MSRB REPORTS

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Volume 4, Number 4 June 1984

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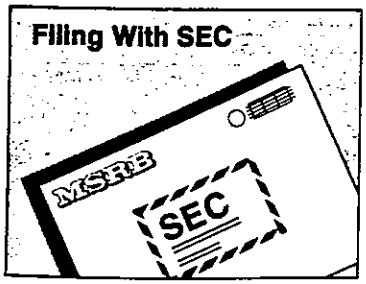

Route To:

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Rule G-5

Amendment Filed on Remedial Notices by Registered Securities Associations

On June 12, 1984 the Board filed with the Securities and Exchange Commission a proposed amendment to Board rule G-5 that would apply to municipal securities brokers and dealers who are members of a registered securities association, specifically the National Association of Securities Dealers, Inc. ("NASD"). The amendment would subject municipal securities brokers and dealers who are NASD members to Article III, Section 38 of the NASD Rules of Fair Practice, which authorizes the NASD to direct a member to limit its business or take other remedial actions when it appears that the member is experiencing financial or operational difficulties. The proposed amendment will become effective upon approval by the Commission.

Background

In May 1982, the Securities and Exchange Commission amended its net capital and customer protection rules (rules 15c3-1 and 15c3-3, respectively) to reduce substantially the net capital requirements for certain brokers and dealers. Subsequently, on August 19, 1982, the NASD proposed to adopt new Section 38 to Article III of its Rules of Fair Practice ("early warning rule"). The NASD's early warning rule is designed to minimize the potential for member firms to experience serious financial difficulties as a result of their having reduced capital reserves.[1]

The NASD's early warning rule addresses two levels of possible financial or operational difficulties relating to minimum net capital, ratio requirements or scheduled capital withdrawals and will be administered by a newly-formed District Surveillance Committee.[2] The rule authorizes the District Surveillance Committee to issue a notice restricting an NASD member from expanding its business whenever certain specified early warning financial criteria are exceeded. In a situation in which a second set of warning criteria with lower tolerances is exceeded, the rule authorizes the District Surveillance Committee to require a member to reduce or eliminate certain aspects of its business.

The rule also authorizes the District Surveillance Committee to direct a member to limit or decrease its business or take certain other remedial actions for any other financial or operational reason. The remedial actions may include, but are not limited to, the paying of free credit balances to customers, reduction of inventories, the cessation of carrying customer accounts or the filing of special reports with the NASD. The rule also authorizes the District Surveillance Committee to issue additional supplemental notices in cases in which a member's financial or operational difficulties are continuing or worsening or subsequently to lift restrictions when appropriate.

A member firm subject to any notices has a right to a hearing before the District Surveillance Committee and for an independent review by the NASD Board of Governors as well as an appeal to the Securities and Exchange Commission. Action taken by the NASD pursuant to its early warning rule does not preclude a District Business Conduct Committee from filing a formal complaint against a member for violation of the NASD's Rules of Fair Practice.

Discussion

The NASD's early warning rule currently applies to all NASD members except those members who effect transactions solely in municipal securities. At this time the Board believes it is appropriate to subject the relatively small number of sole municipal firms to the NASD's rule so that the early warning requirements will apply uniformly to all municipal securities brokers and dealers who are NASD members.[3]

The Board notes that the rule would apply only when a municipal securities broker or dealer is experiencing relatively significant financial or operational difficulties and then only when the broker or dealer is unwilling to take remedial action on a voluntary basis. The Board believes that the NASD's early warning rule, which is designed to prescribe corrective measures early enough to ensure the continued viability of a firm, is an appropriate response to the amendments to the SEC's net capital rules and is beneficial to the municipal securities industry to the extent that it applies to

Questions concerning the proposed amendment may be directed to Angela Desmond, General Counsel.

[1]The NASD's rule was approved by the Commission on February 17, 1984, and became effective on April 3, 1984.

[2]The District Surveillance Committee will be composed of two current or former NASD District Business Conduct Committee members; two members of the NASD Board of Governors Surveillance Committee (a standing committee of the NASD Board of Governors); and one former member of the NASD Board of Governors.

[3]The Board notes that the rule amendment would not apply to bank dealers. The Board understands that bank regulatory agencies exercise early warning oversight over bank dealers.

"integrated" firms that have a corporate and a municipal securities business. The Board further believes that these benefits would be even greater if the rule was applied to all municipal securities brokers and dealers; the Board cannot identify any reason why securities firms that have only a municipal securities business should not be subject to early warning requirements. Moreover, the Board notes that the NASD's rule applies only to firms required to maintain $25,000 in capital under applicable provisions of the net capital rule; it believes that this capital threshold substantially reduces the likelihood that the rule would apply adversely to smaller firms. Finally, it appears to the Board that the procedural safeguards and rights of review provided by the NASD rule adequately protect against any unfair or unduly harsh applications of the rule to municipal securities brokers and dealers. The Board understands that the NASD may revise portions of Section 38 later in the year; for that reason, this proposed rule change expressly incorporates the current rule so that the Board may review the NASD's future proposal before it is applied to municipal securities brokers and dealers.

Following the text of the proposed amendment to rule G-5 are Article III, Section 38, of the NASD's Rules of Fair Practice, the NASD's explanation of the Section, the related amendment to the NASD's Code of Procedure, Section 29, and the NASD's August 18, 1983, letter to members which includes a summary of comments received on the proposed rule.

June 12, 1984

Text of Proposed Amendment

Rule G-5. Disciplinary Actions by the ~~Commission, Bank Regulatory Agencies and Registered Securities Associations~~ Appropriate Regulatory Agencies; Remedial Notices by Registered Securities Associations*

(a) No municipal securities broker or municipal securities dealer shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security in contravention of any effective restrictions imposed upon such municipal securities broker or municipal securities dealer by the Commission pursuant to sections 15(b)(4) or (5) or 15B(c)(2) or (3) of the Act or by an appropriate regulatory agency pursuant to section 15B(c)(5) of the Act by a registered securities association pursuant to rules adopted under section 15A(b)(7) of the Act, and no natural person shall be associated with a municipal securities broker or municipal securities dealer in contravention of any effective restrictions imposed upon such person by the Commission pursuant to sections 15(b)(6) or 15B(c)(4) of the Act or by an appropriate regulatory agency pursuant to section 15B(c)(5) of the Act or by a registered securities association pursuant to rules adopted under section 15A(b)(7) of the Act.

(b) No municipal securities broker or municipal securities dealer that is a member of a registered securities association shall effect any transaction in, or induce or attempt to induce the purchase or sale of, any municipal security; or otherwise act in contravention of or fail to act in accordance with rules adopted by the association as of April 3, 1984, pertaining to remedial activities of members experiencing financial or operational difficulties.

NASD Letter to Members on Proposed Rule

National Association of
Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006
August 18, 1983

TO: All NASD Members
RE: Proposed New Rule of Fair Practice to Regulate the Activities of Members Experiencing Financial and/or Operational Difficulties
Last Voting Date Is September 19, 1983

Enclosed herewith is a proposed new rule under Article III of the Rules of Fair Practice. Proposed Section 38 was approved by the Association's Board of Governors and now requires the approval of the membership. If approved, it must then be filed with, and approved by, the Securities and Exchange Commission. As discussed below, the proposed rule was published for member comment on August 19, 1982 (Notice to Members 82-45).

Background and Explanation of the Proposed Rule

The proposed rule provides the Association with authority to prescribe certain remedial courses of action which a member must follow during periods when the member is experiencing financial or operational difficulty. The rule is intended to address such problems in a timely fashion to protect the member, the investing public and other members.

As proposed, the rule addresses two levels of possible financial and/or operational difficulties. First, it restricts a member from expanding its business whenever certain early warning financial criteria relating to minimum net capital, ratio requirements and/or scheduled capital withdrawals are exceeded. Secondly, it covers a deteriorating situation in which another set of warning criteria with lower tolerances are exceeded. In such situations, the proposed rule requires a member to reduce or eliminate certain facets of its business.

In conjunction with adoption of the proposed rule, the Board has also adopted amendments to the Association's Code of Procedure to provide a special procedure to implement the provisions of the rule. Specifically, the procedures provide for the creation of a special Surveillance Committee of the Board and a special District Surveillance Committee to direct the implementation of the rule. The procedures also provide the member with an opportunity for an impartial hearing, an independent review by the Board of Governors and appeal to the Securities and Exchange Commission.

Additionally, the procedures permit a District Surveillance Committee to issue additional or supplemental notices to

*Underlining indicates new language; broken line indicates deletions.

members whenever the Committee finds that the problems which gave rise to previous limitations are continuing or becoming more pronounced. Appropriate hearing procedures are also provided in such cases. Another provision specifies that action taken by the Association pursuant to the proposed rule would not preclude a District Committee from taking formal complaint action for violation of the Rules of Fair Practice.

Finally, the proposed rule is accompanied by an Explanation of the Board of Governors. The Explanation includes examples of conditions that might cause the Association to determine that a member is in or approaching financial and/or operational difficulties. Also included are examples of the types of remedial actions that might be selected to correct the problems. This list of possible problem situations and possible remedial actions is not intended to be, and is not, all inclusive. Rather, the list and the Explanation in general is intended to facilitate members' understanding of how the proposed rule would be administered and implemented by citing hypothetical problems and corrective actions as examples.

Comments Received

The Association received 15 comment letters on the proposed rule. Each letter was reviewed by the Association's Capital and Margin Committee and the full Board of Governors. The general concerns expressed in these letters and the Board's decisions regarding such are described below. General headings are used since similar points are made in more than one letter.

Applicability of the Rule—In response to the comments, the Board agreed that as to dual members (i.e., firms which are members of two or more self-regulatory organizations), the proposed rule would be limited solely to those members which have been designated to the NASD by the Securities and Exchange Commission pursuant to Rule 17d-1 (the regulatory allocation rule for financial responsibility).

The question of whether the rule should include introducing firms as well as firms carrying customer accounts was also addressed by the Board. It noted that certain introducing firms, particularly those engaged in market making activities or those which hold positions for their own accounts, could potentially pose some risk and exposure as a result of such activities. However, it observed that those firms which introduced strictly agency business, the so-called "$5,000" firms under the net capital rule, posed no such problems. The Committee therefore concluded that the rule should only be applicable to firms required to maintain $25,000 in capital in accordance with the applicable provisions of the net capital rule irrespective of whether such firms carry customer accounts.

Rule Was Too Vague and/or Placed Too Much Power with the Association's Staff—A Number of commentators stated that because of the vagueness of Subsections (b)(2) and (c)(2) of the proposed rule, too much discretion would be left with the Association staff in interpreting these provisions.

It should be emphasized that under the rule, the staff's function is simply to obtain the necessary facts and make recommendations to the District Surveillance Committee. It has no decision-making authority as to implementation of the rule in any case. It would be the responsibility of the District Surveillance Committee, not the staff, to determine whether the provisions of the rule should be implemented. The proposed rule authorizes the District Surveillance Committee, not the staff, to prescribe the limitations by which the member would be obligated to abide.

