MSRB REPORTS

Volume 13, Number 3 | Municipal Securities Rulemaking Board | June 1993

In This Issue

Also in This Issue

MSRB REPORTS (SSN-0277-0911) is published by the Municipal Securities Rulemaking Board, 1818 N Street, NW, Suite 800, Washington, DC 20036-2491. Editor: Ronald W. Smith
POSTMASTER send address changes to MSRB, 1818 N Street, NW, Suite 800, Washington, DC 20036-2491. Telephone (202) 223-9347 Fax (202) 872-0347

Reminder

Invoices for the Board's annual fee of $100 (rule A-14) will be mailed in late September. The annual fee for the 1993-94 fiscal year must be paid by October 31, 1993.

Calendar

May 17	— Issuers may enroll as submitters in the Board's CDI Pilot effective this date
May 28	— As of this date, the 1990 and 1992 collections of imaged official statements and advance refunding documents will be available from the OS/ARD subsystem
June 30	— Comments due to SEC on proposed SEC rule on T+3 settlement
Summer 1993	— Estimated effective date for amendment to rule G-12(b) requiring managing underwriters to provide a registered securities clearing agency with the settlement date for a new issue as soon as the settlement date is known
July 1	— Planned effective date for an amendment to rule G-15(d)(iii) requiring all DVP/RVP customer transactions in depository eligible securities to be settled by book-entry, with two limited exceptions
Sept. 15	— Comments due on draft amendments relating to the suitability of recommendations to customers
Sept. 15	— Comments due on the planned pilot program for publishing inter-dealer transaction information
Fall 1993	— Estimated effective date for an amendment to rule G-12(f)(i) requiring essentially all inter-dealer transactions to be compared in an automated comparison system
Pending	— Amendment to rule G-35, on the Board's arbitration code

Volume 13, Number 3

MSRB REPORTS

June 1993

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [X] Trading
- [X] Sales
- [ ] Operations
- [ ] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other

Planned Pilot Program for Publishing Inter-Dealer Transaction Information

Comments Requested

The Board is proposing a pilot program to collect and publish information on transactions occurring in the inter-dealer market for municipal securities.

The Board is proposing a pilot program to collect and publish information on transactions occurring in the inter-dealer market for municipal securities. The data to be published includes aggregate data about market activity and certain volume and price information about wholesale transactions in frequently traded securities. The purpose of publishing this data is to provide greater "transparency" in the market and to promote investor confidence in the market and in its pricing mechanisms. The Board is requesting comment on features of the pilot program from interested parties.

Introduction

During the past five years, the Board has undertaken various initiatives to further its stated priorities for Board action.[1] These priorities, which have been published on numerous occasions, have set forth the Board's view of areas that most need the attention and continuing commitment of the Board and the industry. With the implementation of the Municipal Securities Information Library,™ (MSIL™)[2] system, the Board has made significant progress on two of these priorities — providing market participants with improved descriptive information on the features of municipal securities and information about the issuers of municipal securities. Similarly, the Board's customer protection project has focussed attention on the ethical standards and the vigorous enforcement of the Board's rules, which also are Board priorities.

The Board is now examining how it can make progress on another of its major goals — that of providing information about the value of municipal securities, as reflected by actual transactions in the market. In light of the increasing participation of retail customers in the municipal market, the Board believes it is important that investors remain confident of the integrity of the market and its pricing mechanisms. Thus, the Board believes that it may be necessary to bring greater "transparency" to the market by publishing information that is based on actual wholesale transactions occurring in the market. Toward this end, the Board is planning a pilot program that will examine the potential benefits and feasibility of publishing certain price and volume information derived from inter-dealer transactions in municipal securities.

General Features of Pilot Program

Only inter-dealer transaction data would be involved in the pilot program. To report transactions to the Board, dealers merely would submit their inter-dealer transactions to a registered clearing agency for automated comparison. Since submission of inter-dealer transactions for automated comparison already is required under Board rule G-12(f), the pilot program would not require dealers to undertake any additional action or costs beyond that which is currently required by that rule.[3]

Since the inter-dealer market is comprised of transactions

Comments on the pilot program should be submitted no later than September 15, 1993, and may be directed to Harold L. Johnson, Deputy General Counsel, or Judith A. Somerville, Uniform Practice Specialist. Written comments will be available for public inspection after Board review.

[1] The Board's priorities are:

1. to provide market participants (investors, dealers, and issuers) with more information regarding the description of securities;
2. to provide market participants with more information about the issuers of securities;
3. to provide market participants with more information about the value of securities;
4. to increase the responsibility of issuer agents (*e.g.*, financial advisors, trustees, transfer agents, paying agents, and bond attorneys) to the market;
5. to raise the ethical standard of the industry and ensure the vigorous enforcement of Board rules; and,
6. to improve the clearance and settlement system for municipal securities consistent with national goals.

MSRB Reports Vol. 10, No. 2 (May 1990) at 2.

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

[3] In April 1993, the Board filed a proposed rule change to rule G-12(f)(i) which, if approved, will eliminate certain narrow exceptions to the general requirement that all eligible inter-dealer transactions be compared through the use of an automated comparison system.

between securities professionals, inter-dealer transaction data should provide a good indication of the wholesale market value of securities. The Board understands that customer transactions also may be relevant in establishing market values and the Board may in the future consider mechanisms to collect data on customer transactions. However, at this time, the ability to collect transaction data on all compared inter-dealer transactions, without the need for a separate transaction reporting system, presents an opportunity for the Board to evaluate a pilot program on market transparency at a minimal cost to the industry.

In the pilot program, the Board will collect and make available data on transactions as soon as the transactions are compared.[4] The Board currently is working with National Securities Clearing Corporation (NSCC) – the central processing facility for automated comparison of municipal securities transactions – on the technical requirements for using comparison data. In the current comparison system, dealers are required to submit transactions to a registered securities clearing agency no later than the day following trade date (T+1), with the initial comparison cycle occurring on the evening of T+1 and compared trade data available on T+2. However, NSCC is in the process of revising the comparison system to accelerate the comparison cycle.[5] Under the redesigned system, dealers will submit transaction data on the evening of trade date, and compared trade data will be available on the morning of T+1. The Board's pilot program will not be implemented until after the redesigned comparison system is operational. Thus, the pilot program is expected to make transaction information available on T+1.[6]

At this time, the Board anticipates that the proposed pilot program to publish market data will become operational by January 1995. The Board would operate the pilot system for one year and then decide whether the program should be continued, modified, or terminated.

Transaction Information To Be Published

Under the pilot program, the Board would make public certain aggregate information about inter-dealer market activity for each day of trade. This information would include, for each trade date:

(i) total par value traded;
(ii) total number of compared transactions;[7] and
(iii) total number of issues traded (*i.e.*, the number of different CUSIP numbers that were involved in compared transactions on that day).

For issues that trade with a certain degree of frequency on a given trade date, additional price and volume information would be released. The published information about these "frequently traded" issues would include, for each such security:

(i) the CUSIP number and securities description;
(ii) the total number of transactions in the security;
(iii) the highest and lowest prices of transactions in the security; and
(iv) the number of transactions in the security involving par values between $100,000 and $1,000,000, inclusive, and the average price of those transactions.

Threshold for Determining "Frequently Traded" Issues

As noted above, the publication of issue-specific volume and pricing information would be limited to "frequently traded" issues. If the trading in an issue on a given day does not meet a pre-defined threshold, no volume or price information for that issue would be published for that day.

