MSRB REPORTS

Volume 4, Number 6 | Municipal Securities Rulemaking Board | November 1984

In This Issue

Robinson Elected Chairman, Williams Vice Chairman—1984–1985

Donald J. Robinson, a partner in the New York City bond law firm of Hawkins, Delafield & Wood, has been elected Chairman by the Board to a one-year term beginning October 1, 1984. Mr. Robinson joined Hawkins, Delafield & Wood in 1969 and has served as bond counsel to municipal securities issuers and counsel to underwriters of municipal securities.

Everett D. Williams, a partner in the San Francisco municipal securities firm of Stone & Youngberg, has been elected by the Board to a one-year term as Vice Chairman. Presently a member of the Stone & Youngberg's Executive Committee, Mr. Williams joined the firm in 1956 and has been a partner since 1960.

Important Announcement

MSRB Offices will move soon.
Watch for notice of new address and date of move.

Also in this Issue

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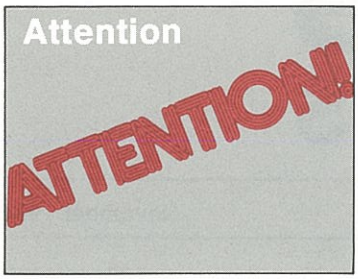

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Examination Schedule Temporarily Changed

From November 19 through November 23, 1984, no PLATO testing will be available, the NASD has announced. Candidates who have enrolled to take an examination for qualification as a municipal securities representative, municipal securities sales principal, or municipal securities principal[1] and who may have planned to make an appointment to sit for the examination on any of those days in mid-November should keep in mind this temporary change in the testing schedule. Candidates, whose enrollments on the PLATO system were scheduled to expire during the period from November 19, 1984 through December 14, 1984, have had their expiration dates extended to December 31, 1984.

This temporary suspension of testing is necessary in order to install modified software in the NASD's test delivery system and was scheduled to coincide with the annual Thanksgiving closing of Control Data Learning Centers.

October 19, 1984

*Test Series 52, Test Series 8, and Test Series 53.

Questions concerning this temporary testing suspension or any other aspect of the Board's qualification program may be directed to Peter H. Murray, Assistant Executive Director, or Doris N. Celarier.

Calendar

September 19—Effective date of amendment to G-5 on early warning notices

October 31—Effective date of amendment to G-15 on transactions in zero coupon, compound interest, and multiplier securities

November 15—Comments due on draft amendment to G-12 on attachment of interest payment checks to registered securities deliveries

February 1—Effective date of amendment to G-12(f)(ii) and G-15(d)(iii) on automated comparison, clearance and settlement; concurrent effective dates for amendment to G-12(f)(ii) and G-15(d)(iii) on indirect participants on temporary exemption of project notes

Pending—SEC approval of amendments to:

- G-12 on delay of sunset date for the extension of close-out procedures for bonds in transfer
- G-32, G-8, and G-9 on disclosures on new issues and recordkeeping

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FROM THE CHAIRMAN

The MSRB is starting its tenth year at a time when the industry is coping with some of the most dramatic changes since its creation. The imposition of the registration requirement by Congress, the implementation of automated clearance and settlement procedures, the wave of credit enhancements and new instruments, and the numerous changes in the tax code have provided little time for reflection on how these forces will shape the industry in the future. What must not be allowed to deteriorate in this period is the communication between the dealer community and the MSRB. Good communication is essential for good self-regulation.

Throughout discussions at Board meetings this past year Board members expressed their strong desire to hear from the industry how a proposal would affect them, what industry practice was under certain conditions, and what role the industry expected the Board to play in the face of change. Board members receive and review all letters and summaries of all telephone calls with the Board staff which deal with Board interpretations to ascertain what the concerns and problems of the industry are. Board members pay close attention to these communications. However, we are concerned that not all views have been presented. We need to hear from firms of all types and sizes and from all locations. To improve our communication with the industry, we are stepping up the number of dealer meetings around the country to listen to your views. We need your cooperation in this task.

People have sometimes remarked that they do not write comment letters to the Board because the Board ignores them. To the contrary, all comment letters sent to the Board are reviewed and discussed by the members at Board meetings. If, and when, amendments are made to the rules, the Board must address these same points in its filings with the SEC. Comment letters, therefore, have a special place in the rulemaking process.

Please take the time to read *MSRB Reports* and let the MSRB know your views. Al Blaylock, MSRB Chairman 1980-81, wrote in one of the early issues about the rulemaking process and the need for industry watchfulness of it. His words should be heeded by us all when he said,

> More than ever, this watchfulness is going to be needed in the coming years. Tolerant annoyance must not be allowed to drift into bored somnolence. After all it is still your industry.