Additionally, the procedure adopted by the Board makes available to a member ample opportunity for appeal of the District Surveillance Committee's decision to the Board of Governors and thereafter to the Securities and Exchange Commission.

The Committee therefore concluded that no changes should be made to the proposed rule based on these comments.

The Proposed Rule Imposes More Restrictive Criteria Than Rule 17a-11, the SEC's "Early Warning" Rule—Several commentators noted that SEC Rule 17a-11 already provided an "early warning" measure with respect to broker-dealers and that the early warning threshold was set at 120%, significantly less than the 150% prescribed in the proposed rule. In response, the Board noted that the purpose of the proposed rule differs from the Commission's rule in that the proposed rule is designed to have a remedial effect on a member. In other words, the rule's approach is to put the Association on notice well before a firm reaches the more "critical" stage of 17a-11 reporting in order that corrective measures may be taken early enough to ensure the continuing viability of the firm. In the Board's opinion, sufficient lead time is necessary in order to address a firm's difficulties before they become irreversible.

The Board therefore determined that the early warning financial criteria as contained in the proposed rule were appropriate and should be retained.

Examples Cited in the "Explanation of the Board of Governors"—Commentators also noted that some situations and remedies specified in the companion explanation to the rule were too narrow in scope, unduly harsh, or not truly indicative in some cases of a firm's true financial health.

The Board emphasizes that the instances cited in the "Explanation" are merely examples of problems and suggested remedies and are not intended to be "automatic" in their application. The language of the rule and the accompanying Explanation make it sufficiently clear that these situations are provided as further explanation and were simply illustrative of situations and corrective actions which could be imposed depending on the circumstances.

The Board therefore determined not to alter the "Explanation of the Board of Governors" as a result of these comments.

Other Areas—One letter noted that the proposed rule did not speak to how and when any restrictions imposed by the rule would be lifted. The Board agreed and revised the procedure to vest responsibility for lifting the imposed restrictions in the District Surveillance Committee. Thus, restrictions once imposed would remain in effect until lifted or modified by the District Surveillance Committee.

Another commentator suggested that the procedure be changed to provide that a hearing on an order issued by the District Surveillance Committee be requested within five (5) business days of the receipt of the notice rather than three (3) business days after the issuance of the notice.

The Board noted that, in most instances, these notices would be hand-delivered to the member and therefore agreed

that receipt of notice would not be difficult to document. The Board therefore determined to amend the procedure retaining the specified time frames but changing the starting point from "issuance" to "receipt of." A request for a hearing would, therefore, have to be made within three business days of receipt of the notice.

The text of the proposed rule and the Explanation of the Board of Governors is attached and merits your immediate attention. Also attached are amendments to the Code of Procedure which do not require a membership vote and are included for informational purposes. Please mark the ballot according to your convictions and return it in the enclosed stamped envelope to "The Corporation Trust Company." Ballots must be postmarked not later than September 19, 1983.

The Board of Governors believes the proposed rule is necessary and appropriate and recommends that members vote their approval.

Questions concerning this notice may be directed to James M. Cangiano at (202) 728-8273, or your District Director.

Sincerely,
/s/ Gordon S. Macklin
President

Article III, Section 38 of the Rules of Fair Practice*

Section 38: Regulation of Activities of Members Experiencing Financial or Operational Difficulties

(a) Application—For the purposes of this rule, the term "member" shall be limited to any member of the Association who is not designated to another self-regulatory organization by the Securities and Exchange Commission for financial responsibility pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17d-1 thereunder. Further, the term shall not be applicable to any member who is subject to paragraphs (a)(2) and (a)(3) of SEC Rule 15c3-1, or is otherwise exempt from the provisions of said rule.

(b) A member, when so directed by the Association, shall not expand its business during any period in which:

(1) Any of the following conditions continue to exist, or have existed, for more than 15 consecutive business days:

(A) A firm's net capital is less than 150 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be prescribed by the Association;

(B) If subject to the aggregate indebtedness requirement under SEC Rule 15c3-1, a firm's aggregate indebtedness is more than 1,000 percent of its net capital;

(C) If, in lieu of subparagraph (b)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than 5 percent of the aggregate debit items thereunder; or,

(D) The deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in (A), (B) or (C) of this subparagraph (1);

or

(2) The Association restricts the member for any other financial or operational reason.

(c) A member, when so directed by the Association, shall forthwith reduce its business:

(1) To a point enabling its available capital to comply with the standards set forth in subparagraphs (b)(1)(A), (B) or (C) of this rule if any of the following conditions continue to exist, or have existed, for more than 15 consecutive business days:

(A) A firm's net capital is less than 125 percent of its net capital minimum requirement or such greater percentage thereof as may from time to time be prescribed by the Association;

(B) If subject to the aggregate indebtedness requirement under SEC Rule 15c3-1, a firm's aggregate indebtedness is more than 1,200 percent of its net capital;

(C) If, in lieu of subparagraph (c)(1)(B) above, the specified percentage of the aggregate debit items in the Formula for Determination of Reserve Requirements for Brokers and Dealers, under SEC Rule 15c3-3 (the alternative net capital requirement) is applicable, a firm's net capital is less than four percent of the aggregate debit items thereunder; or,

(D) If the deduction of capital withdrawals including maturities of subordinated debt scheduled during the next six months would result in any one of the conditions described in subparagraph (c)(1)(A), (B) or (C) of this rule;

or

(2) As required by the Association when it restricts a member for any other financial or operational reason.

Explanation of the Board of Governors

Restrictions on a Member's Activity

This explanation outlines and discusses some of the financial and operational deficiencies which could initiate action under the rule. Subparagraphs (b)(2) and (c)(2) of the rule recognizes that there are various unstated financial and operational reasons for which the Association may impose restrictions on a member so as to prohibit its expansion or require a reduction in overall level of business. These provisions are deemed necessary in order to provide for the variety of situations and practices which do arise and, which if allowed to persist, could result in increased exposure to customers and to broker-dealers.

In the opinion of the Board of Governors, it would be impractical and unwise to attempt to identify and list all of the situations and practices which might lead to the imposition of restrictions or the types of remedial actions the Corporation may direct be taken because they are numerous and cannot be totally identified or specified with any degree of precision. The Board believes, however, that it would be helpful to members' understanding to list some of the other

*All language is new.

bases upon which the Corporation may conclude that a member is in or approaching financial difficulty.

Explanation

(a) For purposes of subparagraphs (b)(2) and (c)(2) of the rule, a member may be considered to be in or approaching financial or operational difficulty in conducting its operations and therefore subject to restrictions if it is determined by the Corporation that any of the parameters specified therein are exceeded or one or more of the following conditions exist:

(1) The member has experienced a reduction in excess net capital of 25% in the preceding two months or 30% or more in the three-month period immediately preceding such computation;

(2) The member has experienced a substantial change in the manner in which it processes its business which, in the view of the Corporation, increases the potential risk of loss to customers and members;

(3) The member's books and records are not maintained in accordance with the provisions of SEC Rules 17a-3 and 17a-4;

(4) The member is not in compliance, or is unable to demonstrate compliance, with applicable net capital requirements;

(5) The member is not in compliance, or is unable to demonstrate compliance, with SEC Rule 15c3-3 (Customer Protection Reserves and Custody of Securities);

(6) The member is unable to clear and settle transactions promptly;

(7) The member's overall business operations are in such a condition, given the nature and kind of its business that, notwithstanding the absence of any of the conditions enumerated in subparagraphs (1) through (5), a determination of financial or operational difficulty should be made; or

(8) The member is registered as a Futures Commission Merchant and its net capital is less than seven percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder.

(b) If the Corporation determines that any of the conditions specified in subparagraph (a) of this Explanation exist, it may require that the member take appropriate action by effecting one or more of the following actions until such time as the Corporation determines they are no longer required:

(1) Promptly pay all free credit balances to customers;

(2) Promptly effect delivery to customers of all fully-paid securities in the member's possession or control;

(3) Introduce all or a portion of its business to another member on a fully-disclosed basis;

(4) Reduce the size or modify the composition of its inventory;

(5) Postpone the opening of new branch offices or require the closing of one or more existing branch offices;

(6) Promptly cease making unsecured loans, advances or other similar receivables, and, as necessary, collect all such loans, advances or receivables where practicable;

(7) Accept no new customer accounts;

(8) Undertake an immediate audit by an independent public accountant at the member's expense;

(9) Restrict the payment of salaries or other sums to partners, officers, directors, shareholders, or associated persons of the member;

(10) Effect liquidating transactions only;

(11) Accept unsolicited customer orders only;

(12) File special financial and operating reports; or

(13) Be subject to such other restrictions or take such other action as the Corporation deems appropriate under the circumstances in the public interest and for the protection of members.

Amendments to Code of Procedure for Handling Trade Practice Complaints*

Section 29: Limitation Procedures under Article III, Section 38 of the Rules of Fair Practice

(a) *Board of Governors Surveillance Committee*—The Board of Governors shall appoint a standing Committee of the Board to be known as the Board of Governors Surveillance Committee which is composed of such members as are from time to time determined by the Board.

(b) *District Surveillance Committee*—As required to implement the provisions of this rule, each District Committee shall create a District Surveillance Committee composed of two current or former District Business Conduct Committee members; two members of the Board of Governors Surveillance Committee, and one former member of the Board of Governors.

(c) *Written Notification*—If the District Surveillance Committee has reason to believe that a member has not complied with any of the conditions contained in subsections (b) or (c) of Section 38, it may exercise the authority conferred by Section 38 by issuing a notice directing the member to limit its business. Such notice shall contain a statement of the specific grounds on which such action is being taken, specify in reasonable detail the nature of the limitations being imposed and inform the member that he has an opportunity to be heard, if such request is made within three business days of receipt of the notice. The District Surveillance Committee shall also provide a similar notice in writing to a member of any revision or modification of restrictions or limitations previously imposed.

(d) *Hearing*—If an opportunity to be heard is requested, it shall be provided by the District Surveillance Committee within five business days of the receipt of the notice. A member requesting the opportunity to be heard shall present its reasons why the notice should be withdrawn or modified and shall be entitled to be represented by counsel. A record shall be kept of the proceeding before the District Surveillance Committee.

(e) *Decision and Effective Date*—(1) The District Surveillance Committee shall within five business days of a hearing issue a written decision approving or modifying the limitations specified in the notice. The decision shall also provide for an appropriate sanction to be immediately imposed for failure to comply with any limitations imposed.

(2) When an opportunity to be heard is not requested, the limitations contained in the notice shall become effective

*All language is new.

three days following receipt of the notice without any written decision unless the District Surveillance Committee decides upon a later effective date or unless the matter is reviewed by the Board of Governors, subject to the provisions of subsections (f), (g), and (h) hereof, and they shall remain in effect until such time as they are removed, revised or modified by the District Surveillance Committee.