To consider the appropriate threshold for defining "frequently traded" issues, the Board has reviewed actual transaction data taken from the automated comparison system.[8] The Board believes that it would be appropriate to report issue-specific information only if four or more transactions in the issue are reported as compared on a given day. Using this threshold and based on recent levels of market activity, the Board anticipates that the daily list of frequently traded issues normally will range between 80 to 350 issues, with an average of about 180 issues each day. The size and composition of the list obviously would vary from day to day, depending upon market activity in specific issues.

Discussion and Request for Comment

The Board is aware that transaction patterns in municipal securities are unlike the transaction patterns found in exchange and NASDAQ markets. In these "listed" markets, for both equity and debt instruments, there is relatively frequent trading as well as firm, two-sided quotations. These characteristics allow market participants to use transaction and quotation data to determine the value of most listed securities on a day-to-day (and usually on an intra-day) basis. In contrast, most issues of municipal securities go long periods of time without any trading and it is generally not possible for dealers to make firm, two-sided markets in municipal issues.[9] The Board accordingly understands that, in the municipal securities market, "transparency" can not provide the day-to-day, direct indicator of market value for most issues, as is the case for listed markets.

---

[4] Not all transactions currently are successfully compared in the initial comparison cycle because certain submissions by dealers are incorrectly coded or are not submitted on a timely basis. NSCC and the Board will work with the industry to reduce the number of submission errors to ensure that the highest possible level of comparison is reached. The automated comparison system has been redesigned with this objective in mind. Successful comparison in the initial comparison cycle is important not only to ensure accuracy in the transaction data that is published by the Board, but also to ensure efficiency in the clearance and settlement of inter-dealer transactions.

[5] For a full description of the redesigned comparison system, see SR-NSCC-93-2, filed with the Securities and Exchange Commission on January 6, 1993.

[6] To the extent that the comparison cycle is further compressed in the future, transaction information would be available earlier.

[7] As an indication of the reliability of the data published, the Board also would publish, for each day of trading, the percentage of submissions that were successfully compared. See note 4, above.

[8] The Board reviewed inter-dealer transaction data from the period August 1991 through January 1992.

[9] The lack of firm, two-sided quotations in the market may relate in part to the "buy and hold" character of the investment and the small "float" available in a typical issue. In addition, the negative tax implications of borrowing tax-exempt securities discourages the making of two-sided markets by further increasing the difficulty of covering short positions.

For those municipal issues that are trading frequently, however, the Board believes that price and volume information may well be useful and may assist market participants in determining the value of the securities. Thus, the Board proposes to publish issue-specific volume and pricing data, but only for those issues that are traded four or more times on a given day. The Board requests comment on whether this is an appropriate threshold for defining "frequently traded" issues and whether there are other standards that should be considered for selecting issues for reporting purposes.

The Board also requests comment on the specific information about frequently traded issues that would be published. For example, the proposed pilot program would separately report the number and average price of transactions with par values between $100,000 and $1,000,000. The Board is proposing this "band" of par value for computation of average price to exclude from the computation transactions that might be priced differently because of their large or small size. The Board is proposing this because it hopes that the "average price" will evolve over time to serve as an indicator of a "typical" inter-dealer market price for a given issue on a given day. Comment is requested on the utility of this approach, whether a different band should be chosen or whether alternative indicators of transaction price levels should be considered.

Finally, the Board requests general comment on the format for the proposed daily published reports and the various information to be included thereon. A sample format follows this notice. The deadline for comments is September 15, 1993.

May 13, 1993

A sample format of the price and volume report is contained on the following page.

SAMPLE
Price and Volume Report
Inter-dealer Municipal Securities Market

Trade Date:	08/05/91	Total Par Traded:	689,769,000
Total Number of Trades:	3,329	Total Number of Issues Traded:	1,938
Number of Issues Traded 4 or More Times:	90	Comparison Rate:	97%

CUSIP #	Security Description	Number of Trades	Volume Traded	High Price	Low Price	Avg. Price[1]	Trades Included in Avg Price
000000-AA-1	X Mun Util Dist Elec Rev Series Y 6.75% 09/01/2009	32	17,640,000	99.075	98.593	98.940	27
000001-BB-2	Y State Housing Agency Single Fam Mtg Sr-B-Rmkt 7.40% 07/01/2011	21	4,240,000	100.000	99.250	99.399	19
000002-CC-3	Z Commonwealth Electric Pwr Auth Pwr Rev 7% 07/01/2021 Ser. P	19	5,474,000	98.250	98.125	98.174	19
000003-DD-4	Y State Housing Agency Single Fam Mtg Sr-B-Rmkt 6.75% 07/01/2023	17	5,000,000	99.750	99.250	99.341	17
.	.	.	.	.	.	.	.
.	.	.	.	.	.	.	.
000099-ZZ-9	ZZ State MBIA Book Entry 6.90% 05/15/2003 .	4	600,000	102.036	101.961	101.999	4

[1] Average price includes only trades with par values between $100,000 and $1,000,000 inclusive.

Volume 13, Number 3

MSRB REPORTS

June 1993

Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [X] Sales
- [ ] Operations
- [ ] Public Finance
- [X] Compliance
- [ ] Training
- [ ] Other

Suitability of Recommendations and Transactions and Related Recordkeeping Requirements: Rules G-19 and G-8

Comments Requested

The Board is requesting comment from all interested parties on draft amendments to rules G-19 and G-8 relating to the suitability of recommendations to customers. The draft amendments would: (1) clarify and strengthen the existing language of rule G-19 which requires suitability determinations to be made when recommending transactions to customers; (2) clarify the obligation of dealers to make reasonable efforts to obtain specific types of customer information from non-institutional accounts in order to make suitability determinations for such customers; and (3) clarify the definition of institutional account in rule G-8(a)(xi).

Over the past year, there has been a considerable amount of discussion about Board rule G-19 on suitability of recommendations to customers. In a letter dated May 8, 1992, the Director of the Division of Market Regulation of the Securities and Exchange Commission asked the Board to review the requirements of rule G-19. In September 1992, the Board requested comments on a number of customer protection issues including the application of rule G-19 to customer transactions. After reviewing these matters, the Board believes that rule G-19 embodies the appropriate general standard for dealers in making recommendations to customers, *i.e.*, when making a recommendation to a customer, a dealer has the obligation to determine that the transaction is suitable for the customer. However, the recent discussions about rule G-19 have focussed on certain language in the rule and there is concern that this language might be interpreted, in some instances, as permitting recommendations to go forward without proper regard to the nature of the security being recommended and the customer to whom it is recommended. Accordingly, the Board is proposing amendments to rules G-19 and G-8(a)(xi) on recordkeeping to clarify the general standard currently embodied in rule G-19 and to remove the provisions that have caused this concern. The Board is seeking comment from all interested parties on these amendments. The deadline for written comments is September 15, 1993.

Current Requirements of Rule G-19

In general, rule G-19 requires a dealer to know its customer and any security that is recommended to the customer and, with this knowledge, to ensure that transactions recommended to the customer are suitable. With respect to making inquiries about the customer, rule G-19 states that a dealer shall either have knowledge or inquire about "the customer's financial background, tax status, and investment objectives and any other similar information."[1] Rule G-8(a)(xi) requires such information about the customer thus obtained to be recorded in the customer account record to assist in monitoring compliance with rule G-19. Dealers must ensure that these records are kept current if subsequent changes in the customer's position affect the suitability of recommendations made to the customer. [2]

With respect to the requirement to know the security, rule G-19 states that the dealer shall not recommend any specific transaction in a security unless the dealer has reasonable grounds, based on the information available from the issuer of the security or otherwise, for recommending a purchase, sale or other transaction in the security. In effect, this means that the dealer must be familiar with the credit quality and features of the security.