In conclusion, to use Clara Peller's famous phrase, we need you to tell us, "Where's the beef?" We know we can rely on you to tell us.

Donald J. Robinson
Partner
Hawkins, Delafield & Wood
MSRB Chairman
1984-85

Board Members 1984-85

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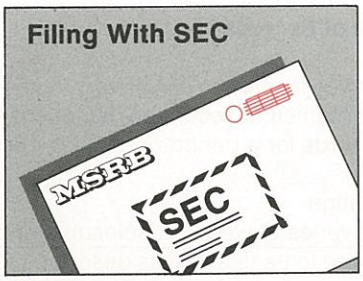

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Disclosures on New Issues: Rules G-32, G-8, and G-9

Principal Changes Proposed

The proposed amendments require that—

- **official statements be delivered automatically to brokers, dealers, and municipal securities dealers who purchase new issue municipal securities and**
- **a record be kept of all deliveries of official statements made pursuant to the requirements of rule G-32.**

Introduction

On October 23, 1984, the Board filed with the Securities and Exchange Commission amendments to rule G-32 on disclosures in connection with new issues and to rules G-8 and G-9 on recordkeeping. The amendments were adopted in response to comments that rule G-32 was not being complied with and are designed to strengthen and facilitate enforcement of the rule. The Board published for comment draft amendments in March[1] and June[2] 1984. After considering the comments received on these exposure drafts, the Board adopted the amendments described below. The amendments will become effective 30 days after their approval by the Commission.

Background

Rule G-32 currently 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.[3] 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.

Amendments to Rule G-32

The Board has determined that the requirements of rule G-32 should be retained and strengthened. The Board believes that the official statement is the single most important disclosure document for an investor in new issue municipal securities for it provides an investor with information necessary to making an informed investment decision. To facilitate the dissemination of official statements to purchasers of new issue municipal securities, the Board has amended rule G-32 to require that all brokers, dealers, and municipal securities dealers who purchase new issue securities automatically be provided with the rule G-32 disclosures at or prior to the time the money confirmation of the transaction is sent. The Board has concluded that the current "on request" provision has resulted in undue delays in the delivery of rule G-32 disclosures to purchasers of new issue securities.

In addition, the Board wishes to remind managing underwriters of their role in assuring that official statements are available in time to be sent out with money confirmations. The Board urges managers who have an opportunity to set a settlement date with issuers to take into consideration the amount of time needed to print and disseminate official statements. Financial advisors to issuers of new issue municipal securities also should advise issuers to be conscious of these considerations in determining a settlement date with underwriters. The Board believes that underwriters would realize significant cost savings if they obtain final official statements prior to sending money confirmations since they would avoid having to send out both the preliminary and final versions.

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

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

[2] *MSRB Reports*, vol. 4, no. 4 (June 1984).

[3] 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.

Amendments to Rules G-8 and G-9

Rules G-8 and G-9 set forth the recordkeeping and record retention requirements respectively for brokers, dealers, and municipal securities dealers. The Board has added a new section to rule G-8 requiring a dealer to maintain a record of deliveries of rule G-32 disclosures and has amended rule G-9 to require that these records be retained for a period of not less than three years. The primary purpose of the proposed 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; these amendments were strongly supported by the commenting regulatory agencies. The recordkeeping requirements also are designed to encourage dealers to institute procedures for delivering the disclosures required under rule G-32.

The Board believes the new recordkeeping provisions are crucial to the vigorous enforcement of rule G-32. It intends to maintain close communications with the enforcement agencies to monitor compliance with the new rule to determine whether further amendments to rule G-32 are necessary.

October 23, 1984

Text of Proposed 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 (xii) No change.

(xiii) Records Concerning Deliveries of Official Statements. A record of all deliveries of official statements or other disclosures concerning the underwriting arrangements (other than a notice or document prepared by the issuer or an agent of the issuer) required under rule G-32.

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) through (ix) No change.

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

(c) through (g) No change.

Rule G-32. Disclosures in Connection with New Issues

(a) 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, broker, dealer or municipal securities dealer, unless, at or prior to sending a final written confirmation of the transaction to the customer, broker, dealer or municipal securities dealer, indicating money amount due, such municipal securities broker or municipal securities dealer sends to the customer:

(i) and (ii) No change.

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. Every municipal securities broker or municipal securities dealer shall promptly furnish the documents and information referred to in this section (a) to any broker, dealer or municipal securities dealer to which it sells new issue municipal securities, upon the request of such broker, dealer or municipal securities dealer.

(b) No change.

*Underlining indicates new language; broken rule through text indicates deletions.

