MSRB REPORTS

Volume 2, Number 7 | Municipal Security Rulemaking Board | October/November 1982

Congress Enacts Legislation Requiring Registration of Municipal Securities Issued After December 31, 1982

For further information refer to the informational notice on page 5 and to the notice concerning proposed amendments to the close-out procedures on page 9.

In This Issue

November—January

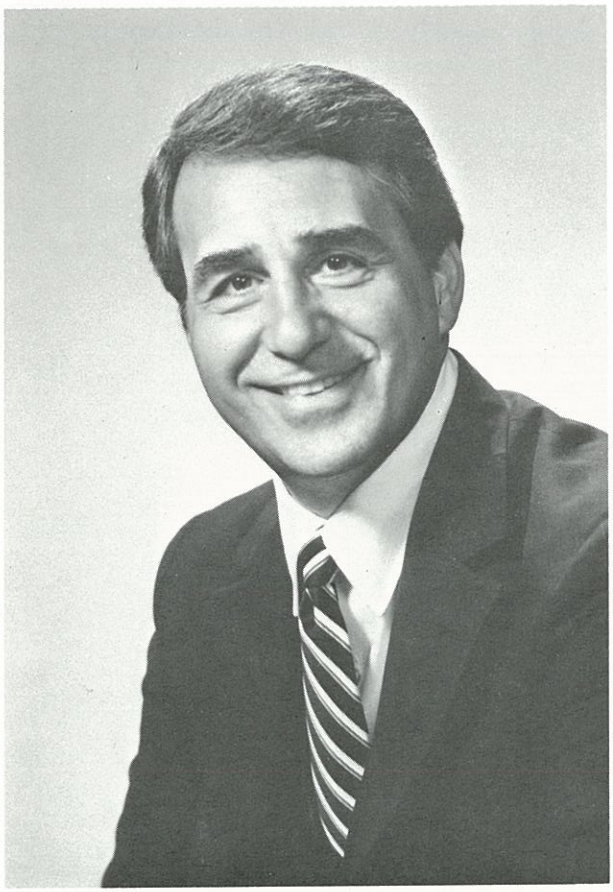
November 19—Comments due regarding
- amendment to rule G-12 on close-out procedures
- rule amendments regarding zero coupon, compound interest, and multiplier securities

January 1—Effective date of federal legislation requiring registration of new issue municipal securities

January 23—Proposed effective date of amendment to rule G-12 requiring specific identification by CUSIP number

Pending—SEC approval of
- rule G-34 on CUSIP numbers
- amendments to rule G-12 (concerning fungibility and specific identification)

Mandolini Elected Chairman for 1982–83



Anthony M. Mandolini

Anthony M. Mandolini, the National Director of Government Services for Peat, Marwick, Mitchell & Co., has been elected by the Board to serve as Chairman for the fiscal year commencing October 1, 1982. Mr. Mandolini is a partner in the Chicago office of Peat Marwick and is involved primarily in the planning, completion and review of major audit and consulting engagements for governmental clients of the firm. Peter Keber, Jr., Vice President, North Carolina National Bank, has been elected to serve as Vice Chairman.

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MSRB REPORTS
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Registration of Municipal Securities

Notice Concerning the Legislation Recently Enacted by Congress

The Board wishes to call the attention of the municipal securities industry, the issuer community and investors in municipal securities to the requirements of the Tax Equity and Fiscal Responsibility Act ("TEFRA"), recently passed by Congress, regarding the registration of new issues of municipal securities. Under certain provisions of TEFRA most municipal securities issued after December 31, 1982 must be issued solely in registered form to preserve their tax-exempt status.[1] Other provisions deny capital gains treatment for municipal securities issued after December 31, 1982 which are required to be registered but are issued in bearer form. The Board believes that these provisions will necessitate significant changes in the practices of all participants in the municipal securities market. The Board strongly urges all affected persons—municipal securities brokers and dealers, issuers, investors, bond counsel, financial advisors, clearing organizations, and others—to consider carefully the impact of these requirements on their activities and to begin planning and implementing any necessary changes to such activities as promptly as possible.

The Board is currently in the process of reviewing its own rules to determine whether any changes to those rules will be necessary in light of the impending registration requirement. The Board has already determined to propose an amendment to the close-out provisions of rule G-12(h) to provide additional time prior to the execution of a close-out if the failure to deliver is the result of a delay in the transfer process; an exposure draft of this amendment will be issued shortly. The Board welcomes industry comments on the application of its rules to transactions in registered municipal securities; a summary of the rules making particular reference to registered municipal securities is appended to this notice.

To assist it in conducting this review, the Board has established a Task Force on Registered Municipal Securities. The Task Force will be chaired by Jean J. Rousseau (Managing Director, Merrill Lynch White Weld Capital Markets Group), immediate past chairman of the Board, and will have as members Alan C. Arnold (Executive Vice President, Howard Weil, Labouisse, and Friedrichs), Lawrence H. Brown (Senior Vice President, The Northern Trust Company), Mary Des Roches (Comptroller-Treasurer of the City of Minneapolis), and Arch W. Roberts (President, Arch W. Roberts & Co.). The Task Force will be asked to study the application of Board rules to transactions in registered securities and to prepare recommendations for the Board's consideration as to appropriate revisions to such rules or possible additional rulemaking. Further, the Board recognizes that there are numerous other issues, not necessarily appropriate subjects for Board rulemaking, that will need to be addressed by industry participants in preparation for the registration requirement. The Board hopes that the Task Force may identify certain of these issues and develop recommended solutions to them that will provide helpful guidance to the participants in the municipal market.

The Task Force plans to hold a meeting in Washington in the near future to which interested parties will be invited to discuss the work of the Task Force and the problems which need to be resolved. This meeting will attempt to assess the likely impact of the registration requirement, to identify those issues of concern to the municipal securities market, and to arrive at some positions on these issues that meet the needs of each of the affected parties. Representatives of various issuer groups, associations representing the dealer and investor communities, interested Federal agencies, and other concerned organizations have been asked to attend the meeting and participate in any ongoing activities of the Task Force. The Board will take steps to ensure that the industry and other interested persons are advised of the results of the Task Force's efforts.

A review of those Board rules with specific application to registered securities is attached to this notice.

October 1, 1982

Comments on the application of the Board's rules to transactions in registered securities or on the work of the Registered Securities Task Force generally may be directed to Jean J. Rousseau, Chairman of the Task Force, at the Board's offices. Questions concerning these matters may be directed to Donald F. Donahue, Deputy Executive Director.

