One commentator, while expressing no opinion on the proposed method, commented on the bidding methods used for transactions in such securities. The Board notes that its rules do not require a specific format for expressing bids or offers in such securities. Rule G-13, however, does require that bids or offers made by dealers be bona fide
[4]For settlement dates less than six months to the hypothetical redemption date, the formula in rule G-33(b)(ii)(B)(1) should be used in lieu of the formula in rule G-33(b)(ii)(B)(2).
[5]Rules G-12(c)(v)(I) and G-15(a)(i)(I) require that securities be priced to the lowest of price to call, price to par option, or price to maturity. Thus, the redemption date used for this calculation method should be the date of an "in whole" refunding call if this would result in a lower dollar price than a computation to maturity.
[6]The formula in G-33(b)(i)(B)(1) should be used for calculations in which settlement date is six months or less to redemption date.

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Activities of Financial Advisors: Rule G-23

Questions and Answers

Answers to frequently asked questions concerning the ethical standards and disclosure requirements for dealers who act as financial advisors to municipal securities issuers.

FINANCIAL ADVISORY RELATIONSHIPS

Q: What is the intent of rule G-23 concerning the activities of financial advisors?

A: The intent of this rule is to establish disclosure requirements and standards for dealers who act as financial advisors to issuers of municipal securities.

Q: When is a dealer acting as a financial advisor?

A: A dealer advising an issuer with respect to the structure, timing, terms and other similar matters concerning a new issue or issues of municipal securities, for a fee or other compensation or in expectation of such compensation is acting as a financial advisor.

Q: Is a dealer acting as a financial advisor for purposes of the rule when it structures a financing while acting as an underwriter on a negotiated issue?

A: No. A financial advisory relationship does not exist when, in the course of acting as an underwriter on a negotiated issue, a dealer advises an issuer, with respect to the structure, timing, terms and other similar matters concerning a new issue of municipal securities.

Q: Does the rule apply if a financial advisor acts as an agent for the issuer in placing the bonds?

A: No. The rule applies only when a dealer, acting as a financial advisor to an issuer, wishes to "acquire as principal . . . from the issuer" the issue.

Q: Are all financial advisors subject to the rule?

A: The Board's rules apply only to financial advisors who are registered as brokers, dealers and municipal securities dealers with the SEC.

Q: Are financial advisory services provided to corporate obligors in connection with IDB financings subject to rule G-23?

A: No. Rule G-23 applies to dealers that agree to render financial advisory services to or on behalf of the "issuer."

Q: Must a financial advisory relationship be evidenced by a writing?

A: Yes. Each financial advisory relationship must be evidenced by a writing entered into prior to, upon, or promptly after the inception of the financial advisory relationship.

Q: Would financial advisory services furnished to a municipal district which has not yet been officially established at the inception of the relationship constitute financial advisory services for the purposes of the rule?

A: Yes. Paragraph (c) of the rule contemplates that the rule may apply even if the municipal issuer does not exist at the inception of the financial advisory relationship.

Q: If a dealer has an agreement with an issuer which provides that the dealer will furnish financial advisory services from time to time at the issuer's request, does a financial advisory relationship exist with respect to a proposed new issue?

A: If a dealer has entered into a blanket agreement to render financial advisory services, a financial advisory relationship with respect to a particular new issue of securities will be presumed to exist. Whether or not the dealer actually has a financial advisory relationship with respect to the new issue is a factual question.

COMPENSATION

Q: Must the dealer and issuer enter into a written agreement regarding the dealer's compensation for its financial advisory services?

A: Yes. The agreement must state the basis of compensation for the financial advisory services, including provisions relating to the deposit of funds with or the utilization of fiduciary or agency services offered by such dealer.

Q: Is a financial advisory agreement which states that "the basis of compensation shall be a fee not to exceed X dollars" sufficient?

A: No. The dealer should specify the fees or commissions it is charging, not merely the highest possible amount of compensation it could receive.

Q: If a dealer provides financial advisory services for a fee and subsequently resigns to negotiate the issue,

does the dealer have to reimburse the issuer for the fees received while acting as the financial advisor?

A: No. If the dealer received these fees for its services during the period it was acting as financial advisor for an issuer it may retain those fees.

UNDERWRITING ACTIVITIES

Q: May a financial advisor for a particular issue underwrite another issue for the same issuer without complying with the requirements of rule G-23(d)?

A: Yes. The rule applies only to a dealer that acts in both capacities with respect to a single issue of securities.

Q: Are there any restrictions on a financial advisor that wishes to underwrite a negotiated issue on which it is financial advisor?

A: Yes Rule G-23(d)(i) requires a financial advisor to:

(a) terminate the financial advisory relationship, in writing, and obtain the issuer's express consent to the dealer s participation in the underwriting;

(b) disclose in writing to the issuer that there may be a conflict of interest in changing from the capacity of financial advisor to underwriter and obtain the issuer's written receipt of such disclosure; and

(c) disclose to the issuer the source and anticipated amount of all remuneration to the dealer with respect to the issue in addition to compensation already received as the financial advisor and obtain the issuer's written receipt of such disclosure.

Q: When must a financial advisor obtain an issuer's consent permitting it to underwrite a negotiated sale?

A: The consent of the issuer must be obtained "at or after" the termination of the financial advisory relationship.

Q: May a financial advisor to an issuer for several issues terminate its financial advisory relationship with the issuer only with respect to a specific negotiated issue which it wishes to underwrite?

A: Yes. Under these circumstances, the advisory relationship may be terminated with respect to the specific negotiated issue.

Q: Must a dealer keep a record of all written agreements, disclosures, acknowledgements and consents?

A: Yes. Each dealer must maintain a copy of the written agreements, disclosures, acknowledgements and consents in a separate file and as required by rule G-9.

Q: What requirement must a financial advisor meet in order to bid on a competitive issue?

A: Rule G-23(d)(ii) requires the financial advisor to obtain the express written consent of the issuer prior to bidding on the issue.

Q: May a financial advisor obtain from the issuer prospective approval to participate in future competitive issues?

A: No. An issuer should have an opportunity to consider whether the financial advisor's potential conflict of interest is sufficient to warrant not consenting to its participation in the sale. The Board has concluded that an unrestricted consent would not afford an issuer such an opportunity and accordingly such blanket consent is not permitted.

Q: May a financial advisor reserve the right to bid on a competitive issue in the official statement or notice of sale?

A: No, since it is not clear that the issuer has a sufficient opportunity to determine whether it is in its best interest to allow its financial advisor to bid on the issue.

Q: Are there any restrictions on a financial advisor that wishes to purchase some of the bonds of an issue in the secondary market or as a member of a selling group?

