MSRB REPORTS

Volume 2, Number 6 | Municipal Securities Rulemaking Board | August 1982

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- amendments to rule G-12 (concerning fungibility and specific identification)

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MSRB REPORTS

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August 1982

Attention

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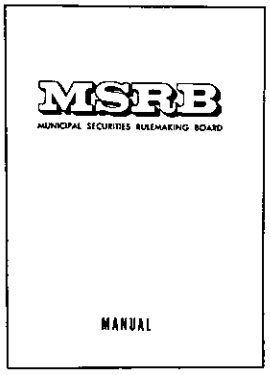

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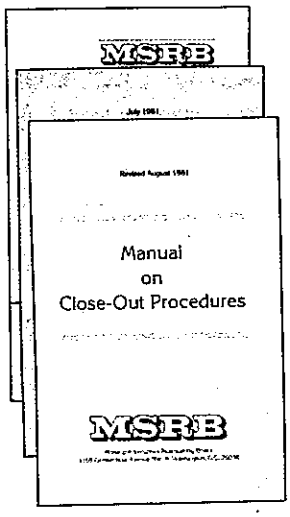

TOPICAL MANUALS

- MANUAL ON CLOSE-OUT PROCEDURES: Question-and-answer form outline of the provisions of rule G-12(h)(i) governing close-out procedures ($2.00 per copy).
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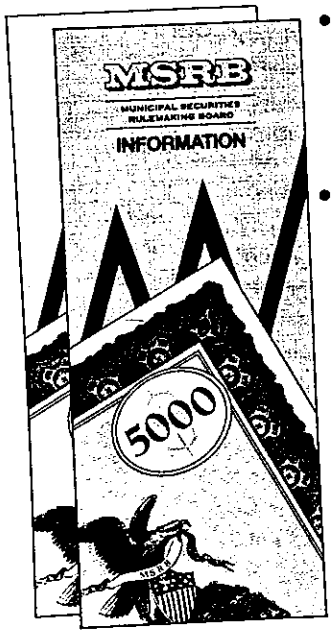

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Request For Comments

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Delivery/Receipt Versus Payment Transactions

The Board has approved for circulation this exposure draft of an amendment to its rules which would establish requirements concerning the confirmation and clearance of certain transactions between municipal securities brokers or dealers and customers which are effected on a delivery-vs.-payment ("DVP") or receipt-vs.-payment ("RVP") basis.* This draft amendment is being circulated for public comment prior to further consideration by the Board. The text of the draft amendment is attached to this notice.

* * *

Background

A. Developments with respect to general securities

Since the late 1960's the securities industry generally has experienced a continuing increase in the number of deliveries on DVP transactions for the accounts of customers that are rejected by such customers' clearing agents due to a lack of instructions regarding acceptance of the deliveries. This problem, which has come to be known as the " 'DK' problem", causes significant expense to brokers and dealers in terms of additional interest costs, clerical and delivery expenses, etc.. Some informed estimates suggest that the additional expenses resulting from the "DK" problem which are attributable solely to the interest cost to carry the rejected deliveries may amount to as much as $100 million annually for the securities industry as a whole.

In 1980 the Securities Industry Association and the New York Stock Exchange formed a joint task force to propose solutions to the "DK" problem. After considerable discussion the joint task force proposed a partial solution to the "DK" problem involving the increased use of securities depositories to confirm and settle DVP and RVP transactions. The joint task force's proposal has been accepted by several of the securities industry self-regulatory organizations, and rule changes to implement the proposal as of January 1, 1983, have been adopted by such organizations.**

The joint task force's proposal, as reflected in the rule changes adopted by these self-regulatory organizations, would generally preclude brokers or dealers from effecting certain transactions for the accounts of customers on a RVP or DVP basis unless the facilities of a securities depository were used for the confirmation and book-entry settlement of such transactions. Under the task force's proposal, a transaction effected on a DVP or RVP basis must be submitted to a depository for confirmation, acknowledgement, and book-entry settlement if the following four conditions are met:

(1) the transaction must be for settlement within the United States;

(2) the securities involved in the transaction must be depository-eligible securities;

(3) either the broker or dealer effecting the transaction or its clearing agent must be a participant in a depository; and

(4) either the customer for whose account the transaction is effected or its clearing agent must be a participant in a depository.

If, in these circumstances, the customer refuses to use the facilities of a depository for the confirmation and settlement of the transaction, the broker or dealer would, under the task force's proposal, be prevented from effecting the transaction on a DVP/RVP basis.

The confirmation and book-entry settlement systems contemplated in the task force proposal and the self-regulatory organizations' rule changes are provided by several of the depositories. Briefly, the confirmation systems involve the

The Board welcomes comments on the draft amendment from all interested persons. In particular, the Board solicits the views of institutional and individual customers regarding the implications of the draft amendment for their investment activities. Letters of comment should be submitted to the Board on or before October 15, 1982, and should be sent to the attention of Donald F. Donahue, Deputy Executive Director. Written comments will be available for public inspection.