[1]The Act exempts from this registration requirement securities with maturities of one year or less from the issue date, securities which are "not of a type offered to the public," and securities which are sold to non-U.S. nationals and are payable outside the United States.

APPENDIX

Requirements of Board Rules Relating to Registered Securities

Set forth below is a summary of certain Board rules making specific reference to registered municipal securities. Other rules which do not specifically refer to registered securities are, of course, equally applicable to transactions in such securities, unless it is clear that, by their terms, they do not apply.

RECORDKEEPING

Board rule G-8 sets forth certain requirements concerning the records to be made and kept by municipal securities brokers and dealers regarding their municipal securities activities. Rule G-8(a)(i) requires, among other matters, that the records of original entry ("blotters") must indicate that a transaction involves registered securities, if this is the case. Rule G-8(a)(iv)(A) requires dealers to make a record of "municipal securities in transfer." Such record must set forth

> the description and the aggregate par value of the securities, the name in which registered, the name in which the securities are to be registered, the date sent out for transfer, the address to which sent for transfer, former certificate numbers, the date returned from transfer, and new certificate numbers.

UNIFORM PRACTICE

Board rule G-12 sets forth certain provisions regarding practices to be followed by municipal securities brokers and dealers in confirming, clearing, and settling inter-dealer transactions in municipal securities.

A. Confirmations

Rule G-12(c)(vi) requires that inter-dealer confirmations indicate if the securities involved in the transaction are fully registered or registered as to principal. The rule also requires that any unusual certificate denominations to be delivered on a transaction (*i.e.*, denominations other than those permitted under rule G-12(e)(v)) must be specified on the confirmation.

B. Denominations

Rule G-12(e)(v) states that registered securities certificates are in "good delivery" form if they are in denominations of multiples of $1000 par value up to $100,000 par value; for example, if a dealer effects a transaction for $54,000 par value securities, such dealer may deliver a single certificate of $54,000 par value. Certificates in other denominations (*e.g.*, a single certificate representing $500,000 par value securities) may not be delivered unless this is agreed upon at the time of trade and specified on the inter-dealer confirmation.

C. Registered vs. Bearer Form

Rule G-12(e)(vi) states that

> [d]elivery of securities which are issuable in both bearer and registered form shall be in bearer form unless otherwise agreed by the parties.

Therefore, if securities are available solely in registered form (as is the case with mortgage revenue securities issued after 1981 and will be the case for most municipal securities issued after 1982), a delivery of registered securities may *not* be rejected.

D. Delivery of Registered Securities

Rule G-12(e)(xiv) sets forth requirements governing the delivery of registered securities. Subparagraphs (A) through (D) of this provision set forth standards for assignments ("bond powers") provided on securities delivered, covering such matters as signatures on assignments, contents of detached assignments, substitutions, and signature guarantees. Subparagraphs (E) and (F) state standards governing the deliverability of securities registered in the name of specified types of persons (*e.g.*, persons since deceased, corporate entities, trustees or guardians, etc.).[2] Subparagraphs (G) and (H) govern the payment of interest checks on deliveries of registered securities, specifying that deliveries on transactions settling after the record date but prior to the interest payment date (or other deliveries on which the recipient will be unable to have the securities transferred prior to the record date) must be accompanied by a currently-dated check for the amount of interest due.

E. Reclamations

Rule G-12(g)(iii)(A)(4) permits reclamation on an inter-dealer transaction for a period of one business day following the delivery date if registered securities are delivered on a transaction on which bearer securities are due. Since most municipal securities issued after 1982 will be available solely in registered form, this reclamation provision will not be applicable; this is currently the case with mortgage revenue securities issued after 1981.

Rule G-12(g)(iii)(C)(2) permits reclamation on an inter-dealer transaction for a period of eighteen months following the delivery date in the event that the transfer agent refuses to transfer registered securities due to a lack of or inadequacy of the documentation required under rule G-12(e)(xiv).

F. Close-Out

Rule G-12(h) sets forth a procedure for the close-out of an uncompleted transaction by the purchasing dealer. The rule currently does not provide any extension of time or delay of the procedure attributable to the reason for the seller's failure to deliver. The Board has proposed, in an exposure draft released on September 29, 1982, to provide for such an extension of time in the event that the seller has submitted the securities owed on the transaction for transfer.

CUSTOMER CONFIRMATIONS

Rule G-15(c) requires that customer confirmations indicate if the securities involved in the transaction are fully registered or registered as to principal. The rule also requires that, if registered securities certificates in denominations other than denominations which are multiples of $1000 par value up to $100,000 par value are to be delivered on the transaction, the demoninations to be delivered must be specified on the confirmation.

[2]The Board notes that there is no general requirement that securities be registered in "street name" to be deliverable on an inter-dealer transaction. If a delivery of registered securities is otherwise in acceptable form such delivery may not be rejected solely due to the type of person in whose name the securities are registered, unless rule G-12(e)(xiv)(F) specifically identifies a registration in such name as unacceptable.

USE OF OWNERSHIP INFORMATION

Among other matters, rule G-24 states that, if a municipal securities broker or dealer has access to confidential information regarding the ownership of municipal securities obtained from an issuer when acting in an agency or fiduciary capacity for the issuer, such broker or dealer is prohibited from using such information in the conduct of its municipal securities activities unless the issuer consents to such use. The Board notes that this provision would apply to information obtained when acting as registrar or transfer agent on an issue of registered securities.

MSRB REPORTS
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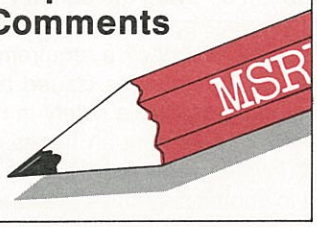
Request For Comments



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Rule G-12(h)

Comments Requested on Proposed Amendments to Close-Out Procedures

The Board is circulating for public comment certain draft amendments to the provisions of Board rule G-12(h) concerning close-out procedures. The amendments are 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(h) sets forth a procedure to be used by municipal securities brokers and dealers seeking to effect close-outs of uncompleted transactions in municipal securities. The Board is of the view that this procedure has generally fostered expeditious resolution of such transactions without imposing undue burdens on persons using it. However, the Board has recently received suggestions from members of the industry as to several improvements in the application of the procedure to certain special circumstances; the Board proposes to amend the rule in accordance with these suggestions. The Board is also proposing an amendment to reflect the likely increase in the number of transfer items and related fails that may result from the impending requirement for issuance of most new issue municipal securities in registered form.