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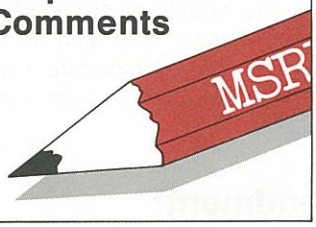
Request For Comments



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Deliveries of Registered Securities—Attachment of Interest Payment Checks: Rule G-12

Principal Change Considered

The draft amendment proposes to require that an interest payment check be attached to a delivery of registered securities made on or after the record date for the securities and not to deliveries made prior to that time.

Action: Send comments

The Board is circulating for public comment a draft amendment to the provisions of Board rule G-12 regarding the attachment of interest payment checks on deliveries of registered securities. The draft amendment would provide greater clarity in the rule by specifying a specific time prior to the record date after which such interest payment checks must be attached. 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-12(e)(xiv)(G) provides with respect to inter-dealer deliveries as follows:

> If a registered security is traded "and interest" and transfer of record ownership cannot be 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.

Rule G-12(e)(xiv)(H) contains similar provisions with respect to inter-dealer deliveries of defaulted securities on which an interest payment is to be made.

In recent months the Board has received numerous inquiries from municipal securities brokers and dealers concerning these requirements. In particular, these persons have sought further guidance concerning the application of these requirements to deliveries of securities made on or during the several days immediately prior to the record date for the securities. These inquiries have indicated to the Board that municipal securities brokers and dealers are interpreting these provisions in a variety of ways. Certain dealers, aware that transfer agents generally process transfer items submitted on or immediately before the record date on an expedited basis, attach interest payment checks only to deliveries of registered securities made after the record date for the securities, reasoning that "transfer of record ownership can . . . be accomplished" on any deliveries made on or prior to the record date.[1] Other dealers attach interest payment checks to any deliveries of registered securities made after three business days prior to the record date on the securities, in recognition of the three-day transfer turnaround requirements under Securities and Exchange Commission rule 17Ad-2. Certain dealers also distinguish between issues handled by a professional transfer agent and those handled by a non-professional agent (e.g., the issuer itself), insisting that interest payment checks be provided at a much earlier time on the latter type of issue, due to anticipated inefficiencies in the transfer process for such securities. These differences in practice have caused frequent disputes among dealers as to whether interest payment checks should be attached to deliveries made just prior to the record date of the securities; in view of these disputes the Board believes that further standardization in this area would be appropriate.

Accordingly, the Board proposes to amend rules G-12(e)(xiv)(G) and (H) to provide that the requirement for the attachment of an interest payment check to a delivery of registered securities shall apply to any delivery made *on or after* the record date for the securities. Deliveries made prior to the record date would not be required, under these rules, to be accompanied by an interest payment check; in circumstances where the securities delivered cannot be transferred by the record date, the receiving dealer would be obliged to file a claim for payment of the interest owed.

The Board believes that the draft amendment provides the most satisfactory solution to the difficulties caused by the lack of clarity in the present rules. The Board recognizes that there will be a number of cases in which securities delivered without an accompanying interest payment check

Comments on the draft amendment should be submitted not later than December 1, 1984, and may be directed to Donald F. Donahue, Deputy Executive Director.

[1]Some of these dealers make a distinction between securities transferred by local transfer agents and those transferred by "out-of-town" transfer agents, and attach interest payment checks to deliveries of the latter type of securities made on the record date (since the receiving dealer would be unable to submit these securities for transfer on the same day).

(in accordance with the standard proposed in the draft amendment) cannot be transferred by the record date. Nonetheless, the Board believes that in the majority of instances deliveries made prior to the record date can be submitted to the transfer agent in time to accomplish transfer prior to the determination of registered holders made on the record date. On balance, therefore, it appears preferable not to require that such deliveries be accompanied by interest payment checks.

In addition to comments on the proposal set forth in the draft amendment, the Board would also welcome comments on the following issues:

1. Is an alternative date preferable?

For the reasons stated above the Board believes that a requirement for the attachment of interest payment checks as of the record date is the most desirable way to clarify the rules. The Board would, however, welcome suggestions from the municipal securities industry on alternative dates which should be considered.

2. To what extent do transfer agent practices conflict with the standard specified in the draft amendment?

The Board understands that in certain instances the practices followed by transfer agents may cause problems if a particular date is specified in the rule.[2] The Board would welcome comments concerning such practices. The Board would also welcome comments concerning possible problems with the draft amendment resulting from any distinctions between registered and non-registered transfer agents.

3. Should the rule provide a procedure for the handling of interest payment claims?

As noted previously, if a dealer receiving a delivery without an accompanying interest payment check is unable to complete the transfer of the securities by the record date, the dealer will have to follow an interest claim procedure in order to obtain the interest due to him. To date dealers have followed informal claim procedures, and the Board has received some complaints of inefficient handling of such claims. The Board would welcome comment concerning whether it would be helpful to the industry to provide for a formal claim procedure in the Board's rules, and, to the extent commentators believe that such a procedure would be helpful, concerning the appropriate form of such a procedure.