(f) *Review by Board*—The written decision issued pursuant to subsection (e) shall be subject to review by the Board of Governors upon application by the member aggrieved thereby filed within five business days of the date of the decision. The decision, or the notice where no opportunity to be heard was requested before the District Surveillance Committee, shall also be subject to review by the Board of Governors on its own motion within 30 calendar days of the decision or notice. Where two members of the District Surveillance Committee disagree with the determination of the Committee, the matter will automatically be reviewed by the Board of Governors. In the case of an appeal, the member shall be given an opportunity to be heard before a subcommittee of the Board within 10 business days of the written decision. If called for review, the matter shall be heard within 30 days of such action. In any hearing before the Board, a member shall be entitled to be represented by counsel. The institution of review, whether by application or on the initiative of the Board, shall operate as a stay of the action by the District Surveillance Committee unless otherwise ordered by the Board.

(g) *Composition of Board of Governors Hearing Subcommittee*—The Board of Governors' hearing subcommittee shall be composed of two members of the Board of Governors' Surveillance Committee and one current member of the Board.

(h) *Decision*—Upon consideration of the record, the Board of Governors shall in writing affirm, modify, reverse, or dismiss the decision of the District Surveillance Committee or remand the matter for further proceedings consistent with its instructions. The Board shall set forth specific grounds upon which its determination is based and shall provide for an appropriate sanction to be immediately imposed for failure to comply with any limitations imposed. If a hearing is held, a decision shall issue within five business days of the hearing and the decision shall be the final action of the Board. If no hearing is requested, the matter shall be considered on the record and a decision shall be issued promptly. Any limitation imposed as a result of Board action shall become effective immediately upon issuance of its decision and shall remain in effect until such time as removed or modified by the District Surveillance Committee.

(i) *Application to Commission for Review*—In any case where a member feels aggrieved by any action taken or approved by the Board of Governors, such member may make application for review to the Securities and Exchange Commission in accordance with Section 19 of the Securities Exchange Act of 1934, as amended. There shall be no stay of the Board's action upon appeal to the Commission unless the Commission determines otherwise.

(j) *Successive Notices*—If it appears at any time to the District Surveillance Committee that, notwithstanding an effective notice or decision under subsections (c), (e) and (h) hereof, the member is still approaching financial or operational difficulty, the District Surveillance Committee may prescribe additional limitations of a member's business in which case all of the procedures specified above shall be followed prior to the implementation thereof.

(k) *Complaint by District Committee*—Action by the Corporation under this Article is not intended to foreclose complaint action by the District Business Conduct Committee under the Code of Procedure for Handling Trade Practice Complaints where a violation of the Rules of Fair Practice may be involved.

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Request For Comments

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Rules G-8 and G-15

Comments Requested on Draft Amendments Concerning Required Representations on Customer Delivery of Securities in Sale Transactions

The Board is considering adoption of amendments to rule G-15 on confirmation, clearance, and settlement of transactions with customers and rule G-8 on recordkeeping that would require dealers to obtain and to record representations from customers concerning delivery of securities in sale transactions. The Board notes that the NASD has interpreted its rules to require similar representations.

The proposed amendment to rule G-15 would require that a municipal securities dealer not accept a customer's sell order unless:

(a) the dealer has possession of the security;

(b) the account record for the customer's account with the dealer indicates ownership of the security;

(c) the dealer: (i) has obtained a representation from the customer that the customer has possession of the security and will deliver it to the dealer within five business days of the acceptance of the order, and (ii) has included a designation of this representation on the trading ticket of such order; or

(d) the dealer: (i) has obtained a representation from the customer that the security is on deposit with a broker, dealer, or municipal securities dealer, or a state or federally regulated banking organization, and that the customer will deliver instructions to that depository no later than the third business day after the trade date to deliver the security against payment, and (ii) has included a designation of this representation on the trading ticket of such order.

The proposed requirement that, if the securities are held by an agent of the customer, the dealer must obtain a representation from the customer that delivery instructions will be transmitted to the agent not later than the third business day after the trade date, corresponds to a similar requirement in rule G-15(d) concerning DVP/RVP transactions. The proposed amendment to rule G-8 which would require that, in memoranda dealing with sale orders by customers, dealers note, where applicable, that representations concerning delivery of securities or the transmission of instructions to agents to deliver securities have been made, will facilitate the compliance inspections of proposed rule G-15(c) by the enforcement agencies. Under rule G-9(b) (iii) and (iv), these memoranda must be retained for three years.

The Board is considering adopting these requirements in order to reduce fails-to-deliver and to improve market efficiency. The Board understands that a number of municipal securities dealers currently follow similar procedures. The Board requests comments from municipal securities dealers as to whether the proposed amendments will promote efficiencies in the municipal securities market and whether delays by customers in the delivery of securities result in a substantial number of fails of municipal securities transactions.

May 24, 1984

Text of Draft Amendments*

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) through (v) No change.

(vi) Records for Agency Transactions. A memorandum of each agency order and any instructions given or received for the purchase or sale of municipal securities pursuant to such order, showing the terms and conditions of the

All interested persons are invited to submit written comments to the Board on the draft amendments. Written comments will be available for public inspection. Letters of comment should be submitted to the Board on or before August 15, 1984, and should be sent to the attention of Diane G. Klinke, Deputy General Counsel.

*Underlining indicates new language.

order and instructions, and any modification thereof, the account for which entered, the date and time of receipt of the order by such municipal securities broker or municipal securities dealer, the price at which executed, the date of execution and, to the extent feasible, the time of execution and, if such order is entered pursuant to a power of attorney or on behalf of a joint account, corporation or partnership, the name and address (if other than that of the account) of the person who entered the order. If an agency order is cancelled by a customer, such records shall also show the terms, conditions and date of cancellation, and, to the extent feasible, the time of cancellation. Orders entered pursuant to the exercise of discretionary power by such municipal securities broker or municipal securities dealer shall be designated as such. Memoranda concerning sale orders by customers shall show, where applicable, that representations concerning delivery of the securities or the transmission of instructions to agents to deliver securities have been made.

For purposes of this subparagraph, the term "agency order" shall mean an order given to a municipal securities broker or municipal securities dealer to buy a specific security from another person or to sell a specific security to another person, in either case without such municipal securities broker or municipal securities dealer acquiring ownership of the security. Customer inquiries of a general nature concerning the availability of securities for purchase or opportunities for sale shall not be considered to be orders. For purposes of this subparagraph and subparagraph (vii) below, the term "memorandum" shall mean a trading ticket or other similar record. For purposes of this subparagraph, the term "instructions" shall mean instructions transmitted within an office with respect to the execution of an agency order, including, but not limited to, instructions transmitted from a sales desk to a trading desk.

(vii) Records for Transactions as Principal. A memorandum of each transaction in municipal securities (whether purchase or sale) for the account of such municipal securities broker or municipal securities dealer, showing the price and date of execution and, to the extent feasible, the time of execution; and in the event such purchase or sale is with a customer, a record of the customer's order, showing the date and time of receipt, the terms and conditions of the order, and the name or other designation of the account in which it was entered and, if such order is entered pursuant to power of attorney or on behalf of a joint account, corporation, or partnership the name and address (if other than that of the account) of the person who entered the order. Memoranda concerning sale orders by customers shall show, where applicable, that representations concerning delivery of the securities or the transmission of instructions to agents to deliver securities have been made.

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

(a) through (b) No change.

(c) Deliveries from Customers

No broker, dealer, or municipal securities dealer shall accept a sell order from a customer in any municipal security unless:

(i) the broker, dealer, or municipal securities dealer has possession of the security;

(ii) the account record for such customer's account with the broker, dealer, or municipal securities dealer made in accordance with the requirements of paragraph (a)(ii) of rule G-8 indicates ownership of the security;

(iii) the broker, dealer, or municipal securities dealer: (A) has obtained a representation from the customer that the customer has possession of the security and will deliver it to the broker, dealer, or municipal securities dealer within 5 business days of the acceptance of the order, and (B) has included a designation of this representation in the memorandum of such order made in accordance with the requirements of paragraph (a)(vi) or (a) (vii) of rule G-8; or,

(iv) the broker, dealer, or municipal securities dealer: (A) has obtained a representation from the customer that the security is on deposit with a broker, dealer, or municipal securities dealer, or any organization subject to state or federal banking regulations, and that the customer will deliver instructions to that depository no later than the close of business on the third business day after the date of acceptance of the order to deliver the securities against payment, and (B) has included a designation of this representation in the memorandum of such order made in accordance with the requirements of paragraph (a)(vi) or (a)(vii) of rule G-8.

(d) Deliveries to Customers

(i) through (xii) No change.

(e) Delivery/Receipt vs. Payment Transactions

(i) through (iii) No change.

MSRB REPORTS
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Request For Comments

Route To:

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

Rules G-8, G-9, and G-32

Comments Requested on Revised Draft Amendments Pertaining to Disclosures on New Issues and Recordkeeping

In March 1984, the Board published for comment draft amendments to rule G-32 on disclosures in connection with new issues and rules G-8 and G-9 on recordkeeping.[1] The draft amendments were published in response to comments that the current requirements of rule G-32 are not being complied with. They were intended to strengthen the disclosure requirements to ensure that purchasers of new issue municipal securities receive copies of official statements when they are prepared by the issuers. After reviewing the comments on the draft amendments, the Board determined to publish for comment these revised draft amendments to rule G-32 before taking final action on the rule.

Background

Rule G-32 prohibits a municipal securities broker or dealer from selling during the underwriting period new issue municipal securities to a customer unless, at or prior to sending the final confirmation of the transaction, a copy of the final official statement, if one is prepared by or on behalf of the issuer, and, in the case of negotiated sales, certain additional written information concerning the underwriting arrangements, are provided to the customer.[2] The rule also requires dealers to furnish copies of official statements and other rule G-32 disclosures upon request to any broker, dealer, or municipal securities dealer to which it sells new issue municipal securities. The Board has stated that if sufficient copies of official statements are not available, a dealer must reproduce the official statement at its own expense. These requirements apply to all dealers who sell new issue securities, not solely to underwriters of the issue. The rule is designed to ensure that a purchaser of new issue securities is provided with all available information relevant to his investment decision.

Comments on Previous Draft Amendments to Rule G-32

As noted above, on March 9, 1984, the Board published draft amendments to its rules G-8, G-9, and G-32. The draft amendments to rule G-32 would require delivery of an official statement, or if no official statement was prepared by the issuer a notice stating that fact, for a 40-day period commencing with the date of sale. This requirement is designed so that dealers who sell new issue securities but who are not syndicate members will know exactly when the official statement delivery period begins and ends. In the case of a syndicate that maintains an unsold balance beyond the 40-day period, the draft amendments would require syndicate members to deliver the rule G-32 disclosures to purchasers of the new issue until the account is closed. The rationale for this provision is that syndicate members know that the account is still active and continue to be engaged in a primary distribution of securities.

The commentators generally did not oppose the proposed 40-day official statement delivery period nor did they comment on the draft requirement that a statement be sent, when applicable, indicating that no official statement has been prepared. One commentator suggested that the time period should run from an issue's dated date rather than the date of sale. The Board has not adopted this suggestion since some issues specify dated dates that are substantially different from the date the securities are issued. The Board welcomes additional comments on the 40-day delivery provisions. In particular the commentators should consider whether the rule should require all dealers to deliver the rule G-32 disclosures until an account which remains open longer than the 40-day period is closed.