A: A financial advisor is not precluded 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.

DISCLOSURE TO CUSTOMERS

Q: Does a dealer have to disclose his role as financial advisor of an issue of which it is an underwriter to a customer?

A: Yes. The dealer must disclose the financial advisory relationship in writing to each customer who purchased such securities from the dealer.

Q: When should a dealer acting as an underwriter make this disclosure?

A: Disclosure must be made to the customer at or before completion of the transaction. Thus, the disclosure may be made in the official statement, the when-issued confirmation or in the final confirmation as long as the customer receives it before completion of the transaction.

APPLICABILITY OF STATE OR LOCAL LAW

Q: Does the rule supersede a state law which prohibits financial advisors from serving as underwriters?

A: The rule specifically provides that it is not intended to supersede any more restrictive provisions of state or local law concerning the activities of financial advisors.

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Disclosure Requirements for New Issue Securities: Rule G-32

Questions and Answers

Answers to frequently asked questions concerning disclosure requirements to customers purchasing new issue securities.

GENERAL

Q: What is the intent of rule G-32?

A: The rule is designed to ensure that a customer who purchases new issue municipal securities is provided with a final official statement, if one is prepared by the issuer, as well as certain other information by settlement date so that the customer possesses all the available information relevant to his investment decision.

Q: Have there been any recent amendments to rule G-32 on disclosures in connection with new issues?

A: Yes. In September 1985, amendments to rule G-32 became effective. The amended rule requires:

(1) delivery of rule G-32 disclosures, including a final official statement, if one is prepared, to a customer purchasing new issue securities by settlement date of the transaction;

(2) delivery of a preliminary official statement only if no final official statement has been prepared, along with a written notice that a final official statement has not been prepared;

(3) financial advisors and/or managing underwriters to make the final official statement available in a timely manner; and

(4) managing underwriters to provide, upon request, purchasing dealers (including syndicate members) with an official statement as well as other information required by rule G-32 and one additional official statement per $100,000 par value of the new issue securities.

DEFINITION OF NEW ISSUE SECURITIES

Q: What are new issue municipal securities?

A: Rule G-32 defines new issue municipal securities as securities of an issuer that are sold by a dealer during the underwriting period, as defined in Board rule G-11(ix).

Q: Do new issue municipal securities include issues of tax-exempt commercial paper?

A: No. Written disclosures usually are provided to investors of tax-exempt commercial paper on a periodic basis rather than at issuance of the securities.

Q: Does rule G-32 apply to new issues of tax-exempt notes as well as bonds?

A: Yes. Rule G-32 does not make any distinction between bonds and notes. It also applies to general obligation issues and revenue issues.

Q: Does rule G-32 apply to securities which are privately placed?

A: Yes. The Board has determined that the rule should apply in such circumstances.

PREPARATION OF OFFICIAL STATEMENTS

Q: What is an official statement?

A: An official statement is a document prepared by an issuer or its representative stating, among other things, information concerning the issuer and the proposed issue of securities.

Q: Is there any obligation for a municipal securities dealer to prepare an offering document if no official statement is prepared by the issuer?

A: No. Rule G-32 requires that a municipal securities dealer furnish an offering statement only if one is voluntarily prepared by or on behalf of an issuer.

Q: What are the responsibilities of managing underwriters that prepare final official statements on behalf of issuers?

A: Managing underwriters are responsible for ensuring that final official statements are printed in sufficient time and in sufficient number to permit dealers to deliver them to customers by settlement of their transactions.

Q: What is "sufficient time?"

A: The official statements must be printed in final form no later than two business days prior to the date the securities are delivered by the manager to the syndicate members.

Q: How many official statements are managing underwriters required to prepare?

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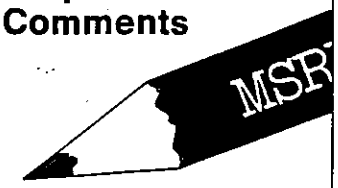
Request For Comments



Route To:

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

Disclosure of Call Features to Customers: Rule G-15

Comments Requested

The Board is considering amendments which would require dealers to deliver to customers, upon request, *written* information about call features of securities within specified time limits.

In recent years, the number and complexity of call features in issues of municipal securities have increased dramatically. Ten years ago, an issue may have had only an optional refunding call and a schedule of sinking fund calls. Today, most issues include those redemption features as well as a number of extraordinary calls. These developments heighten the necessity of a dealer meeting its obligation to explain all material features of a municipal security, including call features, to a customer at or before executing a transaction in the security, and to ensure that any recommended transaction is suitable for the customer in light of the particular features of the security and information known about the customer. This notice reviews a dealer's disclosure obligations under rules G-17, on fair dealing, and G-19, on suitability, which require that a dealer be knowledgeable about all call features of a security prior to effecting any customer transactions in the security, as well as the current confirmation disclosure requirements applicable to call features in rule G-15(a). The Board also is requesting comment on draft amendments to rule G-15(a) that would require a dealer effecting a customer transaction in a municipal security to deliver to its customer, upon request, written information about the call features of the security within specific time limits.

Introduction

Many issues of municipal securities provide that the issuer may or, in some circumstances, must redeem ("call") all or a portion of an outstanding issue prior to its stated date of maturity at a specified price. These redemption features generally are referred to as mandatory and optional calls. Mandatory calls are those outside of the issuer's control based on a predetermined schedule or upon the occurrence of certain events. Such calls include catastrophe or other extraordinary calls and certain sinking fund calls.

A mandatory extraordinary call may arise, for example, when an issuer is required to call bonds if proceeds of an issue are not expended for the purpose of the issue as of a given time or if a letter of credit backing the issue expires and is not renewed. One type of extraordinary mandatory redemption is a catastrophe call in which the issuer must call the issue because of events beyond its control, *e.g.*, the facility is destroyed during construction due to an accident.

A mandatory sinking fund call is a redemption of a portion of an issue from moneys in the sinking fund, which is a fund into which the issuer covenants to make periodic deposits to ensure the timely availability of sufficient moneys for the repayment of principal. A sinking fund provision may include a "super sinker" feature. This provision usually applies to a term maturity, usually from a single family mortgage revenue issue, which will be the first to be called from a sinking fund into which all proceeds from prepayments of mortgages financed by the issue are deposited.

Optional calls are calls which the issuer may determine to exercise usually after a stated date and at a premium and include, for example, in-whole refunding calls. Extraordinary and sinking fund calls also may be optional. For example, an issuer may have authority to determine to redeem bonds in the event that mortgages are prepaid in connection with a housing revenue bond issue.