The specific proposals contained in the draft amendments are as follows:

- **The draft amendments would permit the initiation of a close-out procedure on certain transactions reclaimed after the ninetieth business day following the original settlement date.** The current rule specifies that a close-out notice cannot be issued on a transaction after the ninetieth business day following the settlement date. However, the provisions of rule G-12(g) permit reclamations to be made for up to eighteen months after delivery for certain specified reasons, and indefinitely for other specified reasons. Therefore, the current rule does not permit a reclaiming dealer to use the close-out procedure to ensure completion of the reopened contract, if the reclamation occurs more than ninety business days after the settlement date.

The Board is aware that, in certain instances in the past, the availability of the close-out procedure would have promoted more expeditious resolution of reclaimed transactions. Accordingly, the Board proposes to make the close-out procedure available, for a short period of time, in the event that a transaction is reopened due to reclamation of securities, for certain specified reasons, after the ninetieth business day following the settlement date. The draft amendments would, if adopted, permit the purchaser to initiate a close-out procedure with respect to such a transaction, in accordance with the provisions of the rule, for a period of fifteen business days following the date of reclamation.

This provision would apply, however, only if the delivery had been reclaimed pursuant to the provisions of subparagraphs (g)(iii)(C) or (g)(iii)(D) of rule G-12.[1] If the reclamation has been made for some other reason (*e.g.*, securities with mutilated coupons, or missing the legal opinion, both grounds for reclamation under subparagraph (g)(iii)(A)), the provision of the draft amendments would not apply, and a close-out could not be initiated with respect to the reclaimed transaction after the ninetieth business day following the settlement date. Since the time periods for reclamations for other reasons are relatively brief, the Board does not believe that additional time for initiation of a close-out procedure is warranted.

All interested persons are invited to submit written comments to the Board on the draft amendment. Written comments will be available for public inspection. Letters of comment should be submitted to the Board on or before November 19, 1982, and should be sent to the attention of Donald F. Donahue, Deputy Executive Director.

[1]Subparagraph (g)(iii)(C) of rule G-12 provides that reclamation may be made within 18 months of a delivery for any of the following reasons:
(1) irregularity in delivery, including, but not limited to, delivery of the wrong issue (*i.e.*, issuer, coupon rate or maturity date), duplicate delivery, delivery to the wrong party or location, or over delivery;
(2) refusal to transfer or deregister by the transfer agent due to a lack of documentation required by paragraph (e)(xiv) of the rule; or
(3) information pertaining to the description of the securities was inaccurate for either of the following reasons:
(i) information required by subparagraph (c)(v)(E) of the rule was omitted or erroneously noted on a confirmation, or
(ii) information material to the transaction but not required by subparagraph (c)(v)(E) of the rule was erroneously noted on a confirmation.
Subparagraph (g)(iii)(D) provides that reclamation of a delivery may be made without any time limitation for either of the following reasons:
(1) the security delivered is reported missing, stolen, fraudulent or counterfeit; or
(2) a notice of call for less than the entire issue of securities was published on or prior to the delivery date and the securities were not identified as "called" at the time of trade.

• **The draft amendments would permit a selling dealer who is unable to complete a transaction to require the purchaser to execute a close-out on the transaction.** In certain cases a selling dealer may determine that, owing to misinformation supplied by a customer or for some other reason, it is unable to complete a delivery of securities (*e.g.,* the dealer sells $50,000 par value securities on a customer's instructions, but subsequently learns that the customer has only $30,000 par value securities). In these situations the selling dealer may wish to have the matter resolved through the use of a close-out procedure, but the current rule does not permit it to force the purchaser to initiate and follow through on such a procedure. If the purchaser, for whatever reason, is unwilling to use a close-out procedure, the selling dealer has no recourse, and must bear the risk of the market exposure for as long as the purchaser declines to take action.

The Board believes that it may be appropriate to provide the seller some means to compel the execution of a close-out in these circumstances. Accordingly, the draft amendments would, if adopted, establish such a procedure. Under the draft amendments, if the seller concluded that it would be unable to complete a transaction, the seller could compel the purchaser to close out the transaction by providing formal written notice to the purchaser of its inability to complete the trade. This notice would have to provide an explanation of the seller's inability to complete the transaction. Further, in view of the serious and irrevocable nature of the notice, the draft amendments would require that it be signed by a municipal securities principal.

Upon issuance of such a notice, the draft amendments would require that the purchaser execute a close-out with respect to the transaction, utlizing one of the three methods provided in the rule, not later than the tenth business day following receipt of the notice. The purchaser would not be required to provide any notice to the seller prior to the execution of the close-out, nor could the seller "freeze" execution of the close-out if, for some reason, it becomes able to complete the delivery. The Board believes that providing the purchaser with ten business days in which to accomplish the close-out will afford the purchaser sufficient flexibility in selecting the most appropriate means of executing the close-out.

The general ninety-business-day limitation on issuance of close-out notices would apply in this case as well, so that a seller could not issue a notice seeking to compel a purchaser to execute a close-out on a transaction which is more than ninety business days old.

• **The draft amendments would permit the selling dealer receiving a close-out notice which it does not retransmit to obtain an extension of time if the securities owed on the transaction are in transfer.** The current close-out rule provides an extension of time only in the event that a close-out notice is retransmitted by the selling dealer first receiving it, and no extension is provided based on the reason for the selling dealer's failure to deliver. The Board has been of the view that, in most instances, the standard ten-business-day period between the initiation of a close-out and the commencement of the execution period should be sufficient to resolve any clearance problem delaying the delivery.

In August of this year the Congress passed, as part of the Tax Equity and Financial Responsibility Act, a requirement that most new issues of municipal securities issued after December 31, 1982 must be made available solely in registered form. As a result of this requirement an increasing number of transactions will involve registered securities, and dealers will be required to submit securities for transfer more frequently. Delays in the transfer process may become a more significant factor affecting the municipal clearance process, and more close-out procedures may be initiated on transactions on which the failure to deliver is caused by the need to transfer the securities. Such delays may be a particular problem during the initial months after the effectiveness of the requirement, while the industry is not yet fully acclimated to the handling of registered securities. The Board therefore believes that it may be appropriate to alter the close-out process to take into account this substantial change in the manner in which the industry will be clearing securities and to provide additional time to permit the transfer process to be accomplished.

Accordingly, the draft amendments would provide that, if the selling dealer receiving the notice of close-out from the originating purchaser has submitted the securities which it is failing to deliver to be transferred, the selling dealer may delay the delivery deadline and the execution period specified on the notice for ten business days by advising the purchaser of the reason for its failure to deliver.[2] The selling dealer must advise the purchaser of the reason for its failure to deliver by telephone not later than the close of business on the business day following its receipt of the telephone notice of close-out from the purchaser; the selling dealer must confirm this notice in writing, sent return receipt requested not later than the following business day, including in such notice a statement of the dates of the new delivery deadline and the new execution period, as extended by the seller's action.