The Board welcomes comments on the attached draft amendments from all interested persons. Letters of comment should be received by the Board on or before August 15, 1984, and should be sent to the attention of Angela Desmond, General Counsel.

[1] *See MSRB Reports*, vol. 4, no. 2 (March 1984).

[2] The underwriting period is defined in rule G-11(a)(ix) as:
. . . the period commencing with the first submission to a syndicate of an order for the purchase of new issue municipal securities or the purchase of such securities from the issuer, whichever first occurs, and ending at such time as the issuer delivers the securities to the syndicate or the syndicate no longer retains an unsold balance of securities, whichever last occurs.

Comments on Rule G-32 Generally

The Board also received a number of comments on the current requirements of rule G-32. These comments indicated that there may be substantial noncompliance with the current requirements of the rule. In particular, the Board received commments that dealers are unable to obtain copies of official statements from underwriters or are charged a fee for each official statement. These commentators suggested that the Board should place more responsibility on managing underwriters for obtaining sufficient copies of official statements to permit compliance with the official statement delivery requirements of the rule.

The Board also received comments that it is too costly to reproduce copies of both the preliminary and final official statements and that only one official statement should be required to be sent. One commentator stated that it is physically impossible for dealers who are not members of a syndicate to deliver official statements with final money confirmations because they are unable to obtain official statements by that date. Another commentator suggested that a dealer with branch offices also may have difficulty circulating official statements to its various offices in a timely manner.[3]

Proposed Revisions to Rule G-32

The Board is considering further revisions to rule G-32 to address these issues. The Board is considering revising rule G-32 to place primary responsibility on managing underwriters for assuring that, when an official statement is prepared by or on behalf of an issuer, adequate copies of official statements are made available to syndicate members and other dealers selling new issue securities so as to permit compliance with the rule. Managers are in the best position to assure that the issuer prints an adequate number of official statements or to order them directly from the printer or have the official statement reproduced. The Board expects that managers will supply their syndicate members with an adequate number of copies of the rule G-32 disclosures to permit them to deliver enough copies to dealers who purchase the new issue securities from them. If a manager does not provide sufficient copies to its syndicate members, it would be required to provide the disclosures directly to the purchasing dealers.

With respect to the requirement that all dealers deliver the rule G-32 disclosures prior to or with the final money confirmation of the transaction, the Board believes that it is appropriate to continue to require syndicate members to deliver final official statements prior to or with the final money confirmation of a transaction in new issue municipal securities. The Board understands that syndicate settlements usually occur at least two weeks after the date of sale; it believes that dealers should be able to prepare and distribute a final official statement by that time or at least to deliver the preliminary official statement (which usually is prepared before the date of sale) by that date.

In addition, the Board is proposing to require underwriters which sell new issue municipal securities to dealers to provide those dealers with the G-32 disclosures prior to or with the final money confirmations of the transactions. It appears that the current "upon request" provision undermines the ability of a dealer that is not a syndicate member to provide these disclosures to customers to whom it sells the new issue securities.

With respect to the responsibilities of selling dealers that are not syndicate members, the Board believes that such dealers should continue to be required to deliver final official statements prior to or with the final money confirmation. However, the Board is considering whether it may be appropriate to permit such a dealer, when it cannot obtain the official statement or other rule G-32 disclosures before timely mailing of the final confirmation, to send out these disclosures to its customer or other purchasing dealer within one business day of their receipt from the syndicate member or other dealer from which it purchased the new issue securities. The Board welcomes comments whether such a provision will facilitate ultimate compliance with the disclosure requirements of the rule or whether the draft provision would undermine compliance with the rule.

As noted above, rule G-32 requires that a preliminary official statement be sent out when the final version is not prepared by the time the final money confirmation for the transaction in the new issue municipal securities is sent out. If one is prepared, it is incumbent upon the selling dealer to obtain or reproduce sufficient copies of the official statement to comply with the rule. If the final official statement has not been prepared by the time of sending the final confirmation, current rule G-32 requires a dealer to send a preliminary official statement. The rule also requires that customers be sent a copy of the final official statement "promptly" after it is prepared by the issuer. The Board is considering amendments to clarify the "promptly" standard by requiring an underwriter to send a final official statement within one business day of its preparation by the issuer to any person or dealer that is not a syndicate member to which it sold the new issue securities.[4] Selling dealers that are not syndicate members, in turn, would be required to send the final official statement to any person or dealer to which it sold the new issue securities within one business day of its receipt from the syndicate member or other dealer from which it purchased the new securities.

The Board also is considering whether, as an alternative to adopting certain of the provisions described above, it should simply retain the current requirement that all dealers selling new issue securities deliver the rule G-32 disclosures prior to or with the final confirmation of the transactions. If it adopts this alternative, it may be necessary also to adopt other provisions to ensure full compliance with that requirement. For example, the Board might prohibit dealers from sending out final confirmations of transactions in new issue securities until the dealer is able to send out the rule G-32 disclosures, or provide other remedies to customers who do not receive these disclosures. The Board specifically requests comments concerning provisions that would encourage compliance with the rule.

Finally, certain commentators suggested that project notes be exempted from the proposed amendments in the same way the Board exempted qualified note syndicates from

[3]One commentator suggested that a central depository should be established for maintaining copies of official statements and making them available to interested persons over the life of the issue.

[4]The Board considers an official statement to be "prepared" once it has been printed or otherwise completed.

certain provisions of rule G-11. The rationale for such an exemption is that official statements never are prepared for these issues, and because purchasers of project notes have no expectation that offering documents will exist, there is no need to advise them that offering documents have not been prepared. The revised amendments contain such an exemption.

Comments on Draft Amendments to Rules G-8 and G-9 on Books and Records

The draft amendment to rule G-8 proposed to add a new section requiring a dealer to maintain a record of deliveries of rule G-32 disclosures and the draft amendment to rule G-9 proposed to require that these records be retained for a period of not less than three years. The primary purpose of the draft recordkeeping requirements is to facilitate enforcement of rule G-32 since the enforcement agencies currently have no accurate way to determine whether a dealer is complying with the rule. The recordkeeping requirements also are designed to encourage dealers to institute procedures for delivering the disclosures required under rule G-32.

Several industry commentators opposed the draft recordkeeping rules on the ground that they would be burdensome. Two agencies charged with enforcement of Board rules stated that recordkeeping requirements would facilitate their efforts to inspect for compliance with rule G-32. In this regard, the Board notes that it has not specified the form in which the proposed records should be kept, but has chosen instead to allow each dealer to determine how it will record deliveries of disclosures required by rule G-32. The Board is not proposing further revisions to the draft amendments to rules G-8 and G-9. It welcomes additional comment concerning the draft recordkeeping requirements.

Text of Draft Amendments*

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)–(xii) No change.

(xiii) Records Concerning Deliveries of Official Statements. A record of the deliveries of the disclosures required under rule G-32, together with a copy of any notice that no official statement had been prepared, or other material concerning the underwriting arrangements (other than a notice or document prepared by the issuer or an agent of the issuer) that was delivered.

Rule G-9. Preservation of Records

(a) No change.

(b) Records to be Preserved for Three Years. Every municipal securities broker and municipal securities dealer shall preserve the following records for a period of not less than three years:

(i) the subsidiary records described in rule G-8(a)(iv);

(ii) the records of put options and repurchase agreements described in rule G-8(a)(v);

(iii) the records relating to agency transactions described in rule G-8(a)(vi);

(iv) the records of transactions as principal described in rule G-8(a)(vii);

(v) the copies of confirmations and other notices described in rule G-8(a)(ix);

(vi) the customer account information described in rule G-8(a)(xi), provided that records showing the terms and conditions relating to the opening and maintenance of an account shall be preserved for a period of at least six years following the closing of such account;

(vii) if such municipal securities broker or municipal securities dealer is subject to rule 15c3-1 under the Act, the records described in subparagraphs (a)(4)(iv) and (vi) and (a)(11) of rule 17a-3 and subparagraphs (b)(5) and (b)(8) of rule 17a-4 under the Act;

(viii) the following records, to the extent made or received by such municipal securities broker or municipal securities dealer in connection with its business as such municipal securities broker or municipal securities dealer and not otherwise described in this rule:

(A) check books, bank statements, cancelled checks, cash reconciliations and wire transfers;

(B) bills receivable or payable;

(C) all written communications received and sent, including inter-office memoranda, relating to the conduct of the activities of such municipal securities broker or municipal securities dealer with respect to municipal securities; and

(D) all written agreements entered into by such municipal securities broker or municipal securities dealer, including agreements with respect to any account; and

(E) all powers of attorney and other evidence of the granting of any authority to act on behalf of any account, and copies of resolutions empowering an agent to act on behalf of a corporation.

(ix) all records relating to fingerprinting which are required pursuant to paragraph (e) of rule 17f-2 under the Act.

(x) all records of deliveries of written disclosures and those disclosures required to be retained as described in rule G-8(a)(xiii).

(c)–(g) No change.

Rule G-32. Disclosures in Connection with New Issues.

(a)(i) Disclosure Requirements. No municipal securities broker or municipal securities dealer shall sell, whether as principal or agent, any new issue municipal securities ~~to a customer~~ unless ~~at or prior to sending a final written confirmation of the transaction to the customer indicating money amount~~ due, such municipal securities broker or municipal securities dealer sends, within the time periods specified in paragraph (ii) and (iii) of this section (a), the following information to the ~~customer~~: purchaser:

*Underlining indicates new language; broken line indicates deletions.

~~(i)~~(A) a copy of the official statement in final form ~~voluntarily furnished~~ prepared by or on behalf of the issuer (or an abstract or other summary of such statement ~~which is prepared by such municipal securities broker or municipal securities dealer~~); and

~~(ii)~~(B) in connection with a negotiated sale of new issue municipal securities, the following information concerning the underwriting arrangements:

~~(A)~~ (1) the underwriting spread;

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

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

~~In the event an official statement in final form is not available at the time the final confirmation indicating money amount due is sent to a customer, an official statement in preliminary form, if any, shall be sent to the customer, provided that an official statement in final form, or an abstract or summary thereof, must be sent to the customer promptly after such official statement becomes available to the municipal securities broker or municipal securities dealer~~.

(ii) Time periods applicable to underwriters. A municipal securities broker or municipal securities dealer that also acts as sole underwriter or is a member of a syndicate or similar account formed for the purchase of a new issue shall send the information as required in this section (i) above, at or prior to sending the final confirmation of the transaction.

(iii) Time periods applicable to dealers who are not underwriters. A municipal securities broker or municipal securities dealer that is not an underwriter shall send the information as required in this section (i) above, at or prior to sending the final confirmation of the transaction. If the municipal securities broker or municipal securities dealer is unable to obtain such information by the date on which it sends the final confirmation, it shall send the information within one business day of its receipt from the underwriter or other municipal securities broker or municipal securities dealer from which it purchased the new issue securities.