Application of Board Rules G-17, G-19, and G-15(a)

Board rule G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

The Board has interpreted rule G-17 to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision and must not omit any material facts which would render other statements misleading. In addition, rule G-19, on suitability, prohibits a municipal securities professional from recommending transactions in municipal securities to a customer unless the professional has reasonable grounds for making the recommendation in light of information about the security available from the issuer or otherwise and believes

Comments on the matters discussed in this notice should be submitted not later than October 31, 1986, and may be directed to Diane G. Klinke, Deputy General Counsel. Written comments will be available for public inspection.

that the transaction in the security is suitable for the particular customer.

The fact that a municipal security may be redeemed in-whole, in-part, or in extraordinary circumstances is essential to a customer's investment decision about the security and is one of the facts a dealer must disclose at or prior to the execution of the transaction. In addition, a dealer, if asked by a customer for more specific information regarding a call feature, should obtain this information and relay it to the customer promptly. Moreover, it would be difficult for a dealer to recommend the purchase of a security to a customer without evaluating information regarding the security's call features to determine whether the transaction would be suitable for the customer.

With respect to confirmations, rule G-15(a) requires dealers to disclose on customer confirmations if a security is subject to redemption prior to maturity by noting "callable"[1] and to include a legend stating that "Call features may exist which could affect yield; complete information will be provided upon request." Thus, a customer, upon receipt of the confirmation, may ask for further information on call features, and dealers have a duty to obtain and disclose such information promptly.[2] Of course, a confirmation is not received by a customer until after a transaction is effected, and the Board wishes to emphasize that confirmation disclosures do not eliminate the duty of a municipal securities professional to explain a security adequately to a customer at or prior to execution of the transaction.

Summary of Draft Amendments to Rule G-15(a)

Because an issue of municipal securities may include a number of complex call features which may affect the price or investment value of a security, the Board believes that its rules should provide a means by which complete information about call features is conveyed to customers in writing upon request. While the current legend for callable securities required on customer confirmations states that complete call information is available upon request, it appears that some dealers are not compiling this information and thus, when asked by customers for the information, are not able to provide it promptly. The Board therefore is considering adopting amendments to rule G-15(a) that would require a dealer effecting a customer transaction to deliver to its customer, upon request, written information about the call features of the security within specific time limits. The delivery of a copy of the portion of the issue's official statement that describes the call features would be sufficient. In particular, the draft amendments would require dealers to deliver complete call information in writing within five business days following the date of the request for such information.[3] In the case of information relating to a transaction executed more than 30 calendar days prior to the date of the request, the information would be delivered to the customer in writing within 15 business days following the date of the request. An oral request for written call information would trigger application of the draft amendments. In addition, the same time limits would apply to customer requests for written call information made at the time of trade.

The draft amendments would not alter the current obligation that a dealer disclose all material facts concerning the transaction to its customer prior to execution of the transaction. The draft amendments, however, would require that, when requested, complete call information be provided in writing to ensure that customers obtain this information promptly. In addition, the draft amendments recognize a dealer's continuing obligation, even after settlement of a transaction, to convey call information about the security to a customer upon request. Finally, the Board is considering interpreting the requirement for delivery of call information to presume that information sent at least three business days prior to the date such information is due has been received by the customer. A similar interpretation was made in regard to official statement delivery requirements under rule G-32.

August 19, 1986

Text of Draft Amendments*

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

(a) Customer Confirmations

(i) and (vi) No change.

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

(B) Information requested pursuant to subparagraph (iii)(E) shall be delivered to the customer in writing within five business days following the date of a request for such information; provided, however, that in the case of information relating to a transaction executed more than 30 calendar days prior to the date of a request, the information shall be delivered to the customer in writing within 15 business days following the date of the request.

(viii) and (ix) No change.

(b) through (e) No change.

[1]If an issue is subject only to a catastrophe call, a dealer is not required to note "callable" on customer confirmations. See MSRB Interpretation of November 7, 1977, by Freida K. Wallison, Executive Director and General Counsel, *MSRB Manual* (CCH) ¶3571.10.

[2]*See* Notice Concerning Disclosure of Call Information to Customers of Municipal Securities (March 4, 1986), *MSRB Manual* (CCH) ¶3581.

[3]For customers who purchase new issue municipal securities for which an official statement has been prepared and who request complete call information, the delivery of the official statement to the customer by settlement date, as required by rule G-32, would result in compliance with the draft amendments.

*Underlining indicates new language

A: Managing underwriters shall prepare enough official statements and other information required by the rule to provide each purchasing dealer, upon request, with an official statement and one additional final official statement per $100,000 par value of the new issue securities.

Q: Did rule G-32 always specify the responsibilities of managing underwriters?

A: No. The Board recently adopted these provisions because it believed that managing underwriters should be responsible for ensuring that final official statements are printed in sufficient time and number to permit dealers to deliver them to customers by settlement date of a transaction in new issue securities. Additionally, the provisions are designed to achieve some balance between the costs associated with the dissemination of official statements borne by underwriters and those borne by dealers selling new issue securities.

Q: In a competitive issue, if a financial advisor prepares an official statement on behalf of the issuer, but is not responsible for printing it, when does the financial advisor have to deliver the final official statement to the managing underwriter for printing?

A: The financial advisor must deliver the final version of the official statement to the managing underwriter promptly after the award is made so that the managing underwriter can complete printing at least two business days prior to the date it delivers the securities to the syndicate members.

Q: What if the financial advisor is responsible for printing the official statement?

A: The financial advisor must prepare sufficient copies, as defined in rule G-32(b)(i), of the final official statement and deliver them to the managing underwriter no later than two business days before the date the manager delivers the securities to the syndicate members.

Q: Does rule G-32 apply to all financial advisors?

A: No. The rule only applies to financial advisors who are registered as brokers, dealers or municipal securities dealers with the SEC.

DELIVERY OF OFFICIAL STATEMENTS TO CUSTOMERS

Q: Does the Board have any requirements governing the delivery of an official statement to a customer?

A: Yes. A dealer is required to send a copy of the official statement, if one is prepared voluntarily by the issuer or its representative, to any customer purchasing new issue municipal securities prior to settlement of the transaction.

Q: How can we assure that customers will receive official statements by settlement?

A: An official statement sent at least three business days prior to settlement will be presumed to have been received by the customer.

Q: What if a manager supplies a dealer with an insufficient quantity of official statements?

A: The obligation of a dealer to furnish an official statement to each customer is not relieved by the manager's failure to supply a sufficient number of copies of an official statement. In such cases it is incumbent upon the dealer to reproduce the official statement at its own expense.

Q: Didn't the rule once require that disclosures be provided to a customer with or prior to sending the final confirmation?