Text of Draft Amendment*

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 (xiii) No change.

(xiv) Delivery of Registered Securities

(A) through (F) No change.

(G) Payment of Interest. If a registered security is traded "and interest," a delivery of such security made on or after the record date for the determination of registered holders for the payment of interest 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.

(H) Registered Securities in Default. If a registered security is in default (*i.e.* is in default in the payment of principal or interest) and a date for payment of interest due has been established, a delivery of such security made on or after the date established as the record date for the determination of registered holders for the payment of interest 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."

(xv) and (xvi) No change.

(f) through (l) No change.

[2]For example, the Board has been advised that certain transfer agents charge additional fees for the handling of a transfer request on an expedited basis.

*Underscoring indicates new language.

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Notice of Approval

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Early Warning Notice: Rule G-5

Principal Change

The amendment authorizes the NASD to require a municipal securities dealer which is an NASD member in financial or operational difficulty to take remedial actions to address these problems.

Introduction

On September 19, 1984, the Securities and Exchange Commission approved the Board's amendment to rule G-5 that would subject municipal securities brokers and dealers that 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 amendment became 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 applies to all NASD members except those members that 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 that are NASD members.[3]

The Board notes that the rule applies 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 "integrated"

Questions concerning this amendment may be directed to Diane G. Klinke, Deputy 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 does not apply to bank dealers. The Board understands that bank regulatory agencies exercise early warning oversight over bank dealers.

firms that have a corporate and a municipal securities business. The Board further believes that these benefits will be even greater now that the rule is applied to all municipal securities brokers and dealers. 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 will 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 in the near future; for that reason, this amendment 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.

October 2, 1984

Text of 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.

*Underlining indicates new language; broken rule through text indicates deletions.

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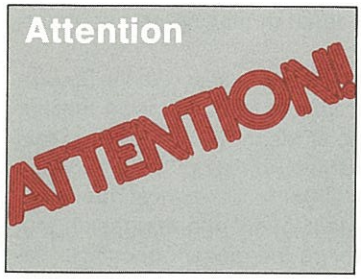

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Report on Pricing: Republication of 1980 Guidelines

In September 1980, the Board issued a report on the establishment of pricing guidelines under rule G-30 on prices and commissions. At that time the Board discussed the relevant factors in determining the fairness of prices and specifically declined to adopt pricing guidelines. The Board is reprinting its Report on Pricing in response to inquiries indicating confusion whether there are pricing guidelines in effect for the municipal securities industry.

October 3, 1984

Report on Pricing

Rule G-30 requires municipal securities professionals to effect transactions with customers at fair and reasonable prices. In a notice dated January 4, 1980, the Board indicated its concern that additional guidance under the rule might be necessary and suggested that one possible course would be to develop specific numeric guidelines. The Board solicited the views of interested parties in the Notice regarding the desirability of taking such a course. As a point of departure for discussion, a "band" of 1 point to 2½ points was put forth as a possible guideline.

In addition to soliciting written comments, the Board also held several open meetings at which prepared statements were presented, and the Board discussed the subject directly with the audiences. These open meetings were held at the Dealer Bank Association Annual Meeting in Rancho Mirage, California (January 31), New York City (March 12), Kansas City, Missouri (April 14), and Seattle, Washington (July 16).

After considering the comments of the industry and other interested persons in response to the Notice, the Board is of the view that setting specific numeric guidelines would not be feasible, in view of the heterogeneous nature of municipal securities transactions and municipal securities dealers. The Board believes that its goal in rule G-30 of promoting customer protection in the pricing area can be achieved through other means. The actions which the Board intends to take are set forth below.

The Board believes that the comment process has served several worthwhile purposes. First, the Notice resulted in focusing the attention of the industry on the matter of pricing practices. The Board is of the view that one salutary effect of this has been to increase the sensitivity of individual municipal securities dealers to this important issue. Second, the comments of the industry served to identify and highlight various factors which may be relevant in making pricing determinations. Third, the comments provided important insights into pricing practices of the industry which should increase the understanding of the regulatory agencies and thereby prove valuable to them in conducting examinations. Finally, the comments were important in helping the Board decide on the actions it would take in the pricing area.

Comments on Pricing Proposal

The Board was extremely gratified by the extent of the response to the Notice. The Board received over 100 comment letters from different types of municipal securities dealers and from all sections of the country, as well as from other regulatory bodies and industry trade organizations. The comment letters in general reflected substantial deliberation and great care in preparation. In addition, commentators at the open meetings and at other meetings provided valuable input to the Board on this subject. The Board wishes to take this opportunity to express its appreciation to all of these commentators.