This time extension, however, would be available only to the selling dealer first receiving the notice of close-out from the originating purchaser. If the notice of close-out is retransmitted to another dealer, and this third dealer is the party which has submitted the securities for transfer, the third dealer would not be able to invoke an additional time extension attributable to the fact that the securities are being transferred. The Board notes that the retransmittal of the close-out notice itself causes a five business day extension of the dates involved in the procedure, and the Board believes that providing an additional ten-day extension would unduly delay the close-out procedure and harm the purchaser's interests in accomplishing a timely completion of the contract.

• **The draft amendments would delete the requiement that a copy of the contra-dealer's confirmation be attached to close-out notices.** The current rule requires that a dealer issuing or retransmitting a close-out notice must attach to such notice a copy of the contra-confirmation of the trans-

[2]The Board notes that this would in practical effect provide a total of twenty-five business days between the settlement date and the earliest time for execution of a close-out notice, during which time the transfer could be completed.

action sent by the dealer who is receiving the close-out notice. This requirement is intended in part to assist the dealer receiving the notice in identifying the transaction which is the subject of the notice.

The Board is of the view that this requirement may no longer be necessary. Since the relevant information regarding the transaction is required to be specified both in the telephone and the written close-out notice, and since a dealer receiving a telephone notice of close-out must proceed based on such telephone notice, not awaiting receipt of the written notice, the requirement to attach the contra-confirmation to the written notice no longer appears to provide significant assistance in identifying the related transactions to the dealer receiving the notice. Accordingly, the draft amendments would delete this requirement.

* * *

The text of the draft amendment follows.

September 29, 1982

Text of Draft Amendments*

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) Notice of Close-Out. If the purchaser elects to close out a transaction in accordance with this paragraph (i), the purchaser shall, not earlier than the fifth business day following the settlement date, notify the seller by telephone of the purchaser's intention to close out the transaction. The purchaser shall state that unless the transaction is completed by a specified date and time, which shall not be earlier than the close of the tenth business day following the date the telephonic notice is given (the fifth business day, in the case of a second or subsequent notice), the transaction may be closed out in accordance with this section at any time during the period of time, which shall not be more than five business days, specified by the purchaser for such purpose. The purchaser shall immediately thereafter send, return receipt requested, a written notice of close-out to the seller. Such notice shall contain the information specified in item (1) of subparagraph (C) below, ~~and shall be accompanied by a copy of the seller's confirmation of the transaction to be closed out or other written evidence of the contract between the parties~~.

(B) (i) Retransmittal. [as in current rule—no substantive change.]

(ii) Transfer of Securities. If a selling dealer receiving a notice of close-out which has not been retransmitted has timely 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.

(C) and (D) No change.

(E) Close-Out Not Completed. If a close-out pursuant to a notice of close-out is not completed in accordance with the terms of the notice and the provisions of this rule, the notice shall expire. Additional close-out notices may be issued, provided that a close-out procedure with respect to a transaction may not be initiated later than the ninetieth business day following the settlement date of such transaction, regardless of the number of close-out notices issued. Notwithstanding the foregoing, in the case of a transaction on which a delivery of securities has been reclaimed pursuant to the provisions of subparagraphs (g)(iii)(C) or (g)(iii)(D) of this rule and which remains uncompleted, the purchaser may initiate a close-out procedure with respect to such transaction at any time during a period of fifteen business days following the date of reclamation.

(F) Completion of Transaction. If, at any time prior to the execution of a close-out pursuant to this paragraph (i), the seller, or any subsequent selling party to whom a notice has been retransmitted, can complete the transaction within two business days, such party shall give immediate notice to the purchaser originating the notice of close-out that the securities will be delivered within such time period. If the originating purchaser receives such notice, it shall not execute the close-out for two business days following the date of such notice; the period specified for the execution of the close-out shall be extended by two business days or, in the event that the notice is given on the last day specified for execution of the close-out, by three business days. Delivery of the securities in accordance with such notice shall cancel the close-out notice outstanding with respect to the transaction. The provisions of this subparagraph shall not apply in the event that the seller has requested execution of a close-out with respect to a transaction in accordance with the provisions of subparagraph (H) of this paragraph (i).

(G) No change.

(H) Close-Out at Seller's Initiative. If, at any time after the settlement date of a transaction, the seller determines that it will not be able to complete such transaction in accordance with its terms, the seller may, not later than the ninetieth business day following the settlement date of such transaction, request execution of a close-out by sending the purchaser a written notice advising the purchaser of its inability to complete the transaction and stating the reason for such inability.

*Underlining indicates new language; material which is lined through would be deleted.

Such notice must be sent return receipt requested and must be signed by a municipal securities principal. The purchaser shall, not later than ten business days after receipt of such notice, execute a close-out with respect to such transaction in accordance with the provisions of subparagraph (D) of this paragraph (i).

(ii) through (iv) No change.

(i) through (l) No change.

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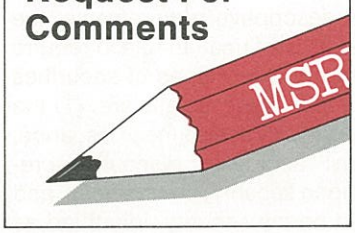
Request For Comments



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Zero Coupon, Compound Interest, and Multiplier Securities

Notice Concerning Such Municipal Securities and Solicitation of Comments on Proposed Amendments

The Board has recently received numerous inquiries from municipal securities brokers and dealers concerning the application of Board rules to transactions in zero coupon, compound interest, and multiplier securities. Certain recent new issues of municipal securities have had several maturities with a stated interest rate of 0% ("zero coupon" securities); securities of these maturities are sold at deep discounts, with the investor's return received in the form of an accretion of this discount to par. Other issues, often described as "compound interest" or "multiplier" securities, are issued with a stated rate of investment return; an investor purchasing such a security would receive at maturity a single payment (the "maturity value") representing both return of the initial principal value and payment of an investment return accrued over the life of the instrument at a stated compounded rate. Interested persons have asked about the confirmation requirements applicable to such securities and whether other disclosures concerning features of the securities should be provided to customers at the time of trade.