(b) Preliminary Official Statement. In the event an official statement in final form has not been prepared by the time the final confirmation is sent to a purchaser, an official statement in preliminary form, if any, shall be sent; provided, however, that

(i) an underwriter shall send an official statement in final form or abstract or summary thereof to any customer, or to any municipal securities broker or municipal securities dealer (in accordance with section (d)), to which it sold the new issue securities, within one business day of preparation of the official statement by or on behalf of the issuer;

(ii) a municipal securities broker or municipal securities dealer that is not an underwriter shall send an official statement in final form or an abstract or summary thereof to any customer or any municipal securities broker or municipal securities dealer to which it sold the new issue securities, within one day of its receipt from the underwriter or other municipal securities broker or municipal securities dealer from which it purchased the new issue securities.

(c) Notice of No Official Statement. If no official statement was prepared by or on behalf of the issuer, a written statement of that fact must be sent on or with the final confirmation.

(d) Responsibilities of Managing Underwriters or Sole Underwriters. In the event a syndicate or similar account has been formed for the purchase of new issue of municipal securities, it shall be the responsibility of the managing underwriter to provide sufficient copies of the final official statement, if one is prepared by or on behalf of the issuer, or abstract thereof and other information as required in section (a) to the syndicate members so as to permit their compliance with the rule.

A managing underwriter on behalf of the syndicate or a sole underwriter shall provide a broker, dealer, or municipal securities dealer that is not a member of the syndicate but buys new issue securities from the syndicate or the sole underwriter with sufficient copies of the information specified in paragraph (a)(i) to enable such broker, dealer or municipal securities dealer to comply with its delivery requirements under this rule.

~~(b)~~ (e) Definition of New Issue Municipal Securities and Official Statement. For purposes of this rule, ~~the following terms have the following meanings~~:

(i) the term "new issue municipal securities" shall mean securities of an issue that are sold by a municipal securities broker or municipal securities dealer ~~to a customer during the underwriting period defined in rule G-11 of the Board, and~~ on or before the 40th day after the date of sale as defined in rule G-11, or, in the case of a member of a syndicate, on or before the 40th day after the date of sale or the last day of the underwriting period (as defined in rule G-11), whichever is later. For purposes of this rule, the term "new issue municipal securities" shall not include public housing authority project notes.

(ii) the term "official statement" shall mean a document prepared by the issuer or its representatives setting forth, among other matters, information concerning the issuer and the proposed issue of securities. A notice of sale shall not be deemed to be an "official statement" for purposes of this rule.

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Notice of Approval

Route To:

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

Rule G-12

Amendments Approved on Inter-Dealer Deliveries of Book-Entry Form Securities

On May 24, 1984, the Securities and Exchange Commission approved amendments to rule G-12 on uniform practice concerning inter-dealer deliveries of certain types of securities which are available only in book-entry form and certain other technical matters. The substantive amendment establishes a standard for delivery of book-entry form securities in circumstances where the securities are not eligible for book-entry clearance through the facilities of a registered securities depository. The amendments will not become effective until July 23, 1984, 60 days after the date of Commission approval.

Board rule G-12(e) establishes certain standards regarding deliveries of securities between municipal securities brokers and dealers. Rule G-12(a)(i), however, provides that such standards do not apply to deliveries made through the facilities of a registered clearing agency:

> [A] transaction which is settled or cleared through the facilities of a registered clearing agency shall be exempt from the provisions of section (e) of this rule.

Therefore, book-entry deliveries through the facilities of a registered securities depository would not be subject to the provisions of section (e) of the rule; book-entry deliveries through the facilities of an entity not registered as a clearing agency, however, would be subject to the provisions of section (e).

The Board has become aware that certain securities are currently being traded and sold in the secondary market which are available only in book-entry form through a system managed by a book-entry agent (generally a commercial bank) which is not registered as a clearing agency. Since inter-dealer deliveries of such securities are subject to the "good delivery" provisions of section (e), the Board believes it appropriate to amend section (e) to include a provision setting forth such standards.

The amendments include in section (e) of the rule a standard for deliveries of such securities between dealers. The amendments require that a dealer making delivery of such securities must do so by arranging to have the securities transferred into the name of the purchasing dealer (or into such name as the purchasing dealer may direct) on the records maintained for this purpose by the book-entry agent for the securities. The delivering dealer therefore would be responsible, under this standard, for completing the book-entry transfer of the securities as a part of the transaction settlement process. The Board believes that such a standard is necessary to ensure the integrity of the clearance and settlement process and to establish appropriate safeguards against inadvertent or intentional misuse of this type of book-entry system.

The amendments also revise the current provisions of the rule relating to deliveries of securities in registered form to reflect the existing requirements under the Internal Revenue Code that most long-term municipal securities be issued solely in registered form.

May 25, 1984

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

(e) Delivery of Securities. The following provisions shall, unless otherwise agreed by the parties, govern the delivery of securities:

(i) through (v) No change.

(vi) Form of Securities.

(A) Bearer and Registered Form. Delivery of securities which are issuable in both bearer and registered form shall be in bearer form unless otherwise agreed by the parties; provided, however, that delivery of securities which are required to be in registered form in order for interest thereon to be exempt from Federal income taxation shall be in registered form.

(B) Book-Entry Form. Notwithstanding the other provisions of this section (e), with respect to a security which may be transferred only by bookkeeping entry, without the physical delivery of securities certificates, on books maintained for this purpose by a person who is not a registered clearing agent, a delivery of such security shall be made only by a book-entry transfer of the ownership of the security to the purchasing dealer or a person designated by the purchasing dealer.

(vii) through (xvi) No change.

(f) through (l) No change.

Questions concerning the amendments may be directed to Donald F. Donahue, Deputy Executive Director.

*Underlining indicates additions.

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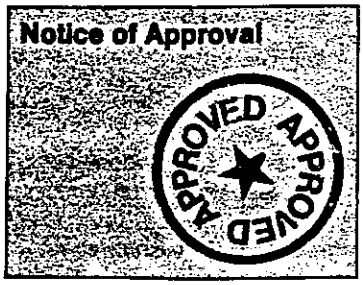

Route To:

- ☒ Manager, Muni. Dept.
- ☒ Underwriting
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- ☒ Operations
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- ☒ Compliance
- ☐ Training
- ☐ Other _____

Rules G-12 and G-15

Amendments Approved on Application of Automated Clearance Requirements to Indirect Participants

On May 10, 1984, the Securities and Exchange Commission approved certain amendments to the provisions of Board rules G-12(f) and G-15(d) concerning the use of automated clearance systems on certain municipal securities transactions. The amendments clarify the application of these requirements to certain municipal securities brokers and dealers who occasionally use clearing agents who are participants in such automated clearance systems. The amendments will become effective concurrently with the provisions of rules G-12(f) and G-15(d).[1]

Rules G-12(f) and G-15(d) will require, when effective, that certain inter-dealer transactions and customer delivery/receipt vs. payment transactions be confirmed or compared (in the case of transactions involving a security assigned a CUSIP number) and settled via book-entry (in the case of transactions involving securities eligible for such settlement) through the facilities of a registered clearing agency or interfaced or otherwise linked registered clearing agencies. These provisions are applicable to transactions involving municipal securities brokers and dealers and customers who are deemed, for purposes of the rules, to be participants in or members of a registered clearing agency. Both rules specify that municipal securities brokers and dealers and customers who clear transactions through an agent who is a participant in or member of a registered clearing agency will be considered to be participants of that registered clearing agency for purposes of the rules' requirements; these persons are generally referred to as "indirect participants" of a registered clearing agency.

Since the Commission's approval of these rules in November 1983,[2] the Board has received several inquiries concerning the extent to which non-participants who occasionally use the services of a participant agent will be considered to be participants of a registered clearing agency and therefore subject to the rules' requirements. In particular, certain industry members have noted that many dealers use agents to clear certain transactions in money center cities, but may use other agents to clear other transactions, or clear those other transactions themselves. Similarly, certain customers may use a participant clearing agent with respect to certain transactions, and a non-participant agent with respect to other transactions. These industry members have inquired whether the use by such a person of an agent who is a participant of a registered clearing agency to clear certain transactions is sufficient to make that person an indirect participant of the registered clearing agency, and therefore potentially subject to the requirements of rules G-12(f) and/or G-15(d), with respect to all of its transactions (including transactions which might not otherwise be cleared through the participant agent).

Upon consideration the Board has concluded that it would be desirable to limit the application of the requirements of rules G-12(f) and G-15(d) in the case of these indirect participants at the time these requirements first become effective. The Board believes that the requirements of rules G-12(f) and G-15(d) should apply to such persons only in the case of transactions otherwise subject to the rules which are cleared through the participant agent, and, accordingly, adopted the amendments to clarify this point in the rules. In the case of transactions cleared through a participant agent, therefore, indirect participant dealers would generally be required, as of August 1, 1984, to submit data concerning any transaction with another participant organization involving a municipal security assigned a CUSIP number to a registered clearing agency (presumably through the facilities of the participant agent) for automated comparison or confirmation of such transaction; indirect participant customers would be required to affirm any delivery/receipt vs. payment transaction so confirmed. As of February 1, 1985, these indirect participants would also be required to settle such transactions via book-entry, if the securities involved in the transaction are eligible for book-entry settlement. Under the amendments, however, these persons would not be con-

Questions concerning the amendments or the requirements of rules G-12(f) and G-15(d) generally may be directed to Donald F. Donahue, Deputy Executive Director.

[1]The provisions relating to the automated comparison or confirmation of transactions are scheduled to become effective on August 1, 1984; the provisions relating to the book-entry settlement of transactions are scheduled to become effective on February 1, 1985.

[2]See Exchange Act Release No. 20365 (November 14, 1983).

sidered to be indirect participants with respect to transactions not cleared through the participant agent (*e.g.*, transactions which they clear themselves) and, consequently, would not be subject to the requirements of rules G-12(f) and/or G-15(d) with respect to such transactions.

The Board believes that this approach is appropriate during the initial implementation of the rules over the next year. The Board continues to believe, however, that the use of automated clearance systems with respect to municipal securities transactions will provide significant benefits to the municipal securities industry generally. Accordingly, the Board intends to monitor the effects of these amendments closely during the implementation of the requirements of rules G-12(f) and G-15(d). The Board further intends to consider and adopt amendments, subsequent to the effective dates of the existing provisions, which would at minimum require those dealers who are indirect participants only by virtue of their occasional use of a participant agent to clear certain transactions to use the automated confirmation or comparison systems with respect to all transactions otherwise subject to these rules.

May 21, 1984

Text of Amendments*

Rule G-12. Uniform Practice

(a) through (e) No change.

(f) Use of Automated Comparison, Clearance, and Settlement Systems.

(i) and (ii) No change.

(iii) For purposes of this section (f) a municipal securities broker or municipal securities dealer who clears a transaction[s] through an agent who is a member of a registered clearing agency or a registered securities depository shall be deemed to be a member of such registered clearing agency or registered securities depository with respect to such transaction.

(g) through (l) No change.

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

(a) through (c) No change.

(d) Delivery/Receipt vs. Payment Transactions.

(i) No change.

(ii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security to which a CUSIP number has been assigned on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent with respect to such transaction is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the confirmation and acknowledgement of such transaction. The provisions of this paragraph (ii) shall apply to transactions effected on or after August 1, 1984.