Most of the commentators expressed opposition to the idea of developing specific numeric guidelines. They suggested that such guidelines would be impractical, inappropriate and unworkable in light of the heterogeneous nature of the municipal markets. In this regard, the commentators emphasized the many differences in the types of municipal securities transactions, the size of transactions, the quality and maturities of municipal securities, the nature of the services provided by municipal securities dealers and the pricing practices of municipal securities dealers in different areas. Many commentators also suggested that specific numeric guidelines would either be too restrictive and thus adversely affect the market for certain types of securities (*e.g.*, local non-rated issues), or be too liberal and thus encourage prices higher than those which would result from the operation of market forces.

Although the majority of the commentators expressed opposition to the establishment of guidelines, several commentators expressed support for them. They suggested that guidelines were necessary to provide municipal securities professionals and the regulatory agencies with greater certainty as to what constitutes a "fair and reasonable" price

Questions concerning this report may be directed to Angela Desmond, General Counsel.

under rule G-30. Certain commentators endorsed the concept of pricing guidelines as a means of ensuring equal regulation of all participants in the municipal markets.

Several commentators expressed support for the concept of guidelines, but suggested that the Board should adopt different benchmarks or separate sets of benchmarks for different size transactions or types of securities.[1] Others suggested that the benchmarks should be limited to "riskless" transactions, contemporaneous transactions, or both.

Many commentators acknowledged that there may be a need to augment rule G-30, but opposed the development of pricing guidelines. These commentators suggested a variety of alternative approaches, several of which the Board intends to pursue.

As indicated above, the Board believes that the comment process was of value because, among other reasons, it provided important insights into the pricing practices of the industry which should increase the understanding of the regulatory agencies and prove valuable to them in conducting examinations. In this connection, the Board intends to provide to the regulatory agencies copies of all the written comments and the transcripts of the open meetings. The Board will also provide copies of these materials to any other interested parties, upon request.

Relevant Factors in Determining the Fairness of Prices

Rule G-30 requires municipal securities professionals to charge customers fair and reasonable prices, taking into account all relevant factors, including several specifically enumerated in the rule. The factors cited in the rule are "the best judgment of the [municipal securities professional] as to the fair market value of the securities at the time of the transaction . . ., the expense involved in effecting the transaction, the fact that the [municipal securities professional] is entitled to a profit, and the total dollar amount of the transaction." In addition, the Board has identified and discussed in notices on rule G-30 a number of other factors which might be relevant in determining the fairness and reasonableness of prices in municipal securities transactions. These factors include the availability of the security in the market, the price or yield of the security, the maturity of the security, and the nature of the professional's business. *See* notices dated September 20, 1977 and October 28, 1978.

Of the many possible relevant factors, the Board continues to be firmly of the view that the resulting yield to a customer is the most important one in determining the fairness and reasonableness of price in any given transaction. Such yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market. This point was stressed in the Notice.

In the Notice, the Board specifically requested comment from the industry on the relevance of the factors previously identified by the Board, and solicited suggestions of other possible factors to be considered in making pricing determinations.

Many commentators expressed agreement with the Board's position that yield is of paramount importance in making pricing determinations, some of them even suggesting that it should be the only test. They emphasized the importance of comparing yields in view of the fact that most municipal securities are traded on a yield basis and suggested that focusing on yield, rather than on the amount of compensation, is appropriate.[2]

Other factors noted by commentators included the rating of the securities involved in a transaction, the fact that there may be an active sinking fund for the securities, and the trading history. This last factor could encompass such matters as the degree of market activity for the securities and the existence or non-existence of market-makers in the securities.

The single factor which was cited most often by commentators concerned the right of municipal securities dealers to be compensated for services provided to customers. The general thrust of these comments was that municipal securities dealers often expend considerable time, effort, and money in providing services to a customer, and that this ought to be taken into account in considering the fairness and reasonableness of prices in given transactions. These services may include researching credits, maintaining markets in, and current information about issues previously sold to customers, and other similar activities.

The Board believes that all of the additional factors identified by the commentators and described above may be relevant in making pricing determinations in particular cases.

Planned Board Actions

The Board intends to take several actions in the pricing area. These actions include (1) working with the regulatory agencies to assure that they are familiar with pricing practices in the municipal markets and that examination techniques enable the regulatory agencies to reach appropriate determinations on pricing matters, (2) providing additional guidance in the future to the industry and the regulatory agencies in the pricing area through the issuance of interpretations and other actions and (3) monitoring closely compliance with, and enforcement of, rule G-30.