Set forth below is a statement of the Board's current views on the appropriate method of preparing confirmations of transactions in zero coupon, compound interest, and multiplier securities. In certain cases the existing confirmation rules are clear. In these cases this notice states how the rules presently apply, and dealers effecting transactions in these types of securities are required to prepare confirmations in the described fashion. In other cases the application of the rules may be less than clear or without modification might produce inappropriate results. In these cases, this notice states the Board's current views on the recommended approach for confirming transactions in these securities; the Board is proposing amendments to its confirmation rules to adopt these approaches as requirements, and hereby solicits comments from industry members and other interested persons on these proposals. These proposals would not, of course, be effective until they are filed with and approved by the Securities and Exchange Commission.

Written comments should be submitted not later than November 19, 1982 and may be sent to the attention of Donald F. Donahue, Deputy Executive Director. Written comments will be available for public inspection.

The Board wishes again to stress that its fair dealing rule, rule G-17, imposes an obligation on persons selling these, as well as other types of municipal securities to the public to adequately disclose important characteristics of the securities being sold. For example, it would be important that investors be aware that such securities do not pay interest on a periodic basis. Further, the call features applicable to zero coupon, compound interest, and multiplier securities usually permit such securities to be called at a price substantially below the maturity value; the Board is of the view that this may be material information which should be disclosed at or before the time of trade. Additionally, because the tax considerations associated with investments in these types of securities are complex, investors purchasing such securities should be advised, at minimum, of the need to consult with tax advisors on the proper treatment of income received from such investments. The Board is of the view that persons dealing in these securities must be mindful of this general obligation to adequately disclose information regarding such securities, particularly during this period of some uncertainty regarding the definitive confirmation requirements.

The specific confirmation issues and the Board's current views on them are as follows:

- **Par Value or Quantity of Securities**

Board rules G-12 and G-15 currently require that confirmations of transactions state the "par value of the securities" involved in the transaction. Industry members have expressed confusion as to the "par value" that should be shown on a transaction in zero coupon or multiplier securities.

The Board notes that a primary purpose of the confirmation is to record in writing certain basic details about a transaction and the securities involved in such transaction. One of these basic details is the number or quantity of securities involved in the transaction. Traditionally, the measure of

quantity used has been the "par value" of the securities; however, an alternative measure of the quantity of securities can be used if confusion exists as to the meaning of "par value" or if such measure would more accurately reflect the basis on which a transaction is effected.

The Board is of the view that an alternative measure of quantity is appropriate in the case of transactions in zero coupon, compound interest, and multiplier securities. Such securities are likely to be traded and sold on the basis of their maturity value, and investors purchasing such securities are likely to do so, in large part, based on the representation that a certain maturity value will be received within a certain period of time. Accordingly, the Board is of the view that the confirmation of a transaction in such securities should identify the quantity of securities in terms of the maturity value of the security.[1]

The Board therefore proposes to amend the confirmation requirements to require that confirmations of transactions in zero coupon, compound interest, and multiplier securities state the "maturity value" involved in the transaction.

- **Description of Security/Interest Rate**

Board rules G-12 and G-15 require that confirmations state certain descriptive details about the securities, including, among other matters, the "interest rate" of the securities. As a general matter the existing description requirements apply to transactions in these securities in the same manner as they would to other types of securities.

With respect to the requirement to disclose the "interest rate," the current confirmation rules require that a confirmation of a transaction in a zero coupon security state the rate as "0%". The Board has concluded that confirmations of transactions in compound interest and multiplier securities also should identify the "interest rate" on such securities as "0%", and proposes to amend its confirmation rules to require that such disclosure be made. The Board believes that such disclosure is necessary to alert purchasers of these securities to the fact that they will not receive "interest" payments in the same fashion as on more traditional municipal securities, and also may prevent customers from mistakenly assuming that such securities pay "interest" in addition to the investment return included in the maturity value of such securities. The Board notes also that, in light of the proposed method, described below, of disclosing transaction moneys, many dealers have to specify a "0%" rate of interest on the confirmation in order to prevent inclusion of an "accrued interest" amount on the confirmation.

The Board is aware, however, that compound interest and multiplier securities may include an "interest rate" in their description, or may state a rate on the securities certificate. The Board does not believe that such rate should be disclosed as the "interest rate," but is of the view that such rate should be stated on the confirmation as additional descriptive detail. To the extent that such rate is already included on the confirmation in accordance with the proposed requirement to state the original offering yield, described below, it would not need to be repeated.

- **Additional Descriptive Details**

In addition to the current descriptive requirements, the Board is proposing to amend its confirmation rule to require that additional details regarding these types of securities be included on the confirmation. These details are: (1) the initial principal amount of the security at the time of issuance, (2) the date on which "interest" accrual (or discount accretion, in the case of a zero coupon security) commences, and (3) the original offering yield on the security, identified as such, at the time the new issue was sold to the public.[2] The Board is of the view that these additional details may serve to ensure accurate identification of the issue involved in the transaction.

The Board notes also that this information may be necessary to an investor seeking to determine the tax consequences of any future transaction in such securities. Since the tax exemption of income received is a primary investment consideration for purchasers of municipal securities, it may be appropriate that this information, which may be needed by the investor to distinguish between the tax exempt income and any taxable gain (or capital loss) incurred on a subsequent transaction, should be provided to investors on the confirmation of the transaction. In view of the complexity of, and uncertainties surrounding, the considerations involved in determining the proper tax treatment of transactions in these securities, however, the Board notes that purchasers should still be urged to consult with their tax advisors on the consequences of any such transactions.

The Board also proposes to require that customer confirmations of transactions in such securities include a designation that the investor will receive "no periodic payments" on such securities. The Board believes that such a statement will protect all parties by reinforcing the investor's understanding that a periodic interest payment, traditional on most types of longer-term municipal securities, will not be received on these securities.

- **Transaction Moneys**

Rules G-12 and G-15 currently require that confirmations show the "total dollar amount of [the] transaction," as well as its components—an "extended principal amount" and an "amount of accrued interest." The Board has concluded that this manner of presenting the transaction moneys may not be appropriate in the case of compound interest and multiplier securities.

In reaching this conclusion the Board has been cognizant of how these requirements would apply to a transaction in zero coupon securities. Since such securities have a stated interest rate of "0%", they would not have "accrued interest." A confirmation of a transaction in such securities, therefore, would set forth an "extended principal amount" and an (equal) "total dollar amount," with both the initial principal value and the investment return (accreted discount) included in this single sum.

The Board is of the view that a similar method of presenting the money detail on a confirmation of a transaction in a compound interest or multiplier security would be appro-

[1]The Board notes that, in the case of a zero coupon security, the maturity value of the security will be the same as the "par value," since such securities are initially sold at a stated (deep discount) percentage of "par value."