Suitability Standards

With respect to making a suitability determination for each transaction recommended to a customer, the current rule states a general standard that the dealer must have reasonable

Comments on the draft amendments should be submitted no later than September 15, 1993, and may be directed to Mark McNair, Assistant General Counsel. Written comments will be available for public inspection after Board review.

[1] Rule D-9 defines customer as "any person other than a broker, dealer, or municipal securities dealer acting in its capacity as such or any issuer in transactions involving the sale by the issuer of a new issue of its securities."

[2] *See* Suitability of Recommendations and Transactions: Rule G-19, *MSRB Reports* Vol. 8, No. 2 (March 1988), at 10-11, and Recordkeeping Requirements for Suitability Information: Rule G-8, *MSRB Reports*, Vol.7, No. 1 (January 1987), at 23-24.

grounds to believe, and in fact believe, that a recommendation is suitable for such customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by the dealer (an "affirmative suitability determination"). The rule also states an alternative standard which may be observed, in certain situations, in lieu of an affirmative suitability determination. Under this provision currently in rule G-19, if all requisite customer information is not furnished or known, the rule states that a dealer may nevertheless make a recommendation provided that he has no reasonable grounds to believe (and does not believe) that the recommendation is unsuitable for such customer (the "not unsuitable" provision).

The genesis of the "not unsuitable" provision in rule G-19 is found in the language of an SEC rule on suitability, which was in effect when rule G-19 was adopted in 1978, but which no longer exists.[3] At that time, Securities Exchange Act Rule 15b10-3 provided that, in making recommendations to a customer, a dealer "shall have reasonable grounds to believe that the recommendation is not unsuitable for such customer on the basis of information furnished by such customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by such broker or dealer or associated person." In drafting rule G-19 in 1978, the Board wished to stress a dealer's duty of inquiry as to the customer's financial situation (as did the SEC rule). Additionally, the Board's rule was drafted to require an affirmative suitability determination as a general rule, but the "not unsuitable" provision allowed an alternative standard to be available in situations in which a customer refused to provide requisite information after reasonable inquiry.

Recommendations Concerning Unsuitable Transactions

Currently, rule G-19 also includes another provision stating that, notwithstanding the other requirements of the rule, if a dealer determines that a transaction is not suitable for the customer, and so informs the customer, the dealer may respond to the customer's requests for investment advice concerning municipal securities generally or specific municipal securities and may execute transactions at the direction of the customer (the "notwithstanding" provision). The "notwithstanding" provision was included in the rule to allow dealers to make recommendations to investors who wanted to invest in municipal securities, such as local municipal projects, even after being informed that, based on their financial circumstances, investments in municipal securities would not be suitable.[4]

Proposed Elimination of "Not Unsuitable" and "Notwithstanding" Provisions

In response to the Board's September 1992 Request for Comment on the application of rule G-19, various comments were received on the "not unsuitable" provision. While some commentators believe that the provision should be deleted, other commentators believe it should be retained because some customers do not wish to provide certain information about themselves.[5] The Board believes that most customers, if informed of the reason for the inquiries, are willing to provide enough information for the dealer to determine the suitability of a specific transaction being recommended. Thus, the Board believes that, as a practical matter, deleting the "not unsuitable" provision would codify existing good dealer practices.

Both the "not unsuitable" provision and the "notwithstanding" provision represent departures from the general standard set by rule G-19, *i.e.*, the requirement of an affirmative determination of suitability for each recommendation. In addition, the municipal securities market has evolved significantly in the years since the provisions were adopted. Retail customers – of varying degrees of sophistication – now constitute a much larger and growing part of the investor base. The introduction of increasing numbers of complex, and in some cases, speculative, municipal securities also is characteristic of today's market. Many of these securities are now being sold to retail customers. These factors suggest that rule G-19 should be clear about the responsibility of dealers to make a suitability determination for each recommendation and that a recommendation should not be made unless it is suitable. Thus, although the "not unsuitable" and "notwithstanding" provisions may have served a purpose in the past, the Board believes that removing them will provide a clarification and strengthening of rule G-19 which is appropriate for recommendations made to customers in today's market.

The Board understands that there may be a few customers who, even after reasonable inquiry, do not wish to provide complete data about their financial and tax status. The draft amendment to rule G-19 would preclude dealers from recommending any transaction to such a customer unless the transaction could be determined to be suitable. In this regard, it should be noted that the nature of a recommendation may bear upon the amount of customer information that is required to reach a decision on suitability. For example, with respect to some types of transactions, *e.g.*, those in more speculative securities, the amount of information needed to make a suitability determination will be greater than if a more conservative recommendation is being made. Dealers must be especially careful to obtain all customer information necessary to establish that speculative securities are suitable for the customer or else not make the recommendation.

Finally, it should be noted that rule G-19 applies only to recommendations. Thus, the draft amendment would not apply to unsolicited transactions and, for example, would not preclude a dealer from responding to a customer who requests that the dealer execute a specific municipal securities transaction on the customer's behalf.

Other Clarifications

In addition to the removal of the "not unsuitable" and

[3] The SEC rule applied to SECO firms, *i.e.*, firms that were not members of the NASD.
[4] *See* File No. SR-MSRB-79-4, filed with the Commission May 24, 1979 (amending rule G-19).
[5] Two commentators believed that removing the provision would not be a problem and would make the Board's rule consistent with normal practice in other securities markets. Three other commentators noted that some customers do not want to give financial information.

"notwithstanding" provisions, the draft amendments also would clarify other aspects of rule G-19. These clarifications relate to the type of information that dealers should seek to obtain about customers before making recommendations.

In order to make a suitability determination, a dealer must have information about a customer – either through inquiry or otherwise – sufficient to determine that the proposed transaction is suitable for that customer. The requirement to make a suitability determination applies both to retail and institutional customers. However, the information about the customer necessary to make a suitability determination may be different for institutional and retail customers.

For a non-institutional account, the draft amendments clarify that dealers should make reasonable inquiry about the following information: the customer's financial status, tax status, investment objectives and such other information used or considered to be reasonable and necessary by the dealer in making recommendations to the customer. The Board believes that this information generally is relevant to suitability determinations made for non-institutional accounts. The requirement to make reasonable inquiry as to these items for non-institutional accounts also would be consistent with existing requirements under NASD rules.[6]

Under the draft amendment, dealers also must make suitability determinations before making recommendations to institutional accounts. As a consequence, dealers must know enough about the institution to ensure that any transactions recommended are, in fact, suitable. In some cases – for example, when the customer is a large and sophisticated financial institution – this requirement may be satisfied by the dealer's knowledge of the general nature of the institution and its investment objectives.

The draft amendments do not state a specific list of items that must be obtained from institutional accounts. This is in contrast to the current customer inquiry requirements of rule G-19(b), which even though aimed primarily at retail accounts, are applicable to all customers. As a result, under the current formulation of the rule, dealers sometimes are unclear whether and, if so, how to obtain information such as "tax status" or "financial status" for institutions. The draft amendments clarify the dealer's obligation in such situations by requiring the dealer to obtain enough data from an institutional account to make a suitability determination.

With regard to recordkeeping requirements, under the draft amendments, rule G-8(a)(xi)(F) would require the customer information used to make a suitability determination to be recorded in the customer account record. This applies both to institutional and non-institutional accounts. For non-institutional accounts, the draft amendment also would specifically require a record of the customer account data obtained as a result of inquiries made pursuant to rule G-19(b).

Finally, in order to clarify which accounts are considered institutional and which are considered non-institutional, the Board proposes to amend its definition of "institutional account" in rule G-8, which would also be used in rule G-19. The revised definition of institutional account would include a bank, savings and loan association, insurance company, registered investment company, an investment adviser registered under Section 203 of the Investment Advisers Act of 1940, or any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million. This would replace the current definition which lists fewer specific categories, but which includes a broad category entitled "any other institutional type account."