1. Cooperation with the Regulatory Agencies

One of the major reasons that the Board decided to act in the pricing area was a concern regarding whether rule G-30 was being enforced on a uniform and consistent basis. The regulatory agencies were apparently developing their own standards in the pricing area, and these standards varied from agency to agency. This development was of particular concern to the Board since a primary goal of the Board has been to promote equal regulation of the various segments of the industry.

The Board intends to take several steps to address this concern. In the past, the Board has sponsored and partici-

[1]One common misunderstanding shared by several commentators was that the pricing policy of the National Association of Securities Dealers, Inc. (the "NASD") for corporate securities (the so-called 5% policy) applies to municipal securities transactions. As a general matter, the NASD's rules of fair practice do not apply to municipal securities transactions. Accordingly, the "5% policy" does not apply to municipal securities transactions.

[2]The Board notes that the amendments to rule G-15 on customer confirmations which are scheduled to become effective on December 1, 1980 will significantly expand the yield information made available to customers with respect to their municipal securities transactions. The Board believes that this will assure broad dissemination of yield information on various types of securities, enhance a customer's ability to compare yields among securities, and promote the use of yield information for purposes of price evaluation.

pated in seminars, met with staff and examiners at regional meetings, and reviewed training and examination materials. The Board anticipates continuing these efforts, with special emphasis on the pricing area.

Other contemplated actions by the Board in the interpretive and monitoring areas, which are discussed below, will also help to promote uniform and equal regulation in the pricing area because they will increase the information shared by the regulatory agencies with respect to pricing practices and developments.

2. Providing Additional Guidance

The Board has received numerous inquiries from industry members and the regulatory agencies regarding rule G-30. The nature and volume of these inquiries was one of the reasons that the Board requested industry opinion in this area.

The Board believes that the need for additional guidance has been alleviated through the comment received on the proposed guidelines. The process caused many municipal securities dealers to evaluate their own pricing practices and to discuss the subject among themselves. Further, the comment process resulted in the identification of additional factors which might be relevant in making pricing determinations.

September 26, 1980

The Board will continue to provide guidance in the future through the issuance of interpretations, when appropriate. In the event an inquiry raises an issue of general interest, the Board will issue an interpretive notice addressing the matter.

The Board also intends to discuss with the regulatory agencies the possibility of releasing through the Board, on an anonymous basis, summaries of disciplinary actions taken against municipal securities dealers under rule G-30. The Board believes that such summaries would provide important guidance to the industry in the pricing area, and would also be valuable in promoting equal enforcement of the rule by the various regulatory agencies. The Board notes in this regard that the bank regulatory agencies have recently adopted a policy to disseminate to the public summaries of certain statutory enforcement actions.

3. Monitoring Rule G-30

The Board intends to monitor closely the application and enforcement of rule G-30. One of the principal means will be by reviewing the copies of examination reports furnished to the Board by the regulatory agencies under rule 15Bc7-1. The Board also intends to continue to communicate with the regulatory agencies on an informal basis in order to keep apprised of their experiences with the rule.

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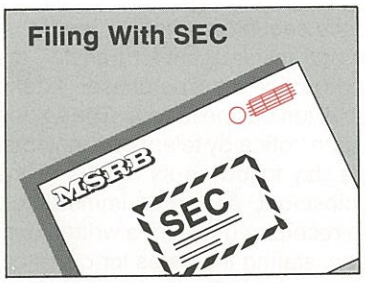

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Close-Out Procedures—Extension for Bonds in Transfer: Rule G-12

Principal Change Proposed

The proposed amendment postpones until January 1, 1986, the sunset date for the time extension provided to recipients of close-out notices on transactions involving securities submitted for transfer.

On October 1, 1984, the Board filed with the Securities and Exchange Commission a proposed amendment to the provisions of Board rule G-12 concerning close-outs of uncompleted transactions. The amendment delays the "sunset" date of an existing provision of the rule pertaining to the time periods applicable to certain close-out procedures. The amendment will not become effective until approval by the Commission.

Board rule G-12(h) prescribes certain procedures to be followed by municipal securities brokers and dealers seeking to close out transactions which have not been completed within a period of time after the settlement date. Among other matters, the rule specifies certain extensions of time which are provided persons receiving notices of close-out in certain circumstances.

In December 1982, in connection with the then-impending effective date of the registration requirements of the Tax Equity and Fiscal Responsibility Act of 1982,[1] the Board adopted an amendment to the close-out provisions to make special provision for delays in the completion of transactions due to the transfer of the securities. This amendment provided an additional extension of time prior to the execution of a close-out to a dealer who received an initial, unretransmitted close-out notice if the securities which were the subject of the notice had been submitted for transfer. The Board adopted this provision due to concern that, during the initial implementation of the registration requirements of TEFRA, the transfer arrangements for registered municipal issues might not be as efficient as possible, and might cause delays in the settlement of trades. The Board anticipated, however, that transfer practices with respect to registered municipal issues would improve over time, as more experience with these procedures was gained; accordingly, the Board included in this amendment a "sunset" provision, so that this transfer extension would not be available on close-out notices issued on or after January 1, 1985.