A: Yes. The Board has extended the deadline for delivery until settlement of the transaction to ensure that a dealer has adequate time to deliver the disclosures to the customer and that the customer will receive the disclosures prior to paying for the securities.

Q: If I am not a member of a new issue underwriting syndicate and I sell securities of that new issue to a customer during the underwriting period, am I required to send that customer a copy of the final official statement?

A: Yes. The rule applies to a dealer who sells new issue municipal securities regardless of whether it is the underwriter or a member of a syndicate.

Q: Is it permissible to send a customer a photocopy of the front page of the official statement during the pre-sale period and subsequently provide the official statement in its entirety by settlement date?

A: Rule G-32 only requires that you send a copy of the final official statement before the settlement date of the transaction. The rule does not prevent you from sending other material prior to that time.

Q: If a dealer mails out a letter to a list of customers soliciting interest in a new issue, and a particular customer inquires as a result of the letter but subsequently does not purchase the securities, is the dealer required to send him an official statement?

A: No, because the customer did not purchase the new issue securities.

Q: May I provide a summary of an official statement in lieu of sending the official statement?

A: No. If an official statement (or a preliminary official statement) is prepared by an issuer, it must be provided to the customer.

Q: What if an issuer in a competitive sale only prepares a preliminary official statement?

A: A dealer selling new issue securities is required to deliver the preliminary version along with written notice that no final official statement will be prepared by settlement of the transaction with the customer.

Q: Didn't the rule previously require that when a final official statement was not prepared in time to send with the money confirmation, a preliminary version, if one existed, had to be sent, and the final official statement sent as soon as it became available from the issuer?

A: Yes. But G-32, as recently amended, only requires that the final version of the official statement be delivered

by settlement date of the transaction. This provision is designed to minimize the costs associated with dissemination of official statements. Of course, a dealer may send a preliminary official statement, in addition to the final official version, if it wishes.

DELIVERY OF OFFICIAL STATEMENTS TO DEALERS

Q: Are managing underwriters responsible for delivering final official statements to purchasing dealers?

A: Yes. Managing underwriters, upon request, must deliver final official statements to all dealers that purchase new issue securities, along with the other G-32 disclosures.

Q: How many official statements are managing underwriters required to deliver to purchasing dealers?

A: The rule states that the managing underwriters shall provide, upon request, purchasing dealers (including syndicate members) with one copy of the final official statement and one additional official statement per $100,000 par value of the new issue purchased by the dealer and sold to the customer.

Q: What other information is a managing underwriter required to deliver to a dealer that purchases new issue municipal securities?

A: The rule also requires a manager to provide instructions on how to obtain additional official statements from the printer to any dealer seeking additional copies of the document.

Q: From which does a purchasing dealer obtain G-32 disclosures, the managing underwriter or the selling dealer?

A: A purchasing dealer may obtain rule G-32 disclosures from either the selling dealer from which it purchased the securities or from the managing underwriter.

DISCLOSURES TO CUSTOMERS IN CONNECTION WITH NEGOTIATED UNDERWRITINGS

Q: In a negotiated underwriting, is a dealer required to furnish any other information in addition to an official statement to a customer?

A: Yes. The dealer must disclose the following information:

(1) the underwriting spread,

(2) the amount of any fee received by the dealer as agent for the issuer in the distribution of the securities; and

(3) the initial offering price for each maturity in the issue that is offered or to be offered in whole or in part by the underwriter.

Q: If these disclosures are not made in the official statement, does the dealer have to disclose them in another document?

A: Yes.

Q: What is the "underwriting spread" for purposes of rule G-32?

A: Rule G-32 requires that the gross spread (*i.e.*, the difference between the price paid to the issuer and the initial reoffering price) be disclosed. A dealer may also include information about expenses, if it wishes to explain to the customer that the gross spread does not constitute the profit actually realized by the dealer.

Q: If we received no fee for acting as an agent to the issuer in the distribution of securities, must this fact be stated?

A: No.

Q: Under rule G-32, are dealers who are not members of a syndicate in a negotiated sale required to disclose the underwriting spread to their customers?

A: Yes. Rule G-32 provides that municipal securities dealers must disclose the information specified in the rule to all customers to whom securities are sold during the underwriting period. This applies to both members and non-member dealers.

Q: Is it permissible to state in the official statement that the underwriting spread is the difference between the price paid to the issuer and the offering price?

A: No. The amount of the spread must be given, either in gross dollars or in dollars or points per bond.

Q: Since we have to provide reoffering prices, is it permissible to provide the price paid to the issuer and let the customer figure the spread?

A: No. The spread must be disclosed separately.

Q: Is it permissible to describe the underwriting spread as the "underwriter's discount?"

A: Yes. This terminology is acceptable.

Q: Would the following format constitute an acceptable disclosure of the underwriting spread:

Application of Proceeds	
Construction costs	$120,000,000
Underwriter's discount	2,500,000
Legal Expenses	200,000
Printing & Miscellaneous Expenses	300,000
Principal amount of bonds	$123,000,000

A: Yes. The underwriting may be expressed either as a total amount or as a listing of the components of the gross spread.

Q: Would the following statement satisfy the requirements of rule G-32 relating to the disclosure of the underwriting spread in a negotiated sale:

"The underwriting spread is 3.476 points"?

A: Yes.

Q: In a negotiated sale some maturities are sold out presale. Has an official statement complied with the requirements of G-32, if in disclosing the initial offering prices, it merely indicates that those maturities are not reoffered?

A: No. The Board has taken the position that the initial offering price for each maturity must be disclosed whether or not a particular maturity is reoffered.

RECORDKEEPING

Q: Must a dealer maintain a record of deliveries of rule G-32 disclosures?

A: Yes. Rule G-8 requires a dealer to maintain a record of deliveries of rule G-32 disclosures. Rule G-9 requires that these records be retained for a period of not less than three years. The rule does provide flexibility to a dealer regarding how to maintain records of the deliveries.

Q: Have dealers always been required to maintain records of deliveries of rule G-32 disclosures?

A: No. These recordkeeping requirements have been in effect since September 1985. The Board has indicated that these recordkeeping requirements for dealers would facilitate enforcement of the other provisions of the rule.

DISCLOSURES IN CONNECTION WITH SECONDARY MARKETS

Q: Is a dealer required to deliver a final official statement if a syndicate has closed and it no longer retains any unsold securities (*i.e.*, bonds paid for and delivered)?

A: No. Rule G-32 requires dealers to deliver final official statements for new issue municipal securities that are sold during the underwriting period. The rule does not require the delivery of final official statements in the secondary market.