(iii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security which is eligible for book-entry settlement through the facilities of such clearing agency on a delivery vs. payment or receipt vs. payment basis for the amount of a customer who is, or whose agent with respect to such transaction is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the book-entry settlement of such transaction. The provisions of this paragraph (iii) shall apply to transactions effected on or after February 1, 1985.

*Underlining indicates additions; brackets indicate deletions.

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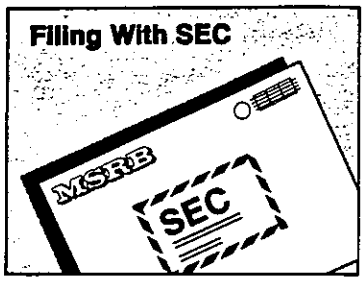

Route To:

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

Rules G-12 and G-15

Amendments Filed on Temporary Exemption of Project Notes from Automated Clearance Requirements

On May 24, 1984, the Board filed with the Securities and Exchange Commission proposed amendments to the provisions of Board rules G-12(f) and G-15(d) concerning the use of automated confirmation or comparison systems on certain transactions in municipal securities. The proposed amendments will exempt transactions in public housing authority project notes from these provisions for a short period of time, during the implementation of a book-entry system for such securities. The provisions being changed by the proposed amendments are scheduled to become effective on August 1, 1984.

On November 14, 1984, the Securities and Exchange Commission approved certain amendments to Board rules G-12(f) and G-15(d) which will require, when effective,[1] that transactions on which certain conditions are met be confirmed, compared, cleared and settled via book-entry through the automated facilities of a clearing agency registered with the Commission. The conditions under which these requirements would apply involve, in part, whether the securities which are the subject of the transaction are eligible for the clearing agency's services: for example, transactions in which the securities are eligible for automated confirmation or comparison (*i.e.*, in which the securities have been assigned a CUSIP number) are subject to the requirement for use of the automated confirmation or comparison systems. Securities which are not eligible for such services (*e.g.*, securities which have not been assigned a CUSIP number) would not be subject to these requirements.[2]

At the time of adoption of these amendments, certain short term municipal securities (public housing authority project notes and others) were not eligible for CUSIP number assignment, and therefore were not eligible for inclusion in the automated clearance systems referenced under the rules. Recently, however, the United States Department of Housing and Urban Development, the Federal Reserve Bank of New York, and Bankers Trust Company have announced completion of the development of a system for the issuance and trading of public housing authority project notes in pure book-entry form.[3] As a part of the development of this book-entry system HUD has sought and obtained a change to the eligibility rules of the CUSIP system to make project notes eligible for CUSIP number assignment. The CUSIP Service Bureau expects to begin assigning numbers to project notes at the time the pilot program starts in June.

As a result of the assignment of CUSIP numbers to project notes, the requirements under rules G-12(f) and G-15(d) for the use of automated systems for comparison or confirmation of transactions will become applicable to transactions in project notes when they become effective on August 1, 1984, since any CUSIP-assigned municipal security is eligible for these systems. Although the Board believes that it is desirable that these requirements apply to transactions in project notes, the Board considers it preferable that they not be applied to such securities during the initial stages of implementation of the book-entry system. Applying these requirements at that time would be likely to complicate the implementation of the system, and cause difficulties to the efforts of persons trading project notes to make any changes necessary to permit them to use the system. Accordingly, the Board has adopted the proposed amendments, which revise the requirements of rules G-12(f) and G-15(d) to exempt transactions in public housing authority project notes from the automated confirmation and comparison requirements until January 1, 1985.[4]

May 29, 1984

Questions concerning the proposed amendments may be directed to Donald F. Donahue, Deputy Executive Director.

[1]The provisions of the rules with respect to the use of automated comparison or confirmation systems are currently scheduled to become effective on August 1, 1984; the provisions requiring the use of book-entry clearance and settlement systems will become effective on February 1, 1985.

[2]The notice of the Commission's approval of the amendments appeared in the December 1983 *MSRB Reports* (vol. 3, n. 7) at 3–6, and is reprinted in *Municipal Securities Rulemaking Board Manual* (CCH) ¶10,280, at 803–805.

[3]Information about the proposed book-entry system is available from Mr. Theodore R. Daniels, Director, Project Financing Division, U.S. Department of Housing and Urban Development, (202) 755-6444.

[4]The Board notes that the requirements becoming effective on February 1, 1985, with respect to the book-entry clearance of transactions in depository-eligible securities will not present problems to the book-entry system for project notes, since project notes will not be eligible for depository services for the foreseeable future (due to the fact that transactions in project notes settle in federal funds).

Text of Proposed Amendments*

Rule G-12. Uniform Practice

(a) through (e) No change.

(f) Use of Automated Comparison, Clearance, and Settlement Systems.

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, with respect to a transaction in municipal securities which are eligible for comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission, if both parties to such transaction are members in one or more of such clearing agencies (and such clearing agencies are interfaced or linked for comparison purposes), each party to the transaction shall submit to its clearing agency information concerning the transaction, as required by the clearing agency's rules, for purposes of automated trade comparison. The provisions of this paragraph (i) shall apply to transactions effected on or after August 1, 1984; provided, however, that transactions in federally guaranteed public housing authority project notes effected prior to January 1, 1985 shall not be subject to the provisions of this paragraph.

(ii) and (iii) No change.

(g) through (l) No change.

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

(a) through (c) No change.

(d) Delivery/Receipt vs. Payment Transactions.

(i) No change.

(ii) No broker, dealer or municipal securities dealer who is, or whose clearing agent with respect to such transaction is, a participant in a clearing agency registered with the Securities and Exchange Commission shall effect a transaction in any municipal security to which a CUSIP number has been assigned on a delivery vs. payment or receipt vs. payment basis for the account of a customer who is, or whose agent with respect to such transaction is, a participant in such clearing agency (or in a clearing agency interfaced or otherwise linked with such clearing agency) unless the facilities of such clearing agency (or the facilities of a clearing agency interfaced or otherwise linked with such clearing agency, as necessary) are used for the confirmation and acknowledgement of such transaction. The provisions of this paragraph (ii) shall apply to transactions effected on or after August 1, 1984; provided, however, that transactions in federally guaranteed public housing authority project notes effected prior to January 1, 1985 shall not be subject to the provisions of this paragraph.

(iii) No change.

*Underlining indicates additions.

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Notice of Approval

Route To:

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

Rule G-15

Amendments Approved on Standards of Delivery to Customers

On May 29, 1984, the Securities and Exchange Commission approved certain amendments to the provisions of Board rule G-15 concerning the confirmation, clearance and settlement of transactions with customers. The amendments establish standards for settlement dates on transactions with customers, and also set forth standards for deliveries of physical securities to customers. The amendments will not become effective until August 6, 1984, 60 days following the date of publication in the *Federal Register*.

Board rule G-12 on uniform practice sets forth certain requirements concerning inter-dealer transactions, including provisions specifying the required content of inter-dealer confirmations, provisions establishing standards for physical deliveries of securities between dealers, and provisions relating to other aspects of the clearance and settlement of inter-dealer transactions. In contrast, Board rule G-15 sets forth requirements concerning the content of transaction confirmations sent to customers, but historically had not set forth specific standards relating to the clearance and settlement of customer transactions.

The amendments incorporate into rule G-15 specific provisions, comparable to the equivalent provisions of rule G-12 on inter-dealer transactions, relating to the establishment of settlement dates on customer transactions (new section (b)) and deliveries of physical securities to customers (new section (c)). The provisions of new section (b) establish the fifth business day following the trade date as the standard settlement date for customer transactions, and provide for the establishment of settlement dates on "cash" and other exceptional transactions. The provisions of new section (c) establish certain standards relating to the proper delivery of securities to customers, covering such matters as the fungibility and specific identification of securities delivered, units of delivery, the form of the securities to be delivered, delivery of coupon and registered securities, and similar matters.

As noted above, the standards for deliveries to customers set forth in the amendments are substantially similar to those relating to the clearance and settlement of inter-dealer transactions set forth in rule G-12. The amendments do, however, impose slightly different or additional delivery standards in certain cases, as follows:

(1) Section (c) is, by its terms, applicable to deliveries made by municipal securities brokers and dealers to customers or persons other than the delivering broker or dealer acting as agent for the receiving customer. The amendments make clear, however, that the delivery standards set forth therein *are not applicable to deliveries made by customers or their agents to municipal securities brokers and dealers*, nor is a customer barred under the amendments from establishing delivery standards with respect to a particular transaction in addition to those specified in section (c).

(2) Subparagraph (c) (iv) (B) sets forth standards for deliveries to customers of securities which are available only in book-entry form; a similar amendment to rule G-12 setting forth comparable standards for inter-dealer deliveries of certain types of such securities was recently approved by the Commission.

(3) Paragraph (c) (xii) sets forth certain standards regarding the delivery of registered securities to customers that, in part, differ significantly from the standards applicable to inter-dealer deliveries. In particular, subparagraph (c) (xii) (A) provides that, in the case of a registered security delivered directly to a customer, the delivering municipal securities broker or dealer shall deliver a security "registered in the customer's name or in such name as the customer shall direct." In the case of a delivery of registered securities to a person acting as agent for the customer, however, subparagraph (c) (xii) (B) permits delivery of registered securities in "good delivery" form, as well as securities registered in the name of (or as directed by) the customer. The standards for "good delivery" form are specified in items (1) through (6) of the subparagraph, and are the same as those applying to inter-dealer deliveries.

(4) The amendments do not include provisions paralleling certain of the requirements of rule G-12 regarding deliveries on inter-dealer transactions, in circumstances where the Board did not believe such provisions would be appropriate for customer transactions.

May 31, 1984

Questions concerning the amendments may be directed to Donald F. Donahue, Deputy Executive Director.

Text of Amendments*

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

(a) No change.

(b) Settlement Dates.

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

(A) Settlement Date. The term "settlement date" shall mean the day used in price and interest computations, which shall also be the day delivery is due unless otherwise agreed by the parties.

(B) Business Day. The term "business day" shall mean a day recognized by the National Association of Securities Dealers, Inc. as a day on which securities transactions may be settled.

(ii) Settlement Dates. Settlement dates shall be as follows:

(A) for "cash" transactions, the trade date;

(B) for "regular way" transactions, the fifth business day following the trade date;

(C) for all other transactions, a date agreed upon by both parties.

(c) Deliveries to Customers. Except as provided in section (d) below, a delivery of securities by a broker, dealer, or municipal securities dealer to a customer or to another person acting as agent for the customer shall, unless otherwise agreed by the parties or otherwise specified by the customer, be made in accordance with the following provisions:

(i) Securities Delivered.

(A) All securities delivered on a transaction shall be identical as to the information set forth in subparagraph (E) of paragraph (a)(i) and, to the extent applicable, the information set forth in subparagraphs (A) and (C) of paragraph (a)(iii). All securities delivered shall also be identical as to the call provisions and the dated date of such securities.

(B) CUSIP Numbers.