[2]On most compound interest and multiplier issues this will also be the rate at which the investment return compounds during the life of the instrument.

priate. As is the case with zero coupon securities, the price of a transaction in these instruments will be based upon the present value of the single "maturity value" amount. It appears questionable whether breaking up this single present value amount into initial principal and "accrued interest" components would provide additional meaningful information to the customer. Further, showing these separate amounts seems to state the current value of the security at the time of a given transaction in a somewhat distorted and inaccurate way. Accordingly, the Board proposes to amend its confirmation rules to permit presentation of the transaction money detail on a confirmation of a transaction in compound interest or multiplier securities in terms of a single present value amount, presented as an "extended principal" and a "total dollar" amount.

- **Yield Disclosure**

Rule G-15 requires that customer confirmations of transactions must set forth the yield of the transaction and the related dollar price. The yield shown on the confirmation must be the lowest of the yield to premium call, yield to par option, or yield to maturity.

This requirement is currently applicable to transactions in zero coupon, compound interest, and multiplier securities, and the Board is firmly of the view that the continued application of this requirement is appropriate. The Board believes, however, that application of the rule to these types of securities might be clarified by deletion of the adjective "premium" in the reference to the "yield to premium call." As is the case with callable traditional municipal securities, these types of securities have call features in which the call commences at a premium price (above the compounded or the accreted value of the security as of the call date) which declines to a price equal to the value of the security as of the call date. Since the latter calls are not really appropriately described as "par options," the deletion of the word "premium" would clarify that a dealer seeking to determine the lowest "yield to call" should take these calls, as well as the premium calls, into consideration.

The text of the proposed amendments follows this notice, and a sample confirmation illustrating the confirmation requirements described herein is on page 16. The Board welcomes the views of all interested persons on the proposed amendments described herein, as well as on the application of current Board rules to transactions in these types of instruments.

October 8, 1982

* * *

Text of Proposed Amendment*

Rule G-15. Customer Confirmations

(a) through (d) No change.

(e) The confirmation of a transaction in a security maturing in more than two years and paying investment return solely at redemption shall not be required to show the par value of the securities specified in subparagraph (iv) of paragraph (a) nor the accrued interest specified in subparagraph (ix) of paragraph (a). Such confirmation shall, however, contain the following information:

(i) the maturity value of the securities;

(ii) the initial principal amount, per security, at the time of issuance;

(iii) the date on which accrual or accretion of the investment return commences;

(iv) the original offering yield on the security, identified as such, at the time the new issue of such securities was sold to the public; and

(v) a designation that such securities make "no periodic payments" of investment return.

Such confirmation must also indicate that the interest rate on the securities is "0%," and must state the rate of investment return shown on the securities certificate, if other than the offering yield required under subparagraph (iv) above.

(e) through (i) renumbered as (f) through (j). No substantive change.

Sample Confirmation on Page 16

*Underlining indicates additions. Comparable amendments would be made to the inter-dealer confirmation provisions of rule G-12(c).

SAMPLE CONFIRMATION

DEALER A
Anywhere, USA

ORIG. NO.	DELIVERED VIA	[redacted]	TRANS. NO.	CODES BL. CODE/DEL. INS.	SETT.	TRADE DATE	SETTLE. DATE	DELIVERY DATE
xxx			0123			9/08/83	9/15/83	

IDENTIFICATION NO.	CONTRA PARTY	C.H. NO.	SPECIAL DELIVERY INSTRUCTIONS
123654	Institution B 122 Main St. Anywhere, USA		Direct

WE	QUANTITY	CUSIP NO.	SECURITY DESCRIPTION
S	1000	561478AM5	Municipal Co. Sgl Fam Mtg Rev Init Prin $20/Dtd 8/10/82/Callable 12.5821 Orig Yld 0% Due 9/01/2014

PRICE		PRINCIPAL	INTEREST		AMOUNT
2.084 12.90YTM	NO PERIODIC PAYMENTS	20.84	-		20.84

MSRB REPORTS
Volume 2, Number 7 October/November 1982

Route To:

- ☐ Manager, Muni. Dept.
- ☒ Underwriting
- ☒ Trading
- ☐ Sales
- ☐ Operations
- ☐ Compliance
- ☐ Training
- ☐ Other_____

Tax-Exempt Notes

Notice Concerning Application of Board Rules to Such Notes and of Filing of Rule Change

The Board understands that some industry practices involving the underwriting and sale of tax-exempt notes may differ from practices relating to the underwriting and sale of tax-exempt bonds and is concerned that these practices may not conform in all respects with the Board's rules. The Board believes that the major portion of the note industry is aware that the Board's rules apply to tax-exempt notes and complies with those rules. Nevertheless, the differences between the manner in which bonds and notes are distributed and traded may have led to a misconception by some note dealers that the Board's rules apply primarily to bonds and that notes are partially or wholly exempt from their application.

The Board wishes to emphasize that all of its rules apply to tax-exempt notes in the same way as they do to all other municipal securities. It urges all tax-exempt note dealers to review the Board's rules to assure compliance with these requirements. It is important to point out that the rules apply to the sale and trading of all new issue notes including those that may not be subject to an underwriting assessment under rule A-13 which is discussed below.

In connection with the industry's review of the application of Board rules to notes, the Board wishes to remind the industry that rule A-13 requires a dealer to pay the Board a specified assessment on all new issues of municipal securities which it underwrites or places, which have an aggregate par value of $1 million or more and a final stated maturity date of 2 years or more. Rule A-13 also requires the filing of Form A-13 for those issues that have a maturity date of 2 years or more.

In addition, rule G-32, concerning disclosures in connection with new issues requires, among other things, a dealer to provide a customer with a copy of the official statement accompanying a new issue, if one is furnished by or on behalf of the issuer, at or prior to sending a final confirmation of the transaction. This requirement places responsibility on a note dealer to obtain or bear the expense of producing sufficient copies of the issuer's official statement for timely delivery to customers. While the Board is aware that the official statement delivery requirements sometimes may require note dealers to bear some expense, it believes that the expense is outweighed by the important customer protections which rule G-32 provides.

The Board will soon file with the Securities and Exchange Commission an amendment to rule G-12(e)(v) that will apply to deliveries of tax-exempt notes. The amendment will conform the rule to current industry practice by requiring that a dealer accept note deliveries in denominations smaller than those specified as sold on the confirmation if the denominations delivered can be put together to constitute any lots specified.

The Board is reviewing the application of certain of its rules to notes to determine if any additional amendments to the rules are necessary in order to accommodate notes, and will inform the industry if it concludes that such amendments are appropriate.

October 4, 1982

Comments concerning this notice should be directed to Angela Desmond, Deputy General Counsel.

