

# MSRB REPORTS

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**Rules G-12 and G-15**

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## Amendments on Interchangeable Securities to Become Effective on September 18, 1988

Effective September 18, 1988, amendments to rules G-12 and G-15 will—

permit interchangeable securities to be delivered in either bearer or registered form, unless the parties agree to a specific form of delivery;

eliminate the one-day reclamation provision for interchangeable securities delivered in registered form; and

eliminate the requirement to designate a security as being in registered form on inter-dealer and customer confirmations.

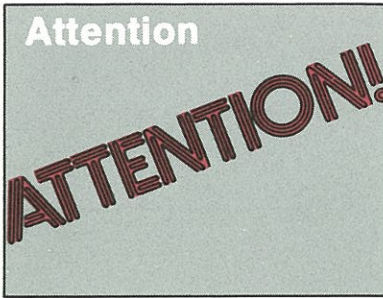
The Board reminds dealers to begin preparations now to facilitate compliance with the amendments.

## Also in This Issue

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### Calendar

<b>June 30</b>	—	Effective date of G-12 and G-15 on book-entry settlement of same-day fund securities
<b>September 18</b>	—	Effective date of G-12 and G-15 on delivery of interchangeable securities

**Route to:**

- Manager, Muni Dept.
- Underwriting
- Trading
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## Book-Entry Settlement of Same-Day Fund Securities: Rules G-12 and G-15

The temporary exemption from the Board's book-entry settlement requirements for same-day fund securities expires on June 30, 1988.

Rule G-12(f)(ii) requires book-entry settlement of an inter-dealer municipal securities transaction if both dealers (or their clearing agents for the transaction) are members of a depository making the securities eligible and the transaction is compared through a registered securities clearing agency. Rule G-15(d)(iii) requires book-entry settlement of a customer transaction if the dealer grants delivery versus payment or receipt versus payment (DVP/RVP) privileges on the transaction and both the dealer and the customer (or their clearing agents for the transaction) are members of a depository making the securities eligible.

In July 1987, The Depository Trust Company (DTC) began a pilot program to provide book-entry settlement services for securities that settle in federal funds (same-day funds securities). Prior to commencement of the DTC program, the Board amended rules G-12(f)(ii) and G-15(d)(iii) to provide a temporary exemption, through June 30, 1988, for same-day funds

securities.<sup>1</sup> The temporary exemption allowed participants in the DTC program to adjust gradually to the new system and to become familiar with it on a transaction-by-transaction basis, rather than being subject to the requirements of the rules during the initiation of the system.<sup>2</sup>

The Board believes that the one-year period for adjustment to the new system has been sufficient for this purpose and plans to allow the exemption to the automated clearance rules to expire, as scheduled, on June 30, 1988. After this date, dealers that are direct participants in DTC will be subject to the requirements of the book-entry delivery rules for all same-day funds municipal securities eligible at DTC. Dealers using clearing agents that are DTC members for same-day funds securities transactions (indirect participants) also will be subject to the requirements of the rules. Both direct and indirect participants in DTC should review their clearing arrangements with DVP/RVP customers who purchase same-day funds securities to ensure that, if the customers are DTC members or use clearing agents that are DTC members, arrangements have been made to settle same-day funds municipal securities by book-entry after June 30, 1988.<sup>3</sup>

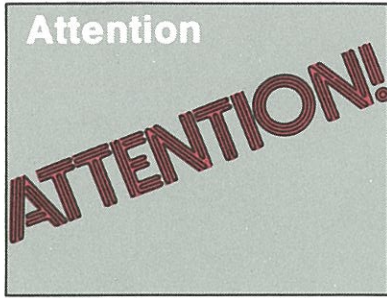
April 28, 1988

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

<sup>1</sup> MSRB Reports Vol. 7, No. 3, (June 1987), at 7-8.

<sup>2</sup> The DTC same-day funds settlement program is distinct from the book-entry settlement system for "next-day" funds securities and includes a number of special features. DTC participants that wish to participate directly in the same-day funds system must apply to DTC to use the system and make contributions to a "participants' fund" for same-day funds participants.

<sup>3</sup> The Board believes that most dealers that effect substantial numbers of transactions in same-day funds securities already have access to the book-entry settlement system, either by direct membership or through a clearing agent with access to the system.



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## Letter of Interpretation

### Rule G-21. Advertisements Showing Current Yield

This is in response to your letter concerning the application of rule G-21, on advertising, to advertisements that include information on current yield of municipal securities.<sup>1</sup> You have asked for the Board's views whether including current yield information in advertisements for municipal securities, alone or with other yield information, would be materially misleading. You also ask if a dealer may advertise current yield if other yield information is included but is in smaller print. The Board has considered this issue and authorized this reply.