The Board believes this clarification will be helpful for dealers who sometimes have had difficulties under the current rule deciding whether an entity is an "institutional type" account. Moreover, because the specific categories and financial thresholds will be the same as those applicable under a similar NASD rule, the Board believes this clarification will assist dealer compliance and NASD enforcement of rule G-19.

Request for Comments

The Board requests comments on the draft amendments to rules G-19 and G-8 and the provisions being deleted. The Board also requests comments on the draft requirement that dealers make reasonable efforts to obtain specific data for non-institutional accounts and the revised definition of institutional account.

May 13, 1993

Text of Draft Amendments*

Rule G-19. Suitability of Recommendations and Transactions; Discretionary Accounts

(a) No change.

(b) ~~Knowledge of Customer. Each broker, dealer or municipal securities dealer at or before recommending the purchase, sale or exchange of a municipal security to a customer shall have knowledge or shall inquire about the customer's financial background, tax status, and investment objectives and any other similar information.~~

Non-institutional Accounts - Prior to recommending to a non-institutional account a municipal security transaction, a broker, dealer or municipal securities dealer shall make reasonable efforts to obtain information concerning:

(i) the customer's financial status;

(ii) the customer's tax status;

(iii) the customer's investment objectives; and

(iv) such other information used or considered to be reasonable and necessary by such broker, dealer or municipal securities dealer in making recommendations to the customer.

The term "institutional account" for the purposes of this section shall have the same meaning as in Rule G-8(a)(xi).

(c) Suitability of Recommendations. ~~No broker, dealer or municipal securities dealer shall recommend the purchase, sale or exchange of a municipal security to a customer unless such broker, dealer or municipal securities dealer, after reasonable inquiry,~~

[6] *See* NASD Manual, Rules of Fair Practice, Art. III, Secs. 2 and 21.

* Underlining indicates additions; strikethrough indicates deletions.

~~(i) has reasonable grounds based upon information available from the issuer of the security or otherwise for recommending a purchase, sale or other transaction in the security; and~~

~~(ii)(A) has reasonable grounds to believe and does believe that the recommendation is suitable for such customer in light of the customer's financial background, tax status, and investment objectives and any other similar information concerning the customer known by such broker, dealer or municipal securities dealer, or~~

~~(B) has no reasonable grounds to believe and does not believe that the recommendation is unsuitable for such customer if all of such information is not furnished or known.~~

~~Notwithstanding the foregoing, if a broker, dealer or municipal securities dealer determines that a transaction in municipal securities or in specific municipal securities would not be suitable for a customer and so informs such customer, the broker, dealer or municipal securities dealer may thereafter respond to the customer's requests for investment advice concerning municipal securities generally or such specific securities and may execute transactions at the direction of the customer.~~

In recommending to a customer any municipal security transaction, a broker, dealer, or municipal securities dealer shall have reasonable grounds:

(i) based upon information available from the issuer of the security or otherwise, and

(ii) based upon the facts disclosed by such customer or otherwise known about such customer

for believing that the recommendation is suitable.

(d) through (e) No change.

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

(a) Description of Books and Records Required to be Made. Except as otherwise specifically indicated in this rule, every municipal securities broker and municipal securities dealer shall make and keep current the following books and records, to the extent applicable to the business of such municipal securities broker or municipal securities dealer:

(i) - (x) No change.

(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) - (E) No change.

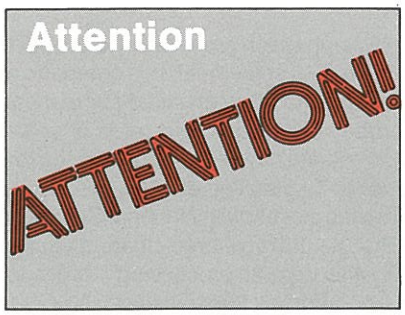
(F) information about the customer ~~obtained~~ used pursuant to rule ~~G-19(b)~~ G-19(c)(ii) ~~such as the customer's financial background, tax status, and investment objectives or such other information used or considered to be reasonable~~ in making recommendations to the customer. For non-institutional accounts, all data obtained pursuant to rule G-19(b) shall be recorded.

(G) - (K) No change.

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.~~ the account of: (i) a bank, savings and loan association, insurance company, or registered investment company; (ii) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940; or (iii) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million. 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), (F), (H), (I) and (K) of this subparagraph with respect to each customer which is an institutional account.

(xii) - (xv) No change.

(b) through (f) No change.



Route to:

- [X] Manager, Muni Dept.
- [ ] Underwriting
- [ ] Trading
- [ ] Sales
- [X] Operations
- [ ] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other

Letter to SEC on Its Proposed Rule on T+3 Settlement

On February 23, 1993, the Securities and Exchange Commission proposed for comment SEC Rule 15c6-1. The proposed rule would establish three business days, instead of five business days, as the standard, regular-way settlement timeframe for most securities transactions. The proposed effective date for the rule is January 1, 1996.

The proposed rule does not at this time include municipal securities within its scope. The SEC, however, has asked for comment on "how to achieve the safety and efficiency benefits of [a three business day settlement cycle] for municipal securities" and a reasonable timeframe for bringing municipal securities within the scope of the rule. Comments are due to the SEC by June 30, 1993.

The Board's comment letter to the SEC on proposed SEC Rule 15c6-1 is reprinted below.

May 17, 1993

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street NW
Washington, D.C. 20549

Re: File No. S7-5-93

Dear Mr. Katz:

The Municipal Securities Rulemaking Board is pleased to offer its comments on proposed Rule 15c6-1, which would establish three business days as the standard settlement timeframe for broker-dealer transactions (T+3 settlement). Although the proposed rule does not include municipal securities within its scope, the Commission requested comment on the methods and timeframe by which the municipal securities market could move to T+3 settlement.[1] The Board appreciates the opportunity to address these questions and to provide information on the Board's activities relating to clearance and settlement of municipal securities.

One of the Board's top priorities for the municipal securities market is the improvement of clearance and settlement systems consistent with national goals.[2] Over the past four years, as various industry groups have discussed various implementation plans for T+3 settlement, the Board has sought to keep the municipal market informed of these discussions and to ensure that the perspective of the municipal securities market is taken into account.[3] In addition, even as the industry discussions have continued, the Board has moved forward with several of its own initiatives to improve clearance and settlement of municipal securities.

As the Commission noted in its Release proposing Rule 15c6-1, there are differences between the municipal and corporate markets that may have bearing upon the methods and the timetable by which the municipal securities market could implement T+3 settlement.[4] In the municipal securities market, the issues that would have to be addressed can be broken down generally into those affecting institutional transactions (*i.e.*, transactions between dealers and transactions between dealers and institutional customers) and issues relating to retail transactions.