(1) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of subparagraph (a)(i)(F) of this rule; provided, however, that for purposes of this item (1), a security shall be deemed to have the same CUSIP number as that specified on the confirmation (a) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (b) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security.

(2) A new issue security delivered by an underwriter who is subject to the provisions of rule G-34 shall have the CUSIP number assigned to the security imprinted on or otherwise affixed to the security.

(ii) Delivery Ticket. A delivery ticket shall accompany the delivery of securities. Such ticket shall contain the information set forth in subparagraphs (A), (B), (D) through (H), (M) and (O) of paragraph (a)(i) and, to the extent applicable, the information set forth in subparagraphs (A), (B), (C), (E), (F) and (G) of paragraph (a)(iii).

(iii) Units of Delivery. Delivery of bonds shall be made in the following denominations:

(A) for bearer bonds, in denominations of $1,000 or $5,000 par value; and

(B) for registered bonds, in denominations which are multiples of $1,000 par value, up to $100,000 par value.

Delivery of other municipal securities shall be made in the denominations specified on the confirmation as required pursuant to paragraph (a)(iii) of this rule.

(iv) Form of Securities.

(A) Bearer and Registered Form. Delivery of securities which are issuable in both bearer and registered form shall be in bearer form unless otherwise agreed by the parties; provided, however, that delivery of securities which are required to be in registered form in order for interest thereon to be exempt from Federal income taxation shall be in registered form.

(B) Book-Entry Form. Notwithstanding the other provisions of this section (c), a delivery of a book-entry form security shall be made only by a book-entry transfer of the ownership of the security to the purchasing customer or a person designated by the purchasing customer. For purposes of this subparagraph a "book-entry form" security shall mean a security which may be transferred only by bookkeeping entry, without the issuance or physical delivery of securities certificates, on books maintained for this purpose by a registered clearing agency or by the issuer or a person acting on behalf of the issuer.

(v) Multilated Certificates. Delivery of a certificate which is damaged to the extent that any of the following is not ascertainable:

(A) name of issuer;
(B) par value;
(C) signature;
(D) coupon rate;
(E) maturity date;
(F) seal of the issuer; or
(G) certificate number

shall not constitute good delivery unless validated by the trustee, registrar, transfer agent, paying agent or issuer of the securities or by an authorized agent or official of the issuer.

(vi) Coupon Securities.

(A) Coupon securities shall have securely attached to the certificate in the correct sequence all appropriate coupons, including supplemental coupons if specified at the time of trade, which in the case of securities upon which interest is in default shall include all unpaid or partially paid coupons. All coupons attached to the certificates must have the same serial number as the certificate.

(B) Anything herein to the contrary notwithstanding, if securities are traded "and interest" and the settlement date is on or after the interest payment date, such securities shall be delivered without the coupon payable on such interest payment date.

*All language in sections (b) and (c) is new.

(C) If delivery of securities is made on or after the thirtieth calendar day prior to an interest payment date, the seller may deliver to the purchaser a draft or blank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, in an amount equal to the interest due, in lieu of the coupon.

(vii) Mutilated or Cancelled Coupons. Delivery of a certificate which bears a coupon which is damaged to the extent that any one of the following cannot be ascertained from the coupon:

(A) title of the issuer;

(B) certificate number;

(C) coupon number of payment date (if either the coupon number or the payment date is ascertainable from the coupon, the coupon will not be considered mutilated); or

(D) the fact that there is a signature:

or which coupon has been cancelled, shall not constitute good delivery unless the coupon is endorsed or guaranteed. In the case of damaged coupons, such endorsement or guarantee must be by the issuer or by a commercial bank. In the case of cancelled coupons, such endorsement or guarantee must be by the issuer or an authorized agent or official of the issuer, or by the trustee or paying agent.

(viii) Delivery of Certificates Called for Redemption. A certificate for which a notice of call has been published on or prior to the delivery date shall not constitute good delivery unless the securities are identified as "called" at the time of trade or the notice of call is applicable to the entire issue of securities. For purposes of this subparagraph an "entire issue of securities" shall mean securities of the same issuer having the same date of issue, maturity date and coupon rate.

(ix) Delivery Without Legal Opinions or Other Documents. Delivery of certificates without legal opinions or other documents legally required to accompany the certificates shall not constitute good delivery unless identified as "ex legal" at the time of trade.

(x) Insured Securities. Delivery of certificates for securities traded as insured securities shall be accompanied by evidence of such insurance, either on the face of the certificate or in a document attached to the certificate.

(xi) Endorsements for Banking or Insurance Requirements. A security bearing an endorsement indicating that it was deposited in accordance with legal requirements applicable to banking institutions or insurance companies shall not constitute good delivery unless it bears a release acknowledged before an officer authorized to take such acknowledgements and was designated as a released endorsed security at the time of trade.

(xii) Delivery of Registered Securities.

(A) Delivery to the Customer. Registered securities delivered directly to a customer shall be registered in the customer's name or in such name as the customer shall direct.

(B) Delivery to an Agent of the Customer. Registered securities delivered to an agent of a customer may be registered in the customer's name or as otherwise directed by the customer. If such securities are not so registered, such securities shall be delivered in accordance with the following provisions:

(1) Assignments. Delivery of a certificate in registered form must be accompanied by an assignment on the certificate or on a separate bond power for such certificate, containing a signature or signatures which correspond in every particular with the name or names written upon the certificate, except that the following shall be interchangeable: "and" or "&"; "Company" or "Co."; "Incorporated" or "Inc."; and "Limited" or "Ltd."

(2) Detached Assignment Requirements. A detached assignment shall provide for the irrevocable appointment of an attorney, with power of substitution, a full description of the security, including the name of the issuer, the maturity date and interest date, the bond or note number, and the par value (expressed in words and numerals).

(3) Power of Substitution. When the name of an individual or firm has been inserted in an assignment as attorney, a power of substitution shall be executed in blank by such individual or firm. When the name of an individual or firm has been inserted in a power of substitution as a substitute attorney, a new power of substitution shall be executed in blank by such substitute attorney.

(4) Guarantee. Each assignment, endorsement, alteration and erasure shall bear a guarantee acceptable to the transfer agent or registrar.

(5) Form of Registration. Delivery of a certificate accompanied by the documentation required in this subparagraph (B) shall constitute good delivery if the certificate is registered in the name of:

(a) an individual or individuals;

(b) a nominee;

(c) a member of a national securities exchange whose specimen signature is on file with the transfer agent or any other municipal securities broker or municipal securities dealer who has filed specimen signatures with the transfer agent and places a statement to this effect on the assignment; or

(d) an individual or individuals acting in a fiduciary capacity.

(6) Certificate in Legal Form. Good transfer of a security in legal form shall be determined only by the transfer agent for the security. Delivery of a certificate in legal form shall not constitute good delivery unless the certificate is identified as being in such form at the time of trade. A certificate shall be considered to be in legal form if documentation in addition to that specified in this subparagraph (B) is required to complete a transfer of the securities.

(C) Payment of Interest. If a registered security is traded "and interest" and transfer of record ownership cannot be or has not been accomplished on or before the record date for the determination of registered holders for the payment of interest, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the

delivery date, whichever is later, for the amount of the interest.

(D) Registered Securities In Default. If a registered security is in default (*i.e.* is in default in the payment of principal or interest) and transfer of record ownership cannot be or has not been accomplished on or before the record date for the determination of registered holders for the payment of interest, an interest payment date having been established on or after the trade date, delivery shall be accompanied by a draft or bank check of the seller or its agent, payable not later than the interest payment date or the delivery date, whichever is later, for the amount of the payment to be made by the issuer, unless the security is traded "ex-interest."

(d) No change.

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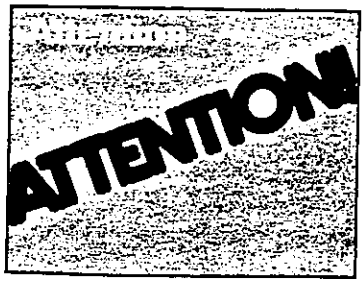

Route To:

- ☒ Manager, Muni. Dept.
- ☒ Underwriting
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Rule G-33

Notice on Recently Effective Changes in Calculations Rule

The Board has recently received a number of inquiries from members of the municipal securities industry and others concerning certain of the provisions of rule G-33 on calculations. In particular, such persons have inquired concerning the acceptability under the rule of the practice of interpolation as a method of determining dollar price from yield. Such persons have also asked whether the rule permits a dealer effecting a transaction at a yield price equal to the interest rate on the securities to presume that the dollar price on the transaction is "100."

The Board wishes to remind members of the industry that both of these practices are no longer permissible. Board rule G-33 generally requires that yields and dollar prices on transactions effected by municipal securities brokers and dealers be computed in accordance with the formulas prescribed in the rule directly to the settlement date of the transaction. Subparagraph (b)(i)(C) of the rule permitted, *until January 1, 1984*, the use of the dollar price "100" as the presumed result on transactions in securities with a redemption value of par effected at a yield price equal to the interest rate on the securities. Subparagraph (b)(i)(D) of the rule permitted, *until January 1, 1984*, the use of interpolation as a method of deriving a dollar price. Since the effectiveness of both of these provisions lapsed as of January 1, 1984, therefore, these practices are no longer in compliance with the requirements of the rule; dollar prices on all transactions effected on a yield basis (including transactions effected on a yield basis equal to the interest rate) should therefore be computed directly to the settlement date of the transaction.

The Board notes that the rule continues to permit a municipal securities broker or dealer to effect a transaction in dollar price terms. Therefore, a dealer wishing to offer or sell a security at par may continue to effect the transaction on a direct dollar price basis at a price of "100."

May 31, 1984

Questions concerning this notice or the provisions of rule G-33 generally should be directed to Donald F. Donahue, Deputy Executive Director.

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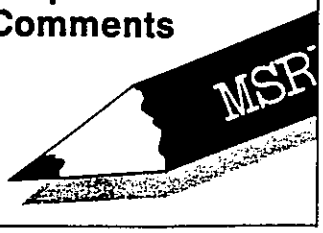
Request For Comments



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Rule G-34

Comments Requested on Draft Amendments Requiring CUSIP Number Reassignment on Issues Subject to Advance Refunding or Secondary Market Enhancement

The Board is circulating for public comment a draft amendment to the provisions of Board rule G-34 regarding the assignment of CUSIP numbers to issues of municipal securities. The draft amendment would require municipal securities brokers and municipal securities dealers to arrange for the reassignment of CUSIP numbers in circumstances where such numbers no longer designate a single, fully fungible issue of securities as a result of actions taken by the broker or dealer. The draft amendment is being circulated for the purpose of eliciting comment prior to further consideration by the Board and filing with the Securities and Exchange Commission.

Board rule G-34 requires that municipal securities brokers or dealers underwriting or participating in the placement of a new issue of municipal securities must apply for the assignment of CUSIP numbers to the new issue, if it is eligible for CUSIP number assignment, and must arrange for the affixing of the numbers to the securities certificates of the new issue once the numbers are assigned. The rule is intended to further the goals of the CUSIP numbering system—facilitating the identification of securities issues through the assignment of a unique alphanumeric security number to each discrete, fungible issue of securities—by providing for the inclusion in the CUSIP numbering system of all eligible issues of municipal securities. The rule also promotes the use of the CUSIP number as a securities identification device by ensuring, through the affixing of assigned numbers to all issues, that the number is readily available for use throughout the securities handling process.