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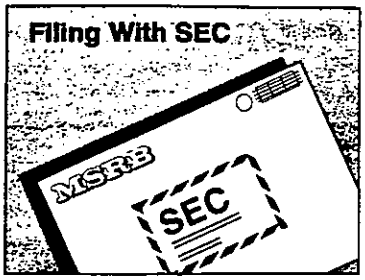


Route To:

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

Customer Account Transfers: Rule G-26

Amendments Filed

When transferring a customer account the carrying dealer would

- **be required to request, in writing, instructions from the customer as to the disposition of any "nontransferable" assets,**
- **be allowed to take exception to a transfer instruction only if it has no record of the account, the transfer instruction is incomplete or the transfer instruction contains an improper signature, and**
- **be required to use a designated transfer instruction form.**

On September 4, 1986, the Board filed with the Securities and Exchange Commission amendments to rule G-26 concerning customer account transfers.[1] Rule G-26 is designed to ensure that customer account transfers are accomplished in a timely and efficient manner by municipal securities dealers. The rule parallels rules adopted by the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) and ensures that a uniform account transfer standard applies to all municipal securities dealers. The proposed amendments would conform rule G-26 to certain of the provisions of the NYSE and NASD rules that have been adopted subsequent to the effective date of rule G-26 in February 1986. The proposed amendments will become effective upon their approval by the Commission.

Background

Rule G-26 requires municipal securities dealers to cooperate in the transfer of customer accounts. The rule establishes specific time limits, generally 10 days, within which a dealer is required to transfer a customer account. It limits the reasons for which a dealer may object to an account transfer instruction to those not involving securities positions or money balance differences. The rule provides for the establishment of fail-to-receive and fail-to-deliver contracts, and requires that fail contracts be resolved in accordance with the Board's close-out procedures, rule G-12(h). In addition, the rule requires the use of automated customer account transfer systems in place at registered clearing agencies when both dealers are participants in the clearing agency. Finally, the rule requires municipal securities dealers to submit copies of account transfer instructions to the enforcement agency having jurisdiction over the dealer carrying the account, if the enforcement agency requests them.

Summary of Amendments

In order for the Board's account transfer procedure to remain similar to that required by the NYSE and the NASD rules, the Board determined to amend rule G-26 to conform to certain of the provisions of the NYSE and NASD requirements adopted subsequent to the effective date of rule G-26 that have application to municipal securities. The proposed amendments would provide that if an account includes a "nonstransferable" asset,[2] the dealer carrying the account must request, in writing, instructions from the customer as to the disposition of the asset, which includes liquidation of the asset or retention by the carrying dealer. In addition, the proposed amendments would allow the carrying dealer to take exception to a transfer instruction only if: (1) it has no record of the account on its books; (2) the transfer instruction is incomplete; or (3) the transfer instruction contains an improper signature. The proposed amendments also designate a transfer instruction form, Form G-26, for use for transfers of customers' municipal securities accounts.[3] Finally, the proposed amendments provide for other technical amendments to rule G-26, including the type of information regarding the securities in the customer account which the carrying dealer must deliver to the receiving dealer.

September 4, 1986

Text of Proposed Amendments*

Rule G-26. Customer Account Transfers

(a) Definitions. For purposes of this rule, the following terms have the following meanings:

(i) The term "delayed delivery asset" means an asset subject to a delayed delivery and includes when-issued securities.

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

[1] SEC File No. SR-MSRB-86-12. Comments filed with the SEC concerning these amendments should refer to the File Number.
[2] A "nontransferable" asset is defined as an asset that is incapable of being transferred from the carrying dealer to the receiving dealer because it is an issue in default for which the carrying dealer does not possess the proper denominations to effect delivery and no transfer agent is available to re-register the securities.
[3] Form G-26 is reprinted after the proposed amendments
* Underlining indicates new language; broken rule indicates deletions

(ii)The term "in-transfer asset" means an asset which has been submitted to the registrar or transfer agent for transfer and shipment to the customer at the time the transfer instruction is received by the carrying party.

(iii)The term "nontransferable asset" means an asset that is incapable of being transferred from the carrying party to the receiving party because it is an issue in default for which the carrying party does not possess the proper denominations to effect delivery and no transfer agent is available to re-register the securities.

~~(a)~~ (b) Responsibility to Expedite Customer's Request. When a customer whose municipal securities account is carried by a ~~municipal securities~~ broker, ~~or~~ dealer or municipal securities dealer (the "carrying party") wishes to transfer its entire account to another ~~municipal securities~~ broker, ~~or~~ dealer or municipal securities dealer (the "receiving party") and gives written notice of that fact to the receiving party, ~~both municipal securities brokers or dealers~~ the receiving party and the carrying party must expedite and coordinate activities with respect to the transfer as follows.

(c) Transfer Instructions.

(i) Parties may use Form G-26, the transfer instruction prescribed by the Board, or the transfer instructions required by a clearing agency registered with the Securities and Exchange Commission in connection with its automated customer account transfer system, or transfer instructions that are substantially similar to those required by such clearing agency, when accomplishing account transfers pursuant to this rule.

(ii) If an account includes any nontransferable assets, the carrying party must request, in writing and prior to or at the time of validation of the transfer instruction, further instructions from the customer with respect to the disposition of such assets. Such request shall provide the customer with the following alternative methods of disposition of nontransferable assets, if applicable:

(A) liquidation, with a specific indication of any redemption or other liquidation-related fees that may result from such liquidation and that those fees may be deducted from the money balance due the customer; or

(B) retention by the carrying party for the customer's benefit

(d) Transfer Procedures

(i) Upon receipt from the customer of a signed ~~broker-to-broker~~ transfer instruction to receive such customer's securities account from the carrying party, the receiving party must immediately submit such instruction to the carrying party. The carrying party must, within five business days following receipt of such instruction, validate and return the transfer instruction to the receiving party (with an attachment reflecting all positions and money balances as shown on its books) or take exception to the transfer instruction for reasons other than securities positions or money balance differences and advise the receiving party of the exception taken.

(ii) A carrying party may take exception to a transfer instruction only if:

(A) it has no record of the account on its books;

(B) the transfer instruction is incomplete; or

(C) the transfer instruction contains an improper signature.

~~(ii)~~ (iii) The carrying party and the receiving party must promptly resolve any exceptions taken to the transfer instruction.

(iv) Upon validation of a transfer instruction, the carrying party must:

(A) "freeze" the account to be transferred, *i.e.*, all open orders must be cancelled and no new orders may be taken; and

(B) return the transfer instruction to the receiving party with an attachment indicating all securities positions and any money balance in the account as shown on the books of the carrying party. Except as hereinafter provided, the attachment must include a then-current market value for all assets in the account. However, delayed delivery assets, nontransferable assets, and assets in-transfer to the customer, need not be valued, although the "delayed delivery," "nontransferable," or "in-transfer" status of such assets, respectively, must be indicated on the attachment. A carrying party must provide the description set forth in rule G-12(c)(v)(E) with respect to any municipal security that has not been assigned a CUSIP number in an account it is to transfer.