Institutional Transactions

The efficient use of automated systems for clearance and settlement is a precondition to any compression of the settlement cycle. In the municipal securities market, these automated systems are comprised of: (i) the automated comparison system for inter-dealer transactions; (ii) the book-entry delivery systems for settlement of securities transactions at

[1] *See* Securities Exchange Act Release S7-5-93 (February 23, 1993) ("SEC Release") at 18-19.
[2] *See MSRB Reports* Vol. 11, No. 3 (September 1991) at 7-8.
[3] The Board has done this through industry group meetings, and through publication of information on the progress of Group of Thirty activities. *See, e.g., MSRB Reports* Vol. 13, No. 2 (April 1993) at 3-10; *MSRB Reports* Vol. 10, No. 4 (October 1990) at 11-18; *MSRB Reports* Vol. 10, No. 1 (January 1990) at 21-25.
[4] SEC Release at 18.

depositories; and (iii) the automated confirmation/affirmation systems for institutional customer transactions. Board rules G-12(f) and G-15(d) currently require use of automated clearance and settlement systems on most inter-dealer and Delivery Versus Payment and Receipt Versus Payment (DVP/RVP) customer transactions.[5]

For the municipal securities market to move to T+3 settlement, it is necessary for automated clearance and settlement systems to be fully utilized, since the time-consuming processes of mailing paper confirmations and accomplishing physical deliveries of certificates clearly are inconsistent with a shortened settlement timeframe. The nature of the municipal securities market makes it difficult to obtain the same efficiencies from automated systems as is obtained in the exchange and NASDAQ markets. Nevertheless, as has been reported to the Commission, the Board over the past ten years has undertaken a number of actions to promote and facilitate use of the systems.[6]

During 1991, the Board began the process of completing the transition of the municipal securities market to automated clearance and settlement. The Board published its implementation plan for this initiative in September 1991 and noted, among other things, that the completion of this transition would be necessary for the municipal securities market to participate in national clearance and settlement goals.[7] Since that time, the Board has been working to facilitate the transition.

CUSIP Numbers

Because the automated clearance and settlement systems for municipal securities require CUSIP numbers to be assigned before processing can take place, it is critical that new issue municipal securities be assigned CUSIP numbers. The Board has worked with the CUSIP Board of Trustees to remove eligibility restrictions that previously have resulted in many small issues of municipal securities being ineligible to receive CUSIP numbers. As a result, as of April 15 of this year, small issues of municipal securities became eligible for CUSIP number assignment.[8] Under rule G-34, dealers are now required to ensure that CUSIP numbers are assigned to these smaller issues.[9]

Automated Comparison of Inter-Dealer Transactions

At this time, the comparison process for municipal securities provides for initial comparison to occur on the evening of T+1 and the results of the initial comparison process to be provided to dealers on T+2. To move to T+3 settlement, this comparison cycle will have to be accelerated to allow for initial comparison on the evening of trade date. In addition, the rates of actual comparison in the initial comparison cycle currently are too low to provide a reliable basis for T+3 settlement.[10]

The Board has been working closely with National Securities Clearing Corporation (NSCC) – the registered clearing agency responsible for operating the central processing facility for automated comparison – to address these issues. NSCC is planning to implement a redesigned comparison system this year which will accelerate the comparison cycle and improve comparison rates.[11] The Board has worked with NSCC in the redesign of the system and also has filed with the Commission rule changes to support system operations and to require mandatory use of the system for all inter-dealer transactions that are eligible for automated comparison.[12] These rule changes are still pending review by the Commission. The Board expects the redesigned comparison system to begin operation in the near future.

Book-Entry Settlement of Institutional Transactions

During 1992-93, the Board filed with the Commission two rule changes to require mandatory use of book-entry settlement for inter-dealer and DVP/RVP customer transactions that are eligible for book-entry settlement.[13] The requirement for book-entry settlement of inter-dealer transactions became effective on January 4 of this year. The requirement for book-entry settlement of DVP/RVP customer transactions currently is pending review by the Commission. The Board has requested a July 1, 1993, effective date for this rule change.

Automated Confirmation/Affirmation of DVP/RVP Customer Transactions

The use of automated confirmation/affirmation systems is an area in which the municipal securities market has had substantial difficulty in obtaining the same degree of success as has been obtained in the corporate securities markets.[14] This may be due, among other factors, to a different institutional customer base for the municipal market and may relate to the ability and willingness of those customers to use the confirmation/affirmation systems.[15] The Board understands that Depository Trust Company (DTC) is designing improvements to its Institutional Delivery System that will provide for

---

[5] The Board believes that the category of "DVP/RVP customer transactions" includes essentially all transactions between dealers and their institutional customers.

[6] *See, e.g., Prospects for Automation of Municipal Clearance and Settlement Procedures, A Report to the Securities and Exchange Commission*, (MSRB, 1983); *Automated Clearance and Settlement In the Municipal Securities Market, A Report To the Securities and Exchange Commission*, (MSRB, 1988). The Board also discussed the status of automated clearance in a recent filing of a proposed rule change with the Commission. *See* SR-MSRB-92-6 (filed August 27, 1992 and approved December 23, 1992, SEC Release No. 34-31645).

[7] *MSRB Reports* Vol. 12, No. 3 (September 1992) at 9-10.

[8] *MSRB Reports* Vol. 13, No. 2 (April 1993) at 15-16.

[9] *Id.*

[10] In 1992, the initial comparison rates were approximately 79 percent for regular way transactions and approximately 37 percent for when-issued transactions.

[11] *See* SR-NSCC-93-2 (filed January 6, 1993).

[12] *See* SR-MSRB-93-3 (filed March 19, 1993) and SR-MSRB-93-6 (filed April 12, 1993).

[13] *See* SR-MSRB-92-6, (book-entry delivery between dealers, filed August 27, 1992); and SR-MSRB-93-5, (book-entry delivery of DVP/RVP customer transactions, filed April 1, 1993).

[14] As of March 1993, the municipal affirmation rate was 81%; the corporate affirmation rate was 96%. In addition, the Board suspects that many transactions that should be submitted to the automated confirmation/affirmation systems are not submitted because certain customers routinely fail to affirm transactions.

[15] For a more complete discussion of this problem, see *Automated Clearance and Settlement in the Municipal Securities Market, A Report to the Securities and Exchange Commission*, (MSRB, 1988) at 18-19.

quicker and more accurate affirmation of confirmations sent through the system.[16] The Board also is working with DTC to address the problems in the municipal securities market relating to use of the system.

Based on the experience of the municipal industry in using automated confirmation/affirmation systems, the Board, has concluded that this aspect of its implementation plan will take substantially longer than other changes mentioned above. In part, this is because success of the systems depends heavily upon actions by customers and their clearing agents – parties that are not regulated by the Board. Thus, in its published implementation plan, the Board set a July 1, 1994, date for requiring all transactions eligible for automated confirmation/affirmation to be processed through such a system.[17] The Board expects to file this rule change with the Commission early next year and to continue working with DTC and industry groups to improve use of confirmation/affirmation systems in the municipal securities market.

Timetable For Reaching Parity with Corporate Markets

As noted above, the final portion of the Board's current automated clearance and settlement implementation plan is expected to be in place by July 1994. While the amendments to rules G-12(f) and G-15(d) will promote use of the automated systems and the goal of T+3 settlement, it should be noted that the ability of the municipal securities market to make the full transition to automated clearance and settlement depends upon a number of other factors as well. Several parts of the implementation plan will require substantial changes in traditional practices among some dealers and institutional customers. The changes will have to be made in conjunction with major revisions in some of the automated clearance systems, which also will demand attention by the industry. The Board intends to monitor closely the progress being made in the industry to ensure that the timetable for the remaining parts of the implementation plan continues to be appropriate.

Depository Eligibility

One remaining issue that must be addressed by the Board in moving to T+3 settlement concerns the possible need for a regulatory measure to ensure that new issues of municipal securities are made depository eligible. If a new issue is made eligible at a depository at the time of issuance – as currently is the case for many new issues – rules G-12(f) and G-15(d), as amended, would require a depository distribution of the new issue. This means, in effect, that the underwriters and other participating dealers would be required to settle all initial interdealer and institutional customer settlement obligations by book-entry on the settlement date for the issue. There is no regulatory requirement, however, that currently causes new municipal issues to be made depository eligible.