The Board has from time to time reviewed the state of municipal transfer practices since the effectiveness of the registration requirements of TEFRA. This review has indicated that, while many agents handle municipal transfers expeditiously, other agents have not yet achieved the desired levels of efficiency in processing transfer requests on municipal issues. Industry members have indicated to the Board their view that problems with certain municipal transfer agents continue to cause delays in the clearance and settlement of some transactions. In general, therefore, while transfer practices on municipal new issues appear to have improved, there remain inefficiencies in the processing of some transfer items and, consequently, some transactions are not completed on a timely basis and become subject to possible close-out procedures.

The Board believes that it would be appropriate to continue to provide in the rule for an extension of time in the event the securities involved in a particular close-out procedure have been submitted for transfer. Accordingly, the proposed amendment would amend the rule to delay the "sunset" date for the existing transfer extension provisions to January 1, 1986. It continues to be the Board's intention, however, that this provision be permitted to lapse. The Board anticipates that the provisions of rules G-12(f) and G-15(d) mandating the use of book-entry delivery procedures, which are scheduled to become effective on February 1, 1985, will significantly enhance the efficiency of the clearance of municipal securities transactions, and may make this time extension provision of the close-out rules no longer necessary. The Board also urges members of the municipal securities industry and others to continue their efforts to promote efficiency in the transfer process.

October 5, 1984

Questions concerning the proposed amendment should be directed to Donald F. Donahue, Deputy Executive Director.

[1]The Tax Equity and Fiscal Responsibility Act of 1982 amended section 103 of the Internal Revenue Code to provide that most municipal securities issued after December 31, 1982, would have to be issued solely in registered form in order for the interest paid on the securities to be tax exempt. The effective date of this provision was subsequently delayed to June 30, 1983.

Text of Proposed Amendment*

Rule G-12. Uniform Practice

(a) through (g) No change.

(h) Close-Out. Transactions which have been confirmed or otherwise agreed upon by both parties but which have not been completed may be closed out in accordance with this section, or as otherwise agreed by the parties.

(i) Close-Out by Purchaser. With respect to a transaction which has not been completed by the seller according to its terms and the requirements of this rule, the purchaser may close out the transaction in accordance with the following procedures:

(A) No change.

(B) (1) No change.

(2) Transfer of Securities. If a selling dealer receiving an initial notice of close-out which has not been retransmitted has submitted the securities owed on the transaction to the registrar or transfer agent for transfer, the selling dealer may, upon notice to the purchaser, extend the dates for close-out by ten business days. The selling dealer must provide such notice by telephone, not later than the first business day following its receipt of the telephone notice of close-out, and must immediately thereafter send, return receipt requested, a written confirmation of such notice, stating the dates for close-out as extended due to such notice. The provisions of this item (2) of subparagraph (B) shall not apply to any notice of close-out initiated on or after January 1, 1986 ~~1985.~~

(C) through (G) No change.

(ii) through (iv) No change.

(i) through (l) No change.

*Underlining indicates additions; broken line through text indicates deletions.

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Customer Delivery of Securities in Sale Transactions: Rules G-15 and G-8

Principal Recommendation

The Board—

• determined not to adopt the draft amendments requiring dealers to obtain and to record representations from customers concerning delivery of securities in sale transactions and

• recommends that municipal securities dealers who do not follow procedures similar to those outlined in the sale transactions draft amendments institute procedures to obtain representations from customers concerning delivery of securities in sale transactions.

Action: Institute internal procedures designed to reduce fails-to-deliver

The Board recently considered adoption of amendments to rule G-15 on confirmation, clearance, and settlement of transactions with customers and rule G-8 on recordkeeping that would have required dealers to obtain and to record representations from customers concerning delivery of securities in sale transactions.[1] The NASD has interpreted its fair practice rules to require similar representations. After considering comments received on the exposure draft amendments, the Board has determined not to adopt the draft amendments.

The proposed amendment to rule G-15 would have required 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, corresponded to a similar requirement in rule G-15(d) concerning DVP/RVP transactions. The proposed amendment to rule G-8 which would have required 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, would have facilitated 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 considered 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 procedures similar to those set forth in the draft amendments and, therefore, believes that the adoption of the draft amendments is unnecessary. The Board recommends that municipal securities dealers that do not follow such procedures institute internal policies to obtain representations from customers concerning the delivery of securities in sale transactions.