Rule G-21 prohibits a dealer from publishing an advertisement concerning a municipal security that the dealer knows or has reason to know is materially false or misleading. The Board has stated that an advertisement showing a percentage rate of return must specify whether it is the coupon rate or the yield. The Board noted that, if a yield is presented, the advertisement must indicate the basis on which the yield is calculated.<sup>2</sup>

The Board frequently has stated that the yield to call or yield to maturity is the most important factor in determining the fairness and reasonableness of the price of any given transaction in municipal securities. Such yields typically are used as a basis for dealers and customers to evaluate an investment in municipal securities. The disclosure of yield to call or yield to maturity is the long-standing practice of the municipal securities industry and this practice is reflected in rule G-15(a) which requires dealers to disclose yield to call or yield to maturity on customer confirmations.<sup>3</sup> A customer who purchases a municipal security relying only on the current yield information disclosed in an advertisement would be confused upon receipt of the confirmation when the yield to call or yield to maturity of the security is different. Moreover, a customer would not be able to compare municipal securities advertised at a current yield with those advertised at a yield to call or yield to maturity.<sup>4</sup> The Board has determined that the use of current yield information in

municipal securities advertisements without other yield information would be materially misleading under rule G-21. Thus, dealers may not show only current yield in municipal securities advertisements.

The Board also has determined that, while showing only current yield information in advertisements is materially misleading, if advertisements also include, at a minimum, the lowest of yield to call or yield to maturity, current yield may be used if all the information is clearly presented as discussed below. The Board notes that including yield to call or yield to maturity in municipal securities advertisements would give customers a more realistic view of the yield they can expect to receive on the investment and would enable them to compare the security advertised with other municipal securities. In addition, the yield to call or yield to maturity information would be consistent with the yield information disclosed on customer confirmations. If the yield to call is used, the call date and price also should be noted.

The Board is concerned that, even if dealers comply with this interpretation of rule G-21 and include current yield and other yield information in municipal securities advertisements, such advertisements still could be misleading due to the size of type used and the placement of the information. For example, it would not be appropriate for the type size of the current yield to be larger than other yield information. Thus, whether a particular advertisement is materially misleading requires the appropriate regulatory body, for example, an NASD District Business Conduct Committee, to consider a number of objective and subjective factors. The Board urges the regulatory authorities to continue to review advertisements on a case-by-case basis to make a determination whether any such advertisements, in fact, are misleading.

The Board also is reviewing the use of yield information, in general, in municipal securities advertisements. We will advise you of any Board action in this area.

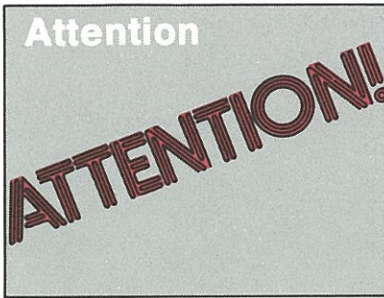
*MSRB Interpretation of April 22, 1988, by Diane G. Klinke, Deputy General Counsel.*

<sup>1</sup> Current yield is a calculation of current income on a bond. It is the ratio of the annual dollar amount of interest paid on a security to the purchase price of the security, stated as a percentage. If the securities are sold at par, the current yield equals the coupon rate on the securities. Current yield, however, does not take into account the time value of money. Thus, generally, if a bond is selling at a discount, the current yield would be less than the yield to maturity and, if the bond is selling at a premium, the current yield would be greater than the yield to maturity.

<sup>2</sup> *Frequently Asked Questions Concerning Advertising, MSRB Reports, Vol. 3, No. 2 (Apr. 1983), at 21-23.*

<sup>3</sup> Rule G-15(a) (i) (I) requires that the yield or dollar price at which the transaction was effected be disclosed on customer confirmations, with the resulting dollar price (if the transaction is done on a yield basis) or yield (if the transaction is done on a dollar basis) calculated to the lowest of dollar price or yield to call, to par option or to maturity. In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated and the call or option date and price used in the calculation must be shown.

<sup>4</sup> The Board also notes that some dealers have used current yield in municipal securities advertisements in an attempt to compete with municipal securities mutual funds, which often use a "current yield" in their advertisements. However, a mutual fund "yield" is not directly comparable to a municipal securities yield because a mutual fund "yield" represents historical information, while the yield on a municipal security represents a future rate of return.