MSRB REPORTS
Volume 2, Number 7 October/November 1982

Route To:

- ☐ Manager, Muni. Dept.
- ☐ Underwriting
- ☒ Trading
- ☐ Sales
- ☒ Operations
- ☐ Compliance
- ☐ Training
- ☐ Other_____

Withdrawal of Proposed SEC Rule 15c2–12 on "Riskless Principal Transactions"

The Securities and Exchange Commission recently announced its decision to withdraw proposed SEC rule 15c2–12. That proposal, which was released for comment by the SEC in October 1978, would have required disclosure on customer confirmations of any mark-up, mark-down or other remuneration that municipal securities dealers receive in effecting "riskless principal transactions" in municipal securities with their customers.* The Board, among others, had vigorously opposed adoption of the proposal. The SEC release announcing withdrawal of the proposal is reprinted below.

October 1, 1982

* * *

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240
[Release No. 34-18987; File No. S7-654]
Securities Confirmations

AGENCY: Securities and Exchange Commission.
ACTION: Withdrawal of proposed rules.
SUMMARY: The Securities and Exchange Commission is withdrawing a proposed rule and a proposed amendment to a rule that would have required disclosure on the customer's confirmation of the amount of any mark-up, mark-down, or similar remuneration received (1) by any broker or dealer effecting a "riskless" principal transaction in a non-municipal debt security with a customer, and (2) by any broker, dealer, or municipal securities dealer effecting a "riskless" principal transaction in a municipal security with a customer.
FOR FURTHER INFORMATION CONTACT: Susan Walters, Esq., Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549 (202-272-7494).
SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today announced the withdrawal of a proposed amendment to Rule 10b-10 (17 CFR 240.10b-10) under the Securities Exchange Act of 1934 (the "Act")[1] and the withdrawal of proposed Rule 15c2–12 (17 CFR 240.15c2–12) under the Act.[2] The proposed amendment to Rule 10b-10 would have made it unlawful for any broker or dealer (other than a market maker) trading as a principal for its own account to effect a transaction in a non-municipal debt security[3] with a customer unless the broker or dealer, at or before the completion of the transaction, gave or sent to the customer written notification disclosing the amount of any mark-up, mark-down, or similar remuneration received if, after having received an order to buy from the customer, he purchased the security from another person to offset a contemporaneous sale to the customer or, after having received an order to sell from such customer, he sold the security to another person to offset a contemporaneous purchase from the customer.[4] Proposed Rule 15c2–12 would have required comparable disclosure in the case of transactions of the same type in a municipal security effected by a broker, dealer, or municipal securities dealer.

The Commissioner received over two hundred comment letters on the proposals, the majority of which opposed their adoption. The commentators opposed to the proposals argued that, among other things, the proposals failed to take into account the substantial differences between the markets for debt and equity securities,[5] called for the disclosure of information that was irrelevant to customers,[6] and imposed an

*The SEC also withdrew a proposed amendment to SEC Rule 10b-10 to require comparable disclosure in connection with "riskless principal transactions" in corporate debt securities. Instead, the SEC has proposed that customer confirmations of transactions in corporate debt securities contain disclosure of yield information. *See* Securities Exchange Act Release No. 18988 (August 20, 1982).

[1] 15 U.S.C. §78a *et seq.*

[2] *See* Securities Exchange Act Release No. 15220 (October 6, 1978), 43 FR 47538 (October 16, 1978).

[3] The proposed amendment would have broadened the application of paragraph (a)(5)(i) of Rule 10b-10 to include both equity and non-municipal debt securities by deleting the phrase "in a transaction in an equity security."

[4] Transactions effected in this manner have been generally referred to as "riskless" principal transactions.

[5] *E.g,* letter from the Securities Industry Association, Corporate Bond Committee (Nov. 17, 1978); letter from the Public Securities Association (Jan. 15, 1979). All comment letters cited are contained in File No. S7-654.

[6] *E.g.,* letter from the Municipal Dealers Association, Inc. (Jan. 15, 1979); letter from the Municipal Securities Rulemaking Board (Jan. 8, 1979).

unreasonable and anti-competitive burden on small broker-dealers.[7]

The proposals were intended, among other things, to prevent or deter pricing abuses. The Commission strongly supports efforts by the Municipal Securities Rulemaking Board to focus greater attention on pricing practices[8] and other self-regulatory efforts to prevent excessive mark-ups. The Commission will also maintain close scrutiny to prevent excessive mark-ups and take enforcement action where appropriate.[9] The Commission is withdrawing the proposals because it has concluded that they would not achieve the purposes of the proposal at an acceptable cost and that there are alternative ways of achieving the same goal with fewer adverse side effects.

By the Commission.

George A. Fitzsimmons
Secretary

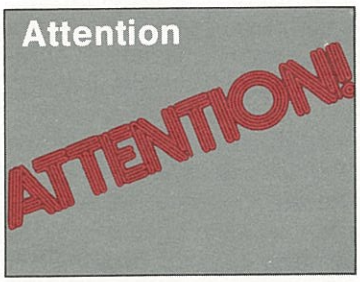
August 20, 1982.

[7]*E.g.*, letter from Merrill Lynch, Pierce, Fenner & Smith, Inc. (Dec. 26, 1978); letter from Bateman Eichler, Hill Richards Inc. (Nov. 29, 1978); letter from Printon, Kane & Co. (Nov. 28, 1978).

[8]*See* MSRB, *Report on Pricing*, Sept. 26, 1981.

[9]*See, e.g.*, Securities Exchange Act Release No. 18628 (Apr. 9, 1982).

MSRB REPORTS
Volume 2, Number 7 October/November 1982



Route To:

- ☐ Manager, Muni. Dept.
- ☐ Underwriting
- ☒ Trading
- ☒ Sales
- ☒ Operations
- ☒ Compliance
- ☒ Training
- ☐ Other_____

Letters of Interpretation

Rule G-3—Persons Engaged in Financial Advisory Activities

I am writing to confirm our telephone conversation of this afternoon concerning the registration and qualification requirements applicable to persons in your firm's public finance department. In our conversation you inquired whether persons who function as financial advisors to municipal isuers, providing advice to such issuers regarding the structure, timing and terms of new issues of municipal securities to be sold by such issuers, are required to be qualified. As I indicated, such persons are required to be registered and qualified as municipal securities representatives. Furthermore, persons who supervise representatives performing such financial advisory services are required to be registered and qualified as municipal securities principals.