The Board is aware that certain events may occur after the underwriting of a particular new issue of municipal securities which affect the integrity of the CUSIP numbers assigned to the issue and may prevent the use of these numbers to uniquely identify securities of the issue. For example, the Board is aware that municipal securities issues have been advance refunded in such a way that portions of what was once a single, fully fungible issue or maturity with a single assigned CUSIP number are refunded to different redemption dates and prices, with securities of these different portions of the issue or the maturity thereby becoming no longer fungible.[1] Further, in recent months programs have been made available for the purchase of bond insurance on a portion of an issue or a maturity, or for the sale of a portion of an issue or a maturity, or for the sale of a portion of an issue or a maturity subject to a put option or tender option written by a person other than the issuer or an agent of the issuer; securities with this insurance or sold with such a put option or tender option attached are similarly no longer fungible with other securities of the same issue or maturity which are uninsured (or insured by a different party) or traded without the option attached. In all of these cases these actions (the advance refunding, the purchase of bond insurance, or the attachment of the put option) have created a distinction in a previously fungible issue of securities which causes the previously assigned CUSIP number no longer to uniquely identify a single, fully fungible issue. The Board is of the view that, given this result, it may be necessary to make provision for the reassignment of the CUSIP numbers to reflect these new distinctions.

Accordingly, the Board proposes to amend rule G-34 to require municipal securities brokers and dealers taking actions which would have such a result to arrange for the reassignment of CUSIP numbers to the issue and for the correction of the numbers previously imprinted on the issue through the use of stickers, silver-leaf corrections or other similar means. The Board believes that such a requirement will help to ensure that necessary corrections are made in a timely fashion, and that the CUSIP numbering system continues to serve the purpose of uniquely identifying fully fungible issues of municipal securities.

May 31, 1984

Comments on the draft amendment should be submitted no later than August 1, 1984, and should be directed to Donald F. Donahue, Deputy Executive Director. Written comments will be available for public inspection.

[1]Such issues have most typically been advance refunded by issue "purpose" (*i.e.*, the designation of the original use of the issue's proceeds), although certain issues have been advance refunded by specific certificate number.

Text of Draft Amendments*

Rule G-34. CUSIP Numbers

(a) New Issue Securities.

(i) Assignment of Numbers.

(A) [present paragraph (a)(i) of the rule; no substantive change.]

(B) [present paragraph (a)(ii) of the rule; no substantive change.]

(C) [present paragraph (a)(iii) of the rule; no substantive change.]

(D) In the event that the proceeds of the new issue will be used, in whole or in part, to refund an outstanding issue or issues of municipal securities in such a way that a part of the outstanding issue or issues previously assigned a single CUSIP number is to be refunded to more than one redemption date and price, the municipal securities broker or municipal securities dealer shall provide to the Board or its designee the following information on the issue or issues to be refunded:

(1) the previously assigned CUSIP number of each such part;

(2) for each such CUSIP number, the redemption dates and prices to be established by the refunding;

(3) for each such redemption date and price, a designation of the portion of such part (*e.g.*, the designation of use of proceeds, series, or certificate numbers) to which such redemption date and price applies.

The municipal securities broker or dealer shall also provide documentation supporting the information provided pursuant to the requirements of this subparagraph (D).

(ii) Number Affixture. [present section (b) of the rule; no substantive change.]

(iii) Underwriting Syndicates. [present section (c) of the rule; no substantive change.]

(b) Secondary Market Securities.

(i) Reassignment of Numbers.

(A) Except as otherwise provided in this paragraph (i), each municipal securities broker or municipal securities dealer who, in connection with a sale or an offering for sale of part, but not all, of an outstanding maturity of an issue of municipal securities, acquires or arranges for the acquisition of a transferrable instrument applicable to such part which alters the security or source of payment of such part shall apply in writing to the Board or its designee for the reassignment of a CUSIP number to the part of the outstanding maturity of the issue which is the subject of the instrument. Such instruments shall include (1) insurance with respect to the payment of debt service on such portion, (2) a put option or tender option, (3) a letter of credit or guarantee, or (4) any other similar device.

(B) The municipal securities broker or municipal securities dealer shall make the application required under this paragraph (i) as promptly as possible, and shall provide to the Board or its designee information sufficient to identify the previously assigned CUSIP number and to describe the nature of the instrument acquired, including the name of any party obligated with respect to debt service under the terms of such instrument. The municipal securities broker or municipal securities dealer shall also provide documentation sufficient to evidence the need for number reassignment and nature of the instrument acquired.

(C) The provisions of this paragraph (i) shall not apply with respect to any part of an outstanding maturity of an issue of municipal securities with respect to which a reassigned CUSIP number that is applicable to such part has already been issued.

(ii) Number Affixture. Each municipal securities broker or municipal securities dealer who applies for the reassignment of a CUSIP number to part of an outstanding issue of municipal securities shall, prior to the delivery of securities of such part of the outstanding issue to any other person, affix to, or arrange to have affixed to the certificates of such securities the CUSIP number reassigned to such part of the outstanding issue. The reassigned number shall be affixed to the securities certificates in a way that obliterates, covers over, or otherwise deletes the previously assigned CUSIP number.

(c) Eligibility. [present section (d) of the rule; no substantive change.]

*Underlining indicates additions; brackets indicate editorial comment.

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Letters of Interpretation

Rule G-17—Transactions in Stripped Bonds and Stripped Coupons

I am writing in connection with our recent conversation concerning municipal bonds which have been stripped of their coupons and are offered for sale in this form. In our conversation you indicated that you have recently become aware of other municipal securities dealers' offering securities in this form for purchase by investors or other municipal securities professionals. You also advised that the offering dealers have not, to your knowledge, advised such persons that any gain received from such a "stripped" bond may be taxable to the holder as ordinary income, but, rather, have represented such gain to be tax-exempt. You asked whether dealers offering such securities in this fashion would be acting in violation of Board rules; you also inquired as to the general obligations of a dealer selling "stripped" coupons or a "stripped" bond to disclose information concerning the tax treatment of such instruments.

It is my understanding that any gain derived from the sale of coupons stripped from a municipal bond or from the sale of a bond stripped of its coupon generally is considered by the Internal Revenue Service to be taxable to the recipient of the gain. Provisions of the Internal Revenue Code specifically address the treatment of a transaction in a "stripped" bond, and provide that gain in excess of the allocated cost basis of such bond is taxable at ordinary income or capital gains rates. Although the treatment of "stripped" coupons is not as clear, certain I.R.S. rulings state clearly that any gain received from a disposition of such coupons is not considered tax-exempt interest.

As I indicated in our conversation, the general "fair dealing" provisions of rule G-17 appear applicable to the situation you described. Rule G-17, as you know, requires that

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

Although the Board does not express a view on the appropriate tax treatment of particular transactions, given our understanding of the position taken by the I.R.S. with respect to these types of transactions it appears that a dealer representing to a customer that any gain subsequently received by the customer on a "stripped" bond offered for sale to the customer by the dealer would be tax-exempt would be acting in violation of these provisions of rule G-17.

Further, in view of the fact that the tax-exempt nature of a municipal instrument is a highly material consideration in the investment decisions of most persons investing in municipal securities, there appears to be an additional obligation that the dealer advise the customer of the potential adverse tax consequences of a transaction in a "stripped" bond or "stripped" coupons. Therefore, a dealer offering to sell to a customer a municipal bond that has been stripped of its coupons, or the coupons stripped from a bond, without advising the customer that any gain or income received from the subsequent disposition of the "stripped" bond or the "stripped" coupons may be taxable to the customer would also appear to be acting in violation of the provisions of rule G-17 and the antifraud provisions of the federal securities laws. The provisions of rule G-17 would also appear applicable to a dealer who induces or attempts to induce a holder of a municipal security to sell a "stripped" coupon or a "stripped" bond without advising such person of the possible adverse tax consequences of this action.—*MSRB interpretation of January 4, 1984, by Donald F. Donahue, Deputy Executive Director.*

Rule G-23—Issuer Consent to Financial Advisor Participation in Underwriting

This reponds to your letter of March 6, 1984, regarding the application of rule G-23, concerning the activities of financial advisors, to the following activities of [name deleted] (the "Company").

Your letter states that the Company serves as a financial advisor to a number of municipal entities with respect to the issuance and delivery of bonds. In the majority of circumstances in which bonds are to be marketed through a competitive bidding process, the Company is requested by the issuer either to bid for the bonds independently for its own account or as a participant with others in a syndicate organized to submit a bid. You state that the Company's customary financial advisory contract, in almost all instances, specifically reserves to the Company the right to bid independently or in a syndicate with others for any bonds marketed through a competitive bid.

However, to further accommodate these circumstances, you state that it is the Company's practice to include in the official statement on any bond issue subject to competitive bids specific language, such as:

> The Company is employed as Financial Advisor to the City in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds. The Company may submit a bid for the Bonds, either independently or as a member of a syndicate organized to submit a bid for the Bonds.

In the notice of sale, the following language is included:

> The Company, the City's Financial Advisor, reserves the right to bid on the Bonds.

You add that these two documents, the official statement and the notice of sale, must be approved by formal resolution of the governing authority of the issuer, such as a city council or a board of directors, before bids are requested or on the date of sale. You ask whether the above language printed in the official statement and the notice of sale, which is approved by formal resolution of the governing authority of the issuer, constitutes compliance with rule G-23(d)(ii).

Rule G-23, concerning the activities of financial advisors, is designed to minimize the *prima facie* conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue. Specifically, rule G-23(d)(ii) provides that a municipal securities dealer which is acting as a financial advisor may not acquire or participate in the distribution of a new issue unless,

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

Compliance with the rule's requirement that an issuer expressly consent in writing to the financial advisor's participation in the underwriting cannot be inferred from its approval of the official statement and notice of sale. These documents are designed primarily to describe the new issue and a passing reference to the advisor's possible participation in the underwriting of the bond issue cannot be construed as express approval of such activity since it is not clear that the issuer is provided with a sufficient opportunity to determine whether it is in its best interests to allow its financial advisor to participate in the competitive bidding.

While the Board does not mandate the form of the issuer's consent, it understands that financial advisory contracts often may include consent language applicable to a specific new issue. Alternatively, financial advisors may obtain the consent of an issuer by means of a separate document. However, a financial advisory contract that reserves to the financial advisor the right to bid for any of the issuer's bonds marketed through a competitive bid does not satisfy the requirements of rule G-23(d)(ii). The Board has stated that such "blanket consents" do not afford an issuer a sufficient opportunity to consider whether, under the particular circumstances of an offering, the financial advisor's potential conflict of interest is sufficient to warrant not consenting to the financial advisor's participation in the sale.—*MSRB interpretation of April 10, 1984 by Diane G. Klinke, Deputy General Counsel.*