The Board is aware that several ideas are being considered to make all new corporate issues depository eligible. These include a suggestion for disclosure requirements under the Securities Act of 1933 for non-depository eligible issues[18] and a uniform SRO rule, presumably for exchange and NASDAQ listed securities, requiring new issue securities to be depository eligible.[19]

For the municipal securities market, several issues will have to be addressed before beginning work on this objective. Many small issues of municipal securities currently are issued and are settled initially with deliveries of physical certificates. One reason that has been cited by underwriters for this practice is cost.[20] In a small issue underwriting, depending upon the number of initial settlements and the locations of the parties, the cost of settling transactions with physical certificates may be less than that of a depository distribution. Thus, some smaller issues may need to be treated differently if there is to be a regulatory measure requiring depository eligibility.

In addition to these practical concerns, the nature of the Board's regulatory authority may require the Board to adopt an approach toward depository eligibility different from that taken in the corporate markets. The Board does not have authority to require municipal issuers to issue securities that qualify under depository operational standards. Municipal securities, of course, are not subject to the disclosure requirements of the Securities Act and the Board cannot require municipal issuers to comment on the depository eligibility status of an issue in the offering documents. Finally, unlike the NASDAQ and exchange markets, the Board does not have the authority to set "listing" requirements to require new issues to meet standards of depository eligibility before trading can occur. The Board, nevertheless, will be looking closely at the issue of encouraging depository eligibility of new issues of municipal securities and will keep the Commission apprised of its actions.

Retail Transactions

Retail sales of municipal securities have grown in recent years and now comprise a major segment of the municipal securities market. Before being able to accomplish T+3 settlement, there are a number of critical issues that must be addressed which affect retail customer transactions. One such issue is how retail customers will provide funds to dealers by T+3 for securities purchases. This issue is made somewhat more difficult by the initiative, which is being undertaken in conjunction with T+3 settlement, requiring institutional settlement in same-day funds.[21] Although retail customers will not be required to pay in same-day funds under this proposal, dealers may face financing costs if retail customer payments are not received in "good" funds by T+3. Another critical issue is how a retail customer possessing a securities certificate will be able to sell the securities through a broker-dealer if the

[16] *See* The Depository Trust Company Memorandum Concerning An Interactive Option For The Institutional Delivery System, dated March 31, 1993.
[17] *See MSRB Reports* Vol. 12, No. 3 (September 1992) at 9-10.
[18] Letter from Richard B. Smith and Robert J. Woldow, Co-chairmen, Legal and Regulatory Subgroup, U.S. Working Committee for the Group of Thirty to Mary E.T. Beach, Senior Associate Director, Division of Corporation Finance, dated December 17, 1992, cited in SEC Release, Footnote 40 at 21.
[19] *See, generally*, SEC Release at 21.
[20] See, *e.g.*, Letter from Regional Municipal Operations Association to MSRB (June 11, 1991) and DTC response; Letter from MSRB to Robert J. Woldow, Executive Vice President and General Counsel, NSCC, dated August 22, 1991. These letters also discussed several other reasons that municipal issues may not be depository eligible.
[21] *See* The Depository Trust Company and National Securities Clearing Corporation, Memorandum Concerning A Same-Day Fund Settlement System Proposal For Industry Evaluation, dated June 1, 1992.

broker-dealer must make T+3 settlement on the "street side" of the transaction.

The Board does not know at this time how these problems will be solved. Because they are shared with the corporate securities markets, it will be important for the Board to see how the corporate securities markets cope with these issues. The Board strongly believes that any action taken by the Board or the Commission in this area should not have the effect of frustrating or restricting the participation by retail investors in the municipal securities market.

Confirmation Disclosure Issues

Finally, in the municipal securities market, T+3 settlement presents issues relating to confirmation disclosure of retail transactions. Under the current five-day settlement cycle, a retail customer generally receives the confirmation in the mail prior to settlement of the transaction. This allows the customer to review the disclosures contained on the confirmation and, if there are disclosures which cause concern, to communicate with the dealer either to resolve the concerns or to attempt to stop the transaction prior to settlement date.

The Board traditionally has viewed confirmation disclosure as particularly important in light of: (i) the many different features that may be found in a municipal security (*e.g.*, call features, put features, escrowed to maturity, non-standard interest payment periods); (ii) the possible tax status of municipal securities (*e.g.*, tax-exempt, subject to federal taxation, subject to alternative minimum tax); and (iii) other factors about specific issues of municipal securities of which investors should be aware. Since the adoption of the Board's customer confirmation rule in 1977, the Board on many occasions has amended the rule and provided interpretive guidance to ensure that required confirmation disclosures kept pace with new developments in the market.[22]

In a T+3 settlement environment, a mailed confirmation will not always reach the customer prior to settlement date. While this may be of limited relevance in the market for corporate equities, it is of more concern in the municipal securities market, where the disclosure role of the confirmation has more fully evolved. The Board is currently reviewing its confirmation rules especially as they relate to the timing and the disclosure content of the customer confirmation.

Conclusion and Recommendation

Moving to T+3 settlement presents a number of unique challenges for the municipal securities market. The clearance and settlement of municipal securities cannot be considered in isolation from the particular nature of securities, the market, and its regulatory structure. The Board, registered clearing agencies, and the participants in the municipal securities market already have expended considerable effort to improve the use of automated clearance and settlement systems for municipal securities and to bring the market into parity with the corporate securities markets. The Board intends to continue to monitor and to address issues that arise in this process. For the near future, these issues include the possible need for a mechanism to require depository eligibility of new issues and a review of the disclosure function of the municipal confirmation in a T+3 settlement environment.

There are, however, additional issues in moving to T+3 settlement that are faced by both the corporate and the municipal securities markets. Primary among these are the issues of how retail customers will pay for securities by T+3 and how retail customers possessing securities certificates will settle their transactions with dealers by T+3. The Commission did not indicate in its Release how these issues would be resolved in the corporate securities markets. Because the Board is uncertain of the mechanisms that ultimately will be adopted in the corporate securities industry, it is unable to say whether the same or different mechanisms will be required in the municipal securities industry.

With respect to the timetable for moving to T+3 settlement, the Board believes that the issues affecting institutional transactions can be addressed by January 1996 – the effective date for proposed Rule 15c6-1. However, given the current uncertainties about how retail issues will be addressed, the Board is not able to provide the Commission with an overall timetable by which the municipal securities market would be able to move to T+3 settlement.

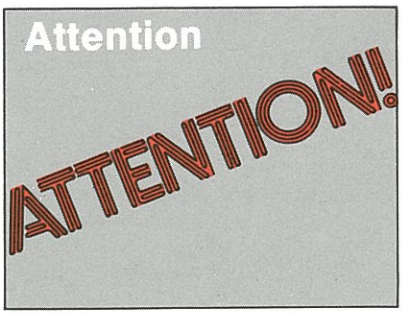
Because of the many special features of the municipal securities market, the Board does not believe that the Commission should include municipal securities within the scope of proposed Rule 15c6-1. As has been noted, the Board has stated that one of its primary goals is to obtain improvements in clearance and settlement of municipal securities consistent with national goals. The Board recommends that the Commission continue to allow the Board to apply its expertise in shaping the solutions that will allow the municipal securities industry to do this in a manner that will accommodate the unique features of the market.

The Board appreciates the Commission's consideration of this comment letter. The Board, of course, would be happy to provide additional information and assistance to the Commission in its consideration of proposed Rule 15c6-1, upon the Commission's request.

Sincerely,

Charles W. Fish
Chairman

[22] *See* Rule G-15(a). This rule and the interpretative guidance on it are included in the *MSRB Manual* at pages 4501-4535.