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## Notice of Interpretation

### Rule G-13. Published Quotations

The Board has received complaints regarding published quotations, such as those appearing in *The Blue List*. The complaints, which have been referred to the appropriate enforcement agency, state that municipal securities offerings published by dealers often do not reflect prices and amounts of securities that currently are being offered by the quoting dealer.

Board rule G-13, on quotations, prohibits the dissemination of a quotation relating to municipal securities unless the quotation represents a bona fide bid for, or offer of, municipal securities. The term quotation is defined to mean any bid for, or offer of, municipal securities. A quotation is deemed to be bona fide if the dealer on whose behalf the quotation is made is prepared to purchase or sell the municipal securities at the price stated and in the amount specified at the time the quotation is made.

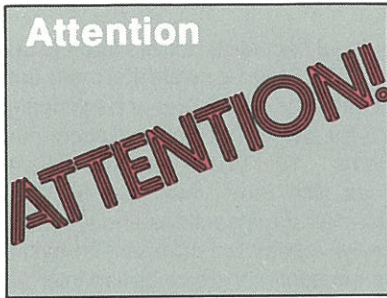
Under rule G-13, the price stated in a quotation for municipal securities must be based on the best judgment of the dealer making the quotation as to the fair market value of such securities at the time the quotation is made. The Board has stated that the price must have a reasonable relationship to the fair market value of the securities, and may take into account relevant factors such as the dealer's current inventory position, overall and in respect to a particular security, and the dealer's

anticipation of the direction of the market price for the securities.

Rule G-13 also prohibits a dealer from entering a quotation on behalf of another dealer if the dealer entering the quotation has any reason to believe that the quotation does not represent a bona fide bid for, or offer of, municipal securities. In addition, participants in a joint account are prohibited from entering quotations relating to municipal securities which are the subject of the joint account, if such quotations indicate more than one market for the same securities. Rule G-13 does not prohibit giving "nominal" bids or offers or giving indications of price solely for informational purposes as long as an indication of the price given is clearly shown to be for such purposes.

A dealer that publishes a quote in a daily or other listing must stand ready to purchase or sell the securities at the stated price and amount until the securities are sold or the dealer subsequently changes its price. If either of these events occur, the dealer must withdraw or update its published quotation in the next publication. Stale or invalid quotations violate rule G-13. Rule G-13 does permit a dealer to publish a quotation for a security it does not own if the dealer is prepared to sell the security at the price stated in the quotation. If the dealer knows that the security is not available in the market or is not prepared to sell the security at the stated price, the quotation would violate rule G-13.

*MSRB Interpretation of April 21, 1988, by Ronald W. Smith, Legal Assistant.*



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## Determining Whether Transactions Are Inter-Dealer or Customer Transactions: Rules G-12 and G-15

**The Board reminds dealers about the need to submit inter-dealer and customer transactions to the correct automated clearance systems.**

In December 1984, the Board published a notice providing guidance to dealers in determining whether certain transactions are inter-dealer or customer transactions for purposes of Board rules. Since the publication of this notice, the Board has continued to receive reports that inter-dealer transactions sometimes are erroneously submitted to automated confirmation/affirmation systems for customer transactions. This practice reduces the efficiencies of automated clearance since these transactions fail to compare in the initial comparison cycle. The Board is re-publishing the notice to remind dealers of the need to submit inter-dealer and customer transactions to the correct automated clearance systems.

\* \* \*

The Board recently has been advised that some members of the municipal securities industry are experiencing difficulties in determining the proper classification of a contra-party as a dealer or customer for purposes of automated comparison and confirmation. In particular, questions have arisen about the status of banks purchasing for their trust departments and dealers buying securities to be deposited in accumulation accounts for unit investment trusts. Because a misclassification of a contra-party can cause significant difficulty to persons seeking to comply with the automated clearance requirements of rules G-12 and G-15, the Board believes that guidance concerning the appropriate classification of contra-parties in certain transactions would be helpful to the municipal securities industry.

### Background

Rule G-12(f)(i) requires dealers to submit an inter-dealer

transaction for automated comparison if the transaction is eligible for automated comparison and both dealers are members of a registered securities clearing agency offering automated comparison services (or use a clearing agent for the transaction that is a member). Rule G-15(d)(ii) requires dealers to use an automated confirmation/affirmation service for delivery versus payment or receipt versus payment (DVP/RVP) customer transactions if the securities have a CUSIP number and the parties to the transaction are members of a registered securities clearing agency offering automated confirmation/affirmation services (or use a clearing agent for the transaction that is a member).