September 24, 1984

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

[1] *See* Notice Requesting Comments on Draft Amendments Concerning Required Representations on Customer Delivery of Securities in Sale Transactions, *MSRB Reports*, June 1984, pp. 9–10.

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Letter of Interpretation

Rules G-12 and G-15—Confirmation Disclosure: Tender Option Bonds with Adjustable Tender Fees

This is in response to your inquiry concerning the application of the Board's rules to certain tender option bonds with adjustable tender fees issued as part of a recent [name of bond deleted] issue. Apparently, there is some uncertainty as to the interest rate which should be shown on the confirmation, and the appropriate yield disclosure required by rule G-15 with respect to customer confirmations in transactions involving these securities.

The securities in question are tender option bonds with a 2005 maturity which may be tendered during an annual tender period for purchase on an annual purchase date each year until the 2005 maturity date. To retain this tender option for the first year after issuance, the option bond owner must pay a tender fee of $27.50 per $1000 in principal amount of the bonds. Beginning in the second year, however, the tender fee may vary each year and will be in an amount determined by the company granting the option (the "Company"), in its discretion, and approved by the bank which issued a letter of credit securing the obligations of the Company. The tender fee must, however, be in an amount which, in the judgment of the Company based upon consultation with not less than five institutional buyers of short term securities, would under normal market conditions permit the bonds to be remarketed at not less than par. If at any time these fees are not paid, the trustee will pay the fee to the Company on behalf of the owner and deduct that amount from the next interest payment sent to the owner unless the owner tenders the bonds prior to the fee payment date. While a system has been set up to receive payment of these tender fees, we understand that the trustee of the issue is assuming that most of the tender fees will be paid through a deduction from the interest payment.

You have advised us that confirmations of the original syndicate transactions in these securities stated the interest rate on the securities as 7⅛%, which is the current effective rate on the bonds taking into account the tender fees during the first year after issuance (*i.e.*, the 9⅞% rate less the 2⅝% fee) and which, because of the yearly tender fee adjustment, is fixed only for one year. The interest rate shown on the bond certificates, however, is the 9⅞% total rate, and no reference is made to the 7⅛% effective rate. In addition, the bonds are traded on a dollar price basis as fixed-rate securities and are sold as one year tender option bonds (although the 2005 maturity date is disclosed). The yield to the one year tender date is the only yield information currently shown on customer confirmations.

You inquire whether it is proper that the confirmation show the interest rate on these securities as 7⅛% and whether the yield disclosure requirements of rule G-15 are met with the disclosure of the yield to the one year tender date. Your inquiry was referred to the Committee of the Board which has responsibility for interpreting the Board's confirmation rules. The Committee has authorized this reply.

Rules G-12(c)(v)(E) and G-15(a)(i)(E) require that dealer and customer confirmations contain a description of the securities, including, among other things, the interest rate on the bonds. The Committee believes that the stated interest rate on these bonds of 9⅞% should be shown as the interest rate in the securities description on confirmations to reduce the confusion that may arise when the bond certificates are delivered and to ensure that an outdated effective rate is not utilized. In order to fully describe the rate of return on these bonds, however, the Committee believes that immediately after the notation of the 9⅞% rate on the confirmations, the following phrase must be added—"less fee for put." Thus, it will be the responsibility of the selling dealer to determine the current effective rate applicable to these bonds and to disclose this to purchasing dealers and customers at the time of trade.[1]

In regard to yield disclosure, rule G-15(a)(i)(I) requires that the yield to maturity be disclosed because these securities are traded on the basis of a dollar price.[2] It appears, however, that an accurate yield to maturity cannot be calculated for these securities. While it is possible to calculate a yield to maturity using the stated 9⅞% interest rate, this figure might be misleading since the adjustable tender fees would not be taken into account. Similarly, a yield calculated from the current effective rate of return would not be meaningful since it would not reflect subsequent changes in the amounts of the tender fees deducted. In view of these difficulties, the Committee believes that confirmations of these securities need not disclose a "yield to maturity." The Committee is also of the view, however, that dealers must include the yield to the one year tender date on the confirmations as an alternative form of yield disclosure.—*MSRB Interpretation of October 3, 1984, by Diane G. Klinke, Deputy General Counsel.*

[1]We understand that these tender option bonds are the first of a series of similar issues and on subsequent issues of this nature the phrase "Bond subject to the payment of tender fee" will be printed on the bond certificates next to the interest rate. This additional description on the bond certificates, although helpful, is not a substitute for complete confirmation disclosure and this interpretation applies to these subsequent issues as well.

[2]Rule G-15(a)(i)(I) requires that on customer confirmations

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

The Board has determined that, for purposes of making this computation, only "in whole" calls should be used. Thus, for these tender option bonds, the yield to maturity is required to be disclosed.