Route to:

- [X] Manager, Muni Dept.
- [X] Underwriting
- [ ] Trading
- [ ] Sales
- [ ] Operations
- [X] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other

Political Contributions

Notice

The Board has determined to meet with issuer groups to discuss whether measures could be adopted by issuers or state legislatures to help ensure that political contributions do not influence the underwriter selection process. In addition, the Board is considering its own options for action in this area, including requiring dealers and associated persons to make additional disclosures regarding their political contributions prior to any underwriting activity.

Since it was created by Congress in 1975, the Municipal Securities Rulemaking Board has developed an extensive regulatory structure under which dealers perform municipal securities activities. Its rules, which must be approved by the Securities and Exchange Commission prior to effectiveness, are divided into a number of categories, including fair practice, professional qualifications, recordkeeping, and operations. The Board believes that these rules, in conjunction with the inspection and enforcement efforts of the National Association of Securities Dealers and federal bank regulatory authorities, have been successful in ensuring that the municipal securities market operates in a fair and efficient manner, and continues to make significant contributions to state and local government activities. Recently, however, certain press reports have heightened public awareness and concern over the role of political contributions in the underwriting process.

In August 1991, the Board issued a statement expressing its concern that the process of selecting an underwriting team not be influenced by political contributions. The Board stated that it is critical that the market engender the highest degree of public confidence so that investors will provide much needed capital to state and local governments. Toward this end, the Board encouraged underwriters and state and local governments to maintain the integrity of the underwriter selection process.

Since August 1991, there has been continuing interest by the Board, industry members and others concerning political contributions. At its meeting on May 13, 1993, the Board determined to meet with issuer groups to discuss whether measures could be adopted by issuers or state legislatures to help ensure that political contributions do not influence the underwriter selection process. In addition, the Board is considering its own options for action in this area, including requiring dealers and associated persons to make additional disclosures regarding their political contributions prior to any underwriting activity. During the next few months, the Board will review issues regarding its authority in this area, as well as the burdens and benefits of any such action.

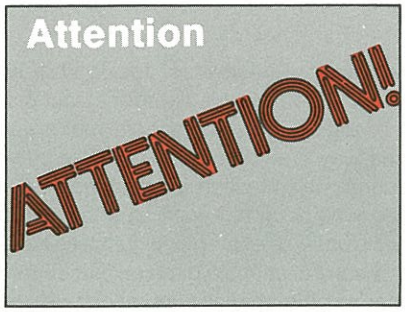
May 19, 1993

Questions about this notice may be directed to Christopher A. Taylor, Executive Director.

Volume 13, Number 3

MSRB REPORTS

June 1993



Route to:

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

Bonds Subject to "Detachable" Call Features

Educational Notice

The Board is providing basic information regarding bonds subject to detachable call features and guidance on the application of its rules to transactions in such securities.

New products are constantly being introduced into the municipal securities market. Dealers must ensure that, prior to effecting transactions with customers in municipal securities with new features, they obtain all necessary information regarding these features. The Board will attempt periodically through educational notices to describe new products or features of municipal securities and review the responsibilities of dealers to customers in these transactions. In this notice, the Board will review detachable call features.

Certain recent issues of municipal securities include a new feature called a detachable call right. This feature allows the issuer to sell its right to call the bond. Thus, upon the sale of this call right, the owner of the right has the ability, at certain times, to require the mandatory tender of the underlying municipal bond. The dates of mandatory tender of the underlying bonds generally correlate with the optional call dates. If the holder exercises such rights, the underlying bondholder tenders its bond to the issuer (just as if the issuer had called the bond) and the holder of the call right purchases the bond. In some instances, issuers already have issued municipal call rights and the underlying bonds in such cases are sometimes referred to as being subject to "detached" call rights.

Bonds subject to detachable call rights generally include a provision that permits an investor that owns both the detached call right and the underlying bond to link the two instruments together, subject to certain conditions. Such "linked" municipal securities would not be subject to being called at certain times by holders of call rights or the issuer. They may, however, be subject to other calls, such as sinking fund provisions. If a customer obtains a linked security, thereafter the customer has the option to de-link the security, again subject to certain conditions, into a municipal call right and an underlying bond subject to a right of mandatory tender.

Applicability of Board Rules

Of course, the Board's rules apply to bonds subject to detachable call features and "linked" securities just as they apply to all other municipal securities. The Board, however, would like to remind dealers of certain Board rules that should be considered in transactions involving these municipal securities.

Rule G-15(a) on Customer Confirmations

Rule G-15(a)(i)(E) requires customer confirmations to set forth "a description of the securities, including ...if the securities are ... subject to redemption prior to maturity ..., an indication to such effect." Additionally, rule G-15(a)(iii)(F) requires a legend to be placed on customer confirmations of transactions in callable securities which notes that "Call features may exist which could affect yield; complete information will be provided upon request."

Confirmations of transactions in bonds subject to detachable call rights, therefore, would have to indicate this information.[1] In addition, the details of the call provisions of such securities would have to be provided to the customer upon the customer's request.

Confirmation disclosure, however, serves merely to support — not to satisfy — a dealer's general disclosure obligations. More specifically, the disclosure items required on the confirmation do not encompass "all material facts" that must be disclosed to customers at the time of trade pursuant to rule G-17.

Rule G-17 on Fair Dealing

Rule G-17 of the Board's rules of fair practice requires municipal securities dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require

Questions or comments about this notice may be directed to Mark McNair, Assistant General Counsel.

[1] With regard to the confirmation requirement for linked securities, if these securities are subject to other call provisions such as sinking fund calls, the customer confirmation must indicate that these securities are callable.

that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and must not omit any material facts which would render other statements misleading. Among other things, a dealer must disclose at the time of trade whether a security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances because this knowledge is essential to a customer's investment decision.

Clearly, bonds subject to detachable calls must be described as callable at the time of the trade.[2] In addition, if a dealer is asked by a customer at the time of trade for specific information regarding call features, this information must be obtained and relayed promptly.

Although the Board requires dealers to indicate to customers at the time of trade whether municipal securities are callable, the Board has not categorized which, if any, specific call features it considers to be material and therefore also must be disclosed. Instead, the Board believes that it is the responsibility of the dealer to determine whether a particular feature is material.

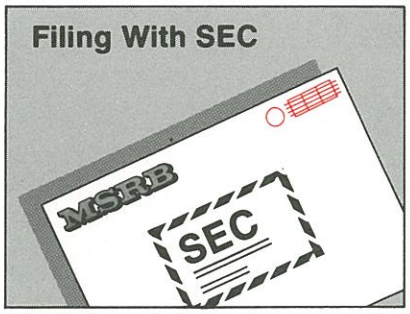
With regard to detachable calls, dealers must decide whether the ability of a third party to call the bond is a material fact that should be disclosed to investors. Dealers should make this determination in the same way they determine whether other facets of a municipal securities transaction are material – is it a fact that a reasonable investor would want to know when making an investment decision? For example, would a reasonable investor who knows a bond is callable base an investment decision on whether someone other than the issuer can call the bond? Does this new feature affect the pricing of the bond?

* * *

The Board is continuing its review of detachable call rights and may take additional related action at a later date. The Board welcomes the views of all persons on the application of Board rules to transactions in securities subject to detachable call rights.

May 13, 1993

[2] Similarly, when considering the application of rule G-17 to transactions in "linked" securities, as with other municipal securities, dealers have the obligation to ensure that investors understand the features of the security. In particular, if a linked security is subject to other call provisions, dealers should ensure that retail customers do not mistakenly believe the bond is "non-callable."