~~(iii)~~ (v) Within five business days following the validation of a transfer instruction, the carrying party must complete the transfer of the account to the receiving party. The receiving party and the carrying party must immediately establish fail-to-receive and fail-to-deliver contracts at the then-current market value as of the date of validation upon their respective books of account against the long/short positions in the customer's accounts that have not been physically delivered/received and the receiving party/carrying party must debit/credit the related money amount. Nontransferable assets and assets in-transfer to the customer are exempt from the requirement that fail-to-receive and fail-to-deliver contracts must be established for positions in a customer's securities account that have not been physically delivered. Zero value fail-to-receive and fail-to-deliver instructions shall be established for delayed delivery assets. The customer's account(s) shall thereupon be deemed transferred.

(vi) To the extent any assets in the account are not readily transferable, with or without penalties, such assets are not subject to the time frames required by the rule; and if the customer has authorized liquidation of any nontransferable assets, the carrying member must distribute the resulting money balance to the customer within five business days following receipt of the customer's disposition instructions.

~~(b)~~ (e) Fail Contracts Established.

Any fail contracts resulting from this account transfer procedure must be closed out in accordance with rule G-12(h).

(e) (f) Prompt Resolution of Discrepancies. Any discrepancies relating to positions or money balances that exist or occur after transfer of a customer's securities account must be resolved promptly.

~~(d)~~ (g) Exemptions.

The Board may exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any dealer or any type of account, security or municipal security.

(e) (h) Participant in a Registered Clearing Agency. When

both the carrying party and the receiving party are direct participants in a clearing agency registered with the Securities and Exchange Commission offering automated customer securities account transfer capabilities, the account transfer procedure, including the establishing and closing out of fail contracts, must be accomplished pursuant to the rules of and through such registered clearing agency.

~~(f)~~ (i) Forwarding Copy of Form G-26 to Enforcement Authority on Request. The carrying party shall forward a copy of each customer account transfer instruction issued pursuant to paragraph ~~(a)~~ (c)(i) to the enforcement authority having jurisdiction over the carrying party member, at the request of such authority.

Text of Form G-26

FORM G-26
CUSTOMER ACCOUNT TRANSFER INSTRUCTION

Date:

Receiving Party — Carrying Party

Receiving Party Account Number — Carrying Party Account Number

Account Title — Tax ID or SS Number

To:

Receiving Party Name and Address

Please receive my entire account from the below indicated carrying party and remit to it the debit balance or accept from it the credit balance in my municipal securities account.

To:

Carrying Party Name and Address

Please transfer my entire municipal securities account to the above indicated receiving party, which has been authorized by me to make payment to you of the debit balance or to receive payment of the credit balance in my municipal securities account. I understand that to the extent any assets or instruments in my municipal securities account are not readily transferable, with or without penalties, such assets or instruments may not be transferred within the time frames required by rule G-26 of the Municipal Securities Rulemaking Board.

I understand that you will contact me with respect to the disposition of any assets in my municipal securities account that are nontransferable. If certificates or other instruments in my securities account are in your physical possession, I instruct you to transfer them in good deliverable form to enable such receiving firm to transfer them in its name for the purpose of sale, when and as directed by me.

Upon validation of this transfer instruction, I instruct you to cancel all open orders for my municipal securities account on your books.

Customer's Signature — Date

Customer's Signature (If joint account) — Date

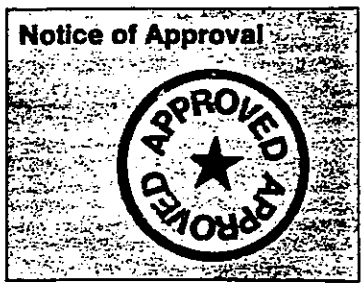
It is suggested that a copy of the customer's most recent account statement be attached.

Receiving Party Contact

Name — Phone Number

MSRB REPORTS

Volume 6, Number 4 September 1986



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Arbitration: Rule G-35

Amendments Approved

The amendments—

- **permit the Director of Arbitration to appoint a panel of three to five arbitrators to decide customer claims under $500,000,**
- **permit the arbitrators to bar at the hearing a respondent's arguments or defense if the respondent fails to submit an answer in a timely manner, and**
- **impose an adjournment fee on the party requesting and granted an adjournment after a panel of arbitrators has been chosen.**

On June 18, 1986, the Securities and Exchange Commission approved amendments to rule G-35, the Board's arbitration code.[1] The amendments conform the provisions of the Board's arbitration code to recent amendments to the Uniform Arbitration Code developed by the Securities Industry Conference on Arbitration which is composed of the representatives of the Board, nine other self-regulatory organizations, four public members, and the Securities Industry Association. The amendments became effective upon approval by the Commission.

Summary of Amendments

Arbitration Panels. The amendment to section 12 of rule G-35 permits the Director of Arbitration to appoint an arbitration panel of from three to five persons to decide customer claims of up to $500,000, and five persons for claims over $500,000. This modifies the current provision which requires a panel of five arbitrators for any customer claim over $100,000 and gives the Director of Arbitration more flexibility in the formation of arbitration panels.[2] The amendment also allows the parties to waive their right to a five-person panel.

Answers of Respondents. The amendment to section allows the arbitrators to decide whether a respondent who fails to file a timely answer may be barred from presenting any arguments or defenses at the hearing. This amendment is designed to encourage respondents to file answers in a timely manner so that claimants can prepare adequately for hearings.

Adjournment Fee. The amendment to section 20 imposes a fee on any party who requests and is granted an adjournment after arbitrators have been appointed. As the volume of arbitration cases increases, it becomes more difficult to reschedule adjourned hearings. In addition, adjournments increase costs and place an administrative burden on arbitrators and on the arbitration staff. The proposed fee covers some of the costs associated with these adjournment requests. The arbitrators are permitted to waive the adjournment fee when appropriate circumstances exist.

June 18, 1986

Text of Amendments*

Rule G-35. Arbitration

Sections 1 through 4. No change.

Section 5. Initiation of Proceedings

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

(a) No change.

(b)(1) No change.

(2)(i) through (ii) No change.

(iii) A respondent, responding claimant, cross-claimant or third party respondent who fails to file an answer within 20 business days from receipt of service, or unless the time to answer has been extended pursuant to subsection (e) below, may, in the discretion of the arbitrators, be barred from presenting any matter, arguments or defenses at the hearing.