For your information, the provision of financial advisory services to municipal issuers is defined to be a municipal securities representative function in Board rule G-3(a)(iii)(B). The requirement that persons performing such function be qualified is set forth generally in rules G-2 and G-3, and the specific qualification requirements applicable to such persons are stated in rules G-3(e) and (i).—*MSRB interpretation of June 10, 1982 by Donald F. Donahue, Deputy Executive Director.*

Rules G-12 and G-15—Callable Securities: Disclosure

I am writing in response to your letter of August 17, 1982, concerning the requirements of Board rules G-12(c)(v)(E) and G-15(a)(v) concerning securities descriptions set forth on confirmations. In your letter you note that certain descriptive details are required to be disclosed on the confirmation only "if necessary for a materially complete description of the securities," and you inquire whether information as to a security's callability is one of these details.

Rules G-12(c)(v)(E) and G-15(a)(v) require confirmations to set forth a

> description of the securities, including at a minimum the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable) or revenue bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, *if necessary for a materially complete description of the securities,* and in the case of any securities, *if necessary for a materially complete description of the securities,* the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service or, if there is more than one such obligor, the statement "multiple obligators" may be shown.
>
> (emphasis added)

As you can see, the phrase "if necessary for a materially complete description of the securities" modifies only the requirements for disclosure of "the type of revenue," or disclosure of "the name of any company or other person obligated . . . with respect to debt service . . . ," and does not modify the requirements for disclosure of the other listed information. Both rules, therefore, deem information as to the "name of the issuer, interest rate, maturity date and if the securities are limited tax, subject to redemption prior to maturity (callable) or revenue bonds" to be necessarily material and subject to disclosure on the confirmation. In the specific case which you cite, that of a security with an "in-part" sinking fund call feature, the confirmation of a transaction in such security would be required to identify the security as "callable."—*MSRB interpretation of August 23, 1982 by Donald F. Donahue, Deputy Executive Director.*

Rules G-12, G-15 and G-17—Original Issue Discount, Zero Coupon Securities: Disclosure of, Pricing to Call Feature

I am writing in response to your inquiry in our recent telephone conversation regarding the application of Board rules to the recent original issue discount and "zero coupon" new issues of municipal securities. In particular, you indicated that these types of securities are often subject to somewhat unusual call provisions, and you inquired as to the application to these types of securities of Board rules concerning the disclosure of call provisions and the use of such call provisions in dollar price and yield computations.

Subsequent to our conversation, I obtained several examples of these call provisions, which were provided to the Board in connection with your inquiry. In the first of these examples, involving an original issue discount security, the call provision commences ten years after issuance, with the redemption price initially set at 90 and increasing by 2 points every three years, reaching a redemption price of 100 twenty-five years after issuance. In the second example, involving a "zero coupon" security, the call provision commences ten years after issuance; the redemption price is based on the compound accreted value of the security (plus a stated redemption premium for the first five years of the call provision), with certain of the securities initially redeemable at an approximate dollar price of 18.

As you know, the call provisions on "zero coupon" and original issue discount securities are one of the special characteristics of such securities, but are not, by any means, the sole special characteristic. The Board is of the view that municipal securities brokers and dealers selling such securities are obliged, under Board rule G-17 as well as under the anti-fraud rules under the Securities Exchange Act, to disclose to customers all material information regarding such special characteristics. As the Board stated in its April 27, 1982 "Notice Concerning 'Zero Coupon' and 'Stepped Coupon' Securities,"

> persons selling such securities to the public have an obligation to adequately disclose the special characteristics of such securities so as to comply with the Board's fair practice rules.

Therefore, in selling an original issue discount or "zero coupon" security to a customer, a dealer would be obliged to disclose, among other matters, any material information with respect to the call provisions of such securities.

I note also that rule G-15 requires customer confirmations of transactions in callable securities to indicate that the securities are "callable," and to contain a legend stating, in part, that information concerning the call provisions of such securities will be made available upon the customer's request. Customer confirmations of transactions in callable original issue discount or "zero coupon" securities would have to contain such a legend, in addition to the designation "callable," and the details of the call provisions of such securities would have to be provided to the customer in writing upon the customer's request.

The requirement under rules G-12 and G-15 for the computation of dollar price and (under rule G-15) yield to a call or option feature would apply to a transaction in an original issue discount or "zero coupon" security. Therefore, if the dollar price to the call on a transaction in such securities is lower than the price to maturity, such dollar price should be used. In the case of customer confirmations, if the yield to call on a transaction in such securities is lower, such yield must be shown. As you noted in our conversation, in view of the redemption price structure of the call provisions on such securities, the price or yield to call on a particular transaction might be lower than the price or yield to maturity, even though the transaction is effected at a price below par. Since heretofore the industry has been accustomed to call provisions at prices at or above par, industry members may wish to pay particular attention to the processing of transactions in original issue discount or "zero coupon" securities with these unusual types of call provisions, to ensure that the dollar price or yield of such transactions is not inadvertently overstated due to a failure to check the price or yield to call.—*MSRB interpretation of June 30, 1982 by Donald F. Donahue, Deputy Executive Director.*

Rule G-21—Advertisements of Securities Not Owned

This is in response to your letter of May 5, 1982 to Donald F. Donahue of the Board staff concerning a dealer bank's advertising practices. Your letter states that the dealer bank has recently published newspaper advertisements which list specific municipal securities as "Current Offerings," and that your review of the dealer's inventory positions has disclosed that "on the date the advertisement was published the dealer held no position in four of the issues advertised and a nominal position in the fifth advertised issue." Your letter reports that the dealer stated that it was his intention to obtain the advertised issues from other dealers when customer orders were received. Your first question is whether "it is misleading and thus in violation of rule G-21, to advertise securities which the dealer does not own . . ."

The Board has recently considered this advertising practice and concluded that it would not violate Board rules provided that: (1) the advertisement indicates that the securities are advertised "subject to availability;" (2) the dealer placing the advertisement is not aware that the bonds are no longer available in the market; and (3) the dealer would attempt to acquire the bonds advertised if contacted by a potential customer.

Your letter also expresses concern that this type of advertising might be seriously misleading to customers since the advertisement must be prepared and the printer's proof copy approved five days in advance of the date of publication. You note that "significant changes in the market can occur over a five, or even three-day period" and that, if such market changes had occurred between submission and publication of the advertisement, the customer could be seriously misled. The Board is aware that delays occur between the time an advertisement is composed and approved for publication by a municipal securities dealer and the time it is actually published. The Board believes that inclusion in the advertisement of a statement indicating that the securities are advertised subject to change in price provides adequate notice to a potential customer that the prices and yields quoted in the advertisement may not represent market yields and prices at the time the customer contacts the dealer. —*MSRB interpretation of July 1, 1982 by Judith R. Sillari, Assistant General Counsel.*