The systems available for the automated comparison of inter-dealer transactions and automated confirmation/affirmation of customer transactions are separate and distinct. As a result, misclassification of a contra-party may frustrate efficient use of the systems. For example, a selling dealer in an inter-dealer transaction may misclassify the contra-party as a customer, and submit the trade for confirmation/affirmation through the automated system for customer transactions while the purchaser (correctly considering itself to be a dealer) seeks to compare the transaction through the inter-dealer comparison system. Since the automated systems for inter-dealer and customer transactions are entirely separate, the transaction will not be successfully compared or acknowledged through either automated system.

### Transactions Effected by Banks

The Board has received certain questions about the proper classification of contra-parties in the context of transactions effected by banks. A bank may be the purchaser or seller of municipal securities either as a dealer or as a customer. For example, a dealer may sell municipal securities to a bank's trust department for various trust accounts. Such purchases by a bank in a fiduciary capacity would not constitute "municipal securities dealer activities" under the Board's rules<sup>1</sup> and are properly classified and confirmed as customer transactions. A second type of transaction by a bank is the purchase or sale of

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

<sup>1</sup> Section 3(a)(30) of the Securities Exchange Act of 1934 defines a bank to be a municipal securities dealer if it "is engaged in the business of buying and selling municipal securities for its own account other than in a fiduciary capacity." For purposes of the Board's rule G-1, defining a separately identifiable department or division of a bank dealer, the purchase and sale of municipal securities by a trust department would not be considered to be "municipal securities dealer activities."

securities for the dealer trading account of a dealer bank. The bank in this instance clearly is acting in its capacity as a municipal securities dealer and the transaction should be compared as an inter-dealer transaction.

A dealer effecting a transaction with a dealer bank may not know whether the bank is acting in its capacity as a dealer or as a customer. The Board is of the view that, in such a case, the dealer should ascertain the appropriate classification of the bank at the time of trade to ensure that the transaction can be compared or confirmed appropriately. The Board anticipates that dealer banks will assist in this process by informing counterparties whether the bank is acting as a dealer or customer in transactions in which the bank's role may be unclear to the contra-party.

#### **Transactions by Dealer Purchasing Municipal Securities for UIT Accumulation Accounts**

The Board has also received several inquiries concerning the appropriate classification of a dealer who purchases municipal securities to be deposited into an accumulation account for ultimate transfer to a unit investment trust (UIT). The dealer buying securities for a UIT accumulation account may purchase and hold the securities over a period of several days before depositing them with the trustee of the UIT in exchange for all of the units of the trust; during this time the dealer is exposed to potential market risk on these securities positions. The subsequent deposit of the securities with the trustee of the UIT in exchange for the units of the trust may be viewed as a separate, customer transaction between the dealer buying the accumulation account and the trust. The original purchase of the securities by the dealer for the account then must be considered an inter-dealer transaction since the dealer is purchasing for its own account ultimately to execute a customer transaction. The Board notes that the SEC has taken this approach in applying its net capital and customer protection rules to such transactions.

The Board is of the view that, for purposes of its automated comparison requirements, transactions involving dealers purchasing for UIT accumulation accounts should be considered inter-dealer transactions. The Board also notes the distinction between this situation, in which a dealer purchases for ultimate transfer to a trust or fund, and situations where purchases or sales of municipal securities are made directly by the fund, as is the case with purchases or sales by some open-end mutual funds. These latter transactions should be considered as customer transactions and confirmed accordingly.

#### **Other Inter-Dealer Transactions**

In addition to questions on the status of a dealer bank and dealers purchasing for accumulation accounts, the Board has received information that a few large firms are sometimes

submitting trades with regional securities dealers into the customer confirmation system. The Board is aware that these firms may classify transactions with regional dealers or bank dealers as "customer" transactions for purposes of internal accounting and compensation systems. The Board reminds industry members that transactions with other municipal securities dealers will always be inter-dealer transactions and should be compared in the inter-dealer automated comparison system without regard to how the transactions are classified internally within a dealer's accounting systems. The Board believes it is incumbent upon those firms who misclassify transactions in this fashion to promptly make the necessary alterations to their internal systems to ensure that this practice of misclassifying transactions is corrected.

\* \* \*

#### **Persons to Contact at Registered Clearing Agencies and Depositories**

The registered securities clearing agencies offering municipal securities services have provided the following names and telephone numbers of persons who can answer questions about the policies, procedures and operations of the clearing agencies relevant to municipal securities.