(c) through (f) No change.

Sections 6 through 11. No change.

Section 12. Designation of Number of Arbitrators

(a) Controversies Involving Persons Other Than Municipal Securities Brokers or Municipal Securities Dealers

(1)Except as otherwise provided in this Arbitration Code, in all arbitration matters in which a person other than a municipal securities broker or municipal securities dealer is involved and where the matter in controversy does not exceed the amount of ~~$100,000~~ $500,000,

Questions about the amendments may be directed to Diane G. Klinke, Deputy General Counsel.

[1] SEC Release No. 34-23336

[2] In inter-dealer controversies, the Code currently provides for a panel of from three to five arbitrators for claims of any amount.

*Underlining indicates new language, broken rule indicates deletions

or where the matter in controversy does not involve or disclose a money claim or the amount of damages cannot be readily ascertained at the time of commencement of the proceeding, the Director of Arbitration shall appoint an arbitration panel which shall consist of no less than three nor more than five arbitrators, at least a majority of whom shall not be associated with a broker, dealer or municipal securities dealer unless such person requests a panel consisting of a majority of arbitrators associated with a broker, dealer or municipal securities dealer.

(2) In all arbitration matters in which a person other than a municipal securities broker or municipal securities dealer is involved, and where the amount in controversy exceeds ~~$100,000~~ $500,000, the Director of Arbitration shall appoint an arbitration panel which shall consist of five arbitrators, unless the parties agree in writing to a panel of three arbitrators, at least three of whom shall not be associated with any broker, dealer or municipal securities dealer unless such person requests a panel consisting of a majority of arbitrators associated with a broker, dealer or municipal securities dealer.

(b) No change.

Sections 13 through 19. No change.

Section 20. Adjournments

(a) The arbitrators may, in their discretion, adjourn any hearing either upon their own initiative or upon the request of any party to the arbitration.

(b) A party requesting an adjournment after arbitrators have been appointed, if said adjournment is granted, shall pay a fee equal to the deposit of costs but not more than $100. The arbitrators may waive this fee or in their award may direct the return of this adjournment fee.

Sections 21 through 35. No change.

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Letters of Interpretation

Rule G-17—Description Provided at or Prior to the Time of Trade

This is in response to your February 27, 1986 letter and our prior telephone conversation concerning the application of Board rules to the description of municipal securities exchanged at or prior to the time of trade. You note that it is becoming more and more common in the municipal securities secondary market for sellers, both dealers and customers, to provide only a "limited description" and CUSIP number for bonds being sold. Recently you were asked by a customer to bid on $4 million of bonds and were given the coupon, maturity date, and issuer. When you asked for more information, you were given the CUSIP number. You then bid on and purchased the bonds. After the bonds were confirmed, you discovered that the bonds were callable and that, when these bonds first came to market, they were priced to the call. You state that the seller was aware that the bonds were callable.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Board rule G-17 provides that

> In the conduct of its municipal securities business, *each broker, dealer, and municipal securities dealer* shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. (emphasis added)

The Board has interpreted this rule to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision and not omit any material facts which would render other statements misleading. The fact that a municipal security may be redeemed in-whole, in-part, or in extraordinary circumstances prior to maturity is essential to a customer's investment decision and is one of the facts a dealer must disclose.

I note from our telephone conversation that you ask whether Board rules specify what information a customer must disclose to a dealer at the time it solicits bids to buy municipal securities. Customers are not subject to the Board's rules, and no specific disclosure rules would apply to customers beyond the application of the antifraud provisions of the federal securities laws. I note, however, that a municipal securities professional buying securities from a customer should obtain sufficient information about the securities so that it can accurately describe these securities when the dealer reintroduces them into the market.

In regard to inter-dealer transactions, the items of information that professionals must exchange at or prior to the time of trade are governed by principles of contract law and essentially are those items necessary adequately to describe the security that is the subject of the contract. As a general matter, these items of information may not encompass all material facts, but must be sufficient to distinguish the security from other similar issues. The Board has interpreted rule G-17 to require dealers to treat other dealers fairly and to hold them to the prevailing ethical standards of the industry. Also, dealers may not knowingly misdescribe securities to another dealer. *MSRB Interpretation of April 30, 1986, by Diane G. Klinke, Deputy General Counsel.*

Rule G-12 and G-15—Disclosure of Pricing: Calculating the Dollar Price of Partially Prerefunded Bonds

This is in response to your March 21, 1986 letter concerning the application of Board rules to the description of municipal securities provided at or prior to the time of trade and the application of rules G-12(c) and G-15(a) on calculating the dollar price of partially prerefunded bonds with mandatory sinking fund calls.

You describe an issue, due 10/1/13. Mandatory sinking fund calls for this issue begin 10/1/05 and end 10/1/13. Recently, a partial refunding took place which prerefunds the 2011, 2012 and 2013 mandatory sinking fund requirements totalling $11,195,000 (which is 43.6% of the issue) to 10/1/94 at 102. The certificate numbers for the partial prerefunding will not be chosen until 30 days prior to the prerefunded date. Thus, a large percentage of the bonds are prerefunded and all the bonds will be redeemed by 10/1/10 because the 2011, 2012, and 2013 maturities no longer exist.

You note that the bonds should be described as partially prerefunded to 10/1/94 with a 10/1/10 maturity. Also, you state that the price of these securities should be calculated to the cheapest call, in this case, the partial prerefunded date of 10/1/94 at 102. You add that there is a 9½ point difference in price between calculating to maturity and to the partially prerefunded date.

You note that the descriptions you have seen on various brokers' wires do not accurately describe these securities and a purchaser of these bonds would not know what they bought if the purchase was based on current descriptions.

You ask the Board to address the description and calculation problems posed by this issue.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Board rule G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

In regard to inter-dealer transactions, the items of information that professionals must exchange at or prior to the time of trade are governed by principles of contract law and essentially are those items necessary adequately to describe the security that is the subject of the contract. As a general matter, these items of information do not encompass all material facts, but should be sufficient to distinguish the security from other similar issues. The Board has interpreted rule G-17 to require dealers to treat other dealers fairly and to hold them to the prevailing ethical standards of the industry.[1] The rule also prohibits dealers from knowingly misdescribing securities to another dealer.[2]

Board rules G-12(c) and G-15(a) require that

> 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. . .

In addition, for customer confirmations, rule G-15(a) requires that

> for transactions effected on the basis of dollar price, . . . the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown . . . .

These provisions also require, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in-whole" calls should be used.[3] This requirement reflects the longstanding practice of the municipal securities industry that a price calculated to an "in-part" call, for example, a partial prerefunding date, is not adequate because, depending on the probability of the call provision being exercised and the portion of the issue subject to the call provision, the effective yield based on the price to a partial prerefunding date may not bear any relation to the likely return on the investment.

These provisions of rules G-12(c) and G-15(a) apply, however, only when the parties have not specified that the bonds are priced to a specific call date. In some circumstances, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to a particular date, *e.g.*, a partial prerefunding date, and that the dollar price will be computed in this fashion. If that is the case, the yield to this agreed upon date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to that date, together with a statement that it is a "yield to [date]." In an August 1979 interpretive notice on pricing of callable securities, the Board stated that, under rule G-30, a dealer pricing securities sold to a customer on the basis of a yield to a specified call feature should take into account the possibility that the call feature may not be exercised.[4] Accordingly, the price to be paid by the customer should reflect this possibility, and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in such a manner may constitute a violation of rule G-30 since the price may not be "fair and reasonable" in the event the call feature is not exercised. The Board also noted that the fact that a customer in these circumstances may realize a yield in excess of the yield at which the transaction was effected does not relieve a municipal securities dealer of its responsibilities under rule G-30.

Accordingly, the calculation of the dollar price of a transaction in the securities you describe, unless the parties have agreed otherwise, should be made to the lowest of price to the first in-whole call, par option, or maturity. While the partial prerefunding effectively redeems the issue by 10/1/10 the stated maturity of the bond is 10/1/13 and, subject to the parties agreeing to price to 10/1/10, the stated maturity date should be used. *MSRB Interpretation of May 15, 1986, by Diane G. Klinke, Deputy General Counsel*

Rule G-15—Callable Securities: Pricing to Mandatory Sinking Fund Calls

This is in response to your February 21, 1986 letter concerning the application of rule G-15(a) regarding pricing to prerefunded bonds with mandatory sinking fund calls.

You give the following example:

Bonds, due 7/1/10, are prerefunded to 7/1/91 at 102. There are $17,605,000 of these bonds outstanding. However, there is a mandatory sinking fund which will operate to call $1,000,000 of these bonds at par every year from 7/1/86 to 7/1/91. The balance ($11,605,000) then will be redeemed 7/1/91 at 102. If this bond is priced to the 1991 prerefunded date in today's market at a 6.75 yield, the dollar price would be approximately 127.94. However, if this bond is called 7/1/86 at 100 and a customer paid the above price, his/her yield would be a minus 52 percent (−52%) on the called portion.

You state that the correct way to price the bond is to the 7/1/86 par call at a 5% level which equates to an approximate dollar price of 102.61. The subsequent yield to the 7/1/91 at 102 prerefunded date would be 12.33% if the bond survived all the mandatory calls to that date. You note that a June 8, 1978, MSRB interpretation states, "the calculation of dollar price to a premium call or par option date should be to that date at which the issuer may exercise an option to call the

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[1] In addition, the Board has interpreted this rule to require that in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision, including a complete description of the security, and not omit any material facts which would render other statements misleading.

[2] While the Board does not have any specific disclosure requirements applicable to dealers at the time of trade, a dealer is free to disclose any unique aspect of an issue. For example, in the issue described above, a dealer may decide to disclose the "effective" maturity date of 2010, as well as the stated maturity date of 2013.

[3] *See* MSRB Interpretation of December 10, 1980, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3571.

[4] *See* MSRB Interpretation of August 10, 1979, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3646.

whole of a particular issue or, in the case of serial bonds, a particular maturity, and not to the date of a call in-part."[1] You believe, however, that, as the rule is presently written, dealers are leaving themselves open for litigation from customers if bonds, which are trading at a premium, are not priced to the mandatory sinking fund call. You ask that the Board review this interpretation.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Rule G-15(a)(i)(I) requires that on customer confirmations the yield and dollar price for the transaction be disclosed as the price (if the transaction is done on a yield basis) or yield (if the transaction is done on the basis of the dollar price) calculated to the lowest price or yield to call, to par option, or to maturity. The provision also requires, in cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, that this must be stated and the call or option date and price used in the calculation must be shown. The Board has determined that, for purposes of making this computation, only "in-whole" calls should be used.[2] This requirement reflects the long-standing practice of the municipal securities industry that a price calculated to an "in-part" call, such as a sinking fund call, is not adequate because, depending on the probability of the call provision being exercised and the portion of the issue subject to the call provision, the effective yield based on the price to a sinking fund date may not bear any relation to the likely return on the investment.

Rule G-15(a)(i)(I) applies, however, only when the parties have not specified that the bonds are priced to a specific call date. In some circumstances, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to a particular date, *e.g.*, put option date, and that the dollar price will be computed in this fashion. If that is the case, the yield to this agreed upon date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to that date, together with a statement that it is a "yield to [date]." In an August 1979 interpretive notice on pricing of callable securities, the Board stated that, under rule G-30, a dealer pricing securities on the basis of a yield to a specified call feature should take into account the possibility that the call feature may not be exercised.[3] Accordingly, the price to be paid by the customer should reflect this possibility, and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in such a manner may constitute a violation of rule G-30 since the price may not be "fair and reasonable" in the event the call feature is not exercised. The Board also noted that the fact that a customer in these circumstances may realize a yield in excess of the yield at which the transaction was effected does not relieve a municipal securities dealer of its responsibilities under rule G-30.

Accordingly, the calculation of the dollar price of a transaction in the securities in your example, unless the parties have agreed otherwise, should be made to the prerefunded date. Of course, under rule G-17 on fair dealing, dealers must explain to customers the existence of sinking fund calls at the time of trade. The sinking fund call, in addition, should be disclosed on the confirmation by an indication that the securities are "callable." The fact that the securities are prerefunded also should be noted on the confirmation. *MSRB Interpretation of April 30, 1986, by Diane G. Klinke, Deputy General Counsel*

[1] See MSRB Interpretation of June 8, 1978, by Mark S. Sisitsky, Deputy General Counsel, *MSRB Manual* (CCH) ¶3571.21.
[2] See MSRB Interpretation of December 10, 1980, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3571.
[3] See MSRB Interpretation of August 10, 1979, by Donald F. Donahue, Deputy Executive Director, *MSRB Manual* (CCH) ¶3646.

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Publications List

Manuals and Rule Texts

MSRB Manual*
Complete text of MSRB rules, interpretive notices and letters. Includes 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. Also includes notices on proposed, amended and rescinded rules from exposure draft through SEC approval.
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MSRB Rules*
Complete text of MSRB rules, interpretive notices and letters as reprinted in the *MSRB Manual*. Also includes samples of forms. Use of the *Rules* satisfies the requirements of rule G-29.
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Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.
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