Route to:

- [X] Manager, Muni Dept.
- [X] Underwriting
- [X] Trading
- [ ] Sales
- [ ] Operations
- [X] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other

MSIL System Changes

Amendments to Facility Filed

The Board has filed two MSIL system changes:

- **Effective May 17, 1993, issuers may enroll as submitters in the Board's CDI Pilot; and**
- **As of May 26, 1993, the 1990 and 1992 collections of imaged official statements and advance refunding documents will be available from the OS/ARD subsystem. Digital audio tapes (DATs) containing the images of the 1990 collection may be purchased for $6,000 plus shipping costs, and the 1992 collection may be purchased for $7,000 plus shipping costs.**

CDI Pilot Opened to Submissions by Issuers

On May 17, 1993, the Board filed an amendment to its Continuing Disclosure Information, or CDI, Pilot facility with the Securities and Exchange Commission.[1] The CDI Pilot is a subsystem of the Municipal Securities Information Library™ (MSIL™) system.[2] The amendment allows issuers as well as trustees to enroll as submitters in the Pilot. Once enrolled, issuers voluntarily may submit disclosure documents to the Pilot. The amendment became effective upon filing with the Commission.

The CDI Pilot is designed to accept short (one to three 8½ x 11-inch pages), time-sensitive continuing disclosure information that affects municipal securities in the secondary market and to disseminate that information to Pilot subscribers.[3]

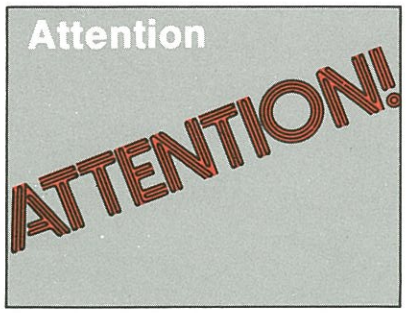
Backlog Collections Available from the OS/ARD Subsystem

On May 26, 1993, DATs containing the 1990 and 1992 collections of imaged official statements and advance refunding documents will be available from the Official Statement/Advance Refunding Document subsystem of the MSIL system.[4] The 1990 collection may be purchased for $6,000 plus shipping costs. The 1992 collection may be purchased for $7,000 plus shipping costs.[5] The subscription fee for the daily DAT service for the current year will remain at $12,000 plus shipping costs. The Board plans to have the 1991 collection available by the end of the year. In addition, individual paper copies of official statements and advance refunding documents are available at $15 each plus shipping costs.

May 26, 1993

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

[1] SEC File No. SR-MSRB-93-7.
[2] Municipal Securities Information Library and MSIL are trademarks of the Board.
[3] For a more complete description of the CDI Pilot, see *MSRB Reports* Vol. 12, No. 1 (April 1992) at 3-5.
[4] For a more complete description of the OS/ARD subsystem, see *MSRB Reports* Vol. 12, No. 2 (July 1992) at 3.
[5] SEC File No. SR-MSRB-93-8.



Route to:

- [X] Manager, Muni Dept.
- [X] Underwriting
- [X] Trading
- [ ] Sales
- [ ] Operations
- [X] Public Finance
- [ ] Compliance
- [ ] Training
- [ ] Other

Groups Explore the Possibility of the CDI Pilot System Accepting Longer Document Submissions by Modem

Notice

On May 20, 1993, the National Federation of Municipal Analysts Board of Governors, the Government Finance Officers Association, the National Council of State Housing Agencies and the Board disseminated a press release concerning their agreement to explore the possibility of the Board's CDI Pilot system accepting longer document submissions by modem. The press release is reprinted below.

The National Federation of Municipal Analysts Board of Governors (NFMA) agreed this week at the group's annual conference to work with the Government Finance Officers Association (GFOA), the National Council of State Housing Agencies (NCSHA) and the Municipal Securities Rulemaking Board (MSRB) to explore the possibility of the MSRB's CDI Pilot system accepting longer document submissions by modem.

These groups intend to focus initially on the transmission and dissemination of Comprehensive Annual Financial Reports (CAFRs) and the NCSHA quarterly and annual reports through the CDI system. They hope that through their joint efforts, the MSRB would be in a position to amend the CDI Pilot system sometime in September or October 1993.

Currently, the CDI Pilot system accepts up to three pages in hard copy. The analyst group, in their ongoing efforts to increase the quality of continuing disclosure, is producing three-page Secondary Market Disclosure Forms for 16 individual security sectors. Through its involvement in this joint effort, NFMA expects to have the CDI system receive CAFRs and annual audits, along with the Disclosure Forms, in the future.

NFMA was founded in 1983. It has over 700 members representing the major institutional investors and other parties involved in the municipal securities market. GFOA, founded in 1906, represents 12,500 state and local government finance officials and other finance experts. NCSHA, which represents the country's state housing agencies, developed quarterly and annual report formats in 1991.

MSRB, a self-regulatory organization, was created in 1975 by an Act of Congress to regulate the municipal securities dealer community, both securities firms and banks. MSRB rulemaking is subject to SEC oversight and examination and enforcement of Board rules is carried out by the National Association of Securities Dealers and the Federal bank regulators.

May 20, 1993

Questions about this notice may be directed to Christopher A. Taylor, Executive Director.

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, 1993 ..... $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

Instructions for Filing Forms G-36
This publication is available to assist underwriters in submitting official statements, advance refunding documents and complete and correct Forms G-36.
1992 ..... no charge

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.
1990 ..... 5 copies per order ..... 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
Based on SICA's *Arbitration Procedures* and edited to conform to the Board's arbitration rules, this pamphlet includes the text of rules G-35 and A-16, a glossary of terms and list of other sponsoring organizations.
1991 ..... no charge

Instructions for Beginning an Arbitration
Step-by-step instructions and forms necessary for filing an arbitration claim.
1991 ..... no charge

The MSRB Arbitrator's Manual
The Board's guide for arbitrators. Based on SICA's *The Arbitrator's Manual*, it has been edited to conform to the Board's arbitration rules. It also contains relevant portions of the *Code of Ethics for Arbitrators in Commercial Disputes*.
1991 ..... $1.00

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.
Quarterly ..... 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
July 1992 ..... no charge

Study Outline: Municipal Securities Principal Qualification Examination
Outline for Test Series 53
January 1993 ..... no charge

Brochure

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

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 order no charge Each additional copy $1.50		
Manual on Close-Out Procedures	$3.00		
Instructions for Filing Forms G-36	no charge		
Arbitration Information and Rules	no charge		
Instructions for Beginning an Arbitration	no charge		
The MSRB Arbitrator's Manual	$1.00		
Study Outline: Municipal Securities Representative Qualification Examination	no charge		
Study Outline: Municipal Securities Principal Qualification Examination	no charge		
MSRB Information for Municipal Securities Investors (Investor Brochure)	1 to 500 copies no charge Over 500 copies $.01 per copy		
		Subtotal	
		D.C. residents add 6% sales tax; Virginia residents add 4.5% sales tax	
		Total amount due	

☐ Check here if you currently do not have a subscription, but want to receive *MSRB Reports*.

☐ Check here if you want to have *MSRB Reports* sent to additional recipients. (Please list names and addresses of any additional recipients on a separate sheet of paper.)

Requested by: _____ Telephone: ( ) _____ Date: _____

Ship to: _____

Attention: _____

Address: _____
(Street address preferred)

_____

All orders for publications that are priced **must** be submitted by mail along with payment for the full amount due. Requests for priced publications will not be honored until payment is received. Make checks payable to the "Municipal Securities Rulemaking Board" or "MSRB."
Orders should be addressed to the Municipal Securities Rulemaking Board, 1640 King Street, Suite 300, Alexandria, VA, 22314, Attention: Publications.