##### **Depository Trust Company**

Brokers and non-bank dealers may call:

Richard Watkins—(212) 709-1111

Val Stevens—(212) 709-1110

Dealer banks may call:

George Monk—(212) 709-1660

Everett Smith—(212) 709-1614

Other institutions may call:

George Monk—(212) 709-1660

##### **Midwest Clearing Corporation/Midwest Securities Trust Company**

James F. Purcell, Jr.—(212) 785-1410

##### **National Securities Clearing Corporation**

Ed Fanning—(212) 510-0478

##### **Philadelphia Depository Trust Company**

Robert Z. Kreszswick—(215) 496-5109

##### **Stock Clearing Corporation of Philadelphia**

Joseph Zibelman—(215) 496-5095

## New Issue of *MSRB Manual*

The updated soft-cover edition of the *MSRB Manual*, dated April 1, 1988, now is available.

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

Copies of the updated *Manual* may be obtained from the Board's offices by submitting a completed order form along with payment in full for the amount due. An order form is located on page 13 of this issue. The cost of the *Manual* is \$5.00.

## Publications List

### Manuals and Rule Texts

#### MSRB Manual

Soft-cover edition containing the text of MSRB rules, interpretive notices and letters, samples of forms, texts of the Securities Exchange Act of 1934 and of the Securities Investor Protection Act of 1970, as amended, and other applicable rules and regulations affecting the industry. Reprinted semi-annually.  
April 1, 1988 ..... \$5.00

#### Glossary of Municipal Securities Terms

Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.  
1985 ..... \$1.50

#### Professional Qualification Handbook

A guide to the requirements for qualification as a municipal securities representative, principal, sales principal and financial and operations principal, with questions and answers on each category. Includes sections on examination procedures, waivers, disqualification and lapse of qualification, the text of MSRB qualification rules and a glossary of terms.  
1988 ..... 5 copies per year ..... no charge  
Each additional copy ..... \$1.50

#### Manual on Close-Out Procedures

A discussion of the close-out procedures of rule G-12(h)(i) in a question and answer format. Includes the text of rule G-12(h)(i) with each sentence indexed to particular questions, and a glossary of terms.  
January 1, 1985 ..... \$3.00

#### Arbitration Information and Rules

Pamphlet reprinting SICA's *Arbitration Procedures* and *How to Proceed with the Arbitration of a Small Claim*, the text of rules

G-35 and A-16, a glossary of terms and list of sponsoring organizations.  
1988 ..... no charge

#### Instructions for Beginning an Arbitration

Step-by-step instructions and forms necessary for filing an arbitration claim.  
1988 ..... no charge

### Reporter and Newsletter

#### MSRB Reports

The MSRB's reporter and newsletter to the municipal securities industry. Includes notices of rule amendments filed with and/or approved by the SEC, notices of interpretations of MSRB rules, requests for comments from the industry and the public and news items.  
Bi/tri-monthly ..... no charge

### Examination Study Outlines

A series of guides outlining subject matter areas a candidate seeking professional qualification is expected to know. Each outline includes a list of reference materials and sample questions.

#### Study Outline: Municipal Securities Representative Qualification Examination

Outline for Test Series 52.  
November 1987 ..... no charge

#### Study Outline: Municipal Securities Principal Qualification Examination

Outline for Test Series 53.  
May 1988 ..... no charge

#### Study Outline: Municipal Securities Financial and Operations Principal Qualification Examination

Outline for Test Series 54.  
1987 ..... no charge

### Brochures

#### MSRB Information for Municipal Securities Investors

Investor brochure describing Board rulemaking authority, the rules protecting the investor, arbitration and communication with the industry and investors. Use of this brochure satisfies the requirements of rule G-10.  
1 to 500 copies ..... no charge  
Over 500 copies ..... \$.01 per copy

#### MSRB Information

Brochure describing Board structure and responsibility, the rulemaking process, and communications with the industry.  
1 to 500 copies ..... no charge  
Over 500 copies ..... \$.05 per copy

# Publications Order Form

Description	Price	Quantity	Amount Due
MSRB Manual (soft-cover edition)	\$5.00		
Glossary of Municipal Securities Terms	\$1.50		
Professional Qualification Handbook	5 copies per year no charge Each additional copy \$1.50		
Manual on Close-Out Procedures	\$3.00		
Arbitration Information and Rules	no charge		
Instructions for Beginning an Arbitration	no charge		
Study Outline: Municipal Securities Representative Qualification Examination	no charge		
Study Outline: Municipal Securities Principal Qualification Examination	no charge		
Study Outline: Municipal Securities Financial and Operations Principal	no charge		
MSRB Information for Municipal Securities Investors (Investor Brochure)	1 to 500 copies no charge Over 500 copies \$.01 per copy		
MSRB Information	1 to 500 copies no charge Over 500 copies \$.05 per copy		
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Orders should be addressed to the Municipal Securities Rulemaking Board, 1818 N Street, NW, Suite 800, Washington, DC 20036-2491, Attention: Publications.