*Although the amendment being proposed by the Board would apply to both DVP and RVP transactions, the problem giving rise to the amendment primarily involves DVP transactions (delivery to the customer against payment) and the amendment will have most effect on those transactions. This notice discusses the amendment, therefore, generally in terms of DVP transactions; the statements would, however, be equally applicable to RVP (receipt from the customer against payment) transactions.

**See, for example, amendments to New York Stock Exchange rule 387, filed on January 18, 1982 (SEC File No. SR-NYSE-82-1), and proposed amendments to the National Association of Securities Dealers Uniform Practice Code adopting new Section 64.

submission of transaction data by the broker or dealer effecting the transaction, the generation and transmission (via computer terminal) to the customer of a hardcopy "confirmation" (or the equivalent) of the transaction, and the transmission of an acknowledgement of the transaction by the customer.* The book-entry settlement systems involve simply the transfer of ownership of securities, generally against payment, from one party to the transaction to the other through entries on the account records of a securities depository, with the actual securities held on deposit at the depository at the time of transfer, and not physically moved from one contra-party to the other.

These systems offer a solution to the "DK" problem, at least with respect to those transactions that will be required under the proposal to be confirmed and settled through them, because they eliminate several factors (*e.g.*, delays in the receipt of mail, or processing delays resulting from large increases in transaction volume) that cause a problem in the transmission of deliver or receipt instructions to a customer's clearing agent. Delays in the receipt of confirmations by customers due to difficulties with the mail service, a major cause of such problems, are eliminated, since transaction confirmations are either transmitted to the customer via computer terminal or generated and affirmed within a computer comparison system; these functions are typically completed within two or three days of the trade date. Delays in the receipt of instructions by customers' clearing agents, whether due to a delay in the customer's receipt of the initial confirmation or to a delay in the mail transmission of the instructions from the customer to the agent, are generally eliminated, since the system used for confirmation and acknowledgement of the transaction is directly linked to the book-entry settlement system; this means that settlement instructions are issued and received promptly after the confirmation and acknowledgement process is completed. Delays in the receipt of confirmations or instructions due to large volume increases are substantially reduced, since these systems can accommodate such increases far more readily than non-computer-based confirmation, acknowledgement, and settlement systems can.

B. Application of these proposals to municipal securities

While the Board does not have the information necessary to quantify the extent of the "DK" problem in the municipal area, the Board is aware that many municipal securities brokers and dealers have experienced in recent years a significant increase in rejections of deliveries due to a lack of instructions. Further, given the municipal securities industry's heavy reliance on the physical delivery of securities (in contrast to other markets, where book-entry settlement is more common), it appears that the "DK" problem may have a more severe effect on the clearance of municipal securities than on the clearance of other types of securities.

The Board is of the view that the partial remedy to the "DK" problem described above should be considered for the municipal securities industry. While certain of the systems required to be used under the task force proposal have been made available for municipal securities transactions only relatively recently**, it is clear that the features of rapid transmission and receipt of confirmations, automatic issuance of delivery/receipt instructions, and easy accommodation to large increases in transaction volume, all of which are present in such systems, appear to offer the same benefits in terms of increased processing clearance efficiency for municipal securities transactions as they do for transactions in other types of securities. Further, the adoption of a requirement such as that proposed by the joint task force would appear to provide a strong impetus to the continued development of automated comparison and clearance systems for municipal securities, and to encourage the use of such systems in all phases of the municipal securities industry's activities. Accordingly, the Board is considering amending its rules to adopt a requirement regarding the confirmation and settlement of DVP/RVP transactions that is substantially similar to that proposed by the joint task force and adopted by certain other self-regulatory organizations.

* * *

The Draft Amendment

The amendment under consideration by the Board would have much the same effect as the task force's proposal. Under the amendment, transactions in depository-eligible securities effected between a municipal securities broker or dealer and a customer***, both of whom are, directly or indirectly, participants in such depository (or another depository or clearing corporation interfaced with such depository)****, must be confirmed, acknowledged, and settled via book-entry through the facilities of such depository, if the transaction is to be effected on a DVP or RVP basis. If, in the case of a transaction subject to the provisions of the proposed amendment, the customer refuses to use the facilities of the depository, the municipal securities broker or dealer would not be able to effect the transaction on a DVP or RVP basis; in the case of a DVP transaction, therefore, this would require that the customer submit payment for the securities prior to the actual delivery.

As is indicated above, the application of the requirements of the draft amendment is contingent upon the transaction involving "depository-eligible" securities (*i.e.*, securities which have been designated by a securities depository as eligible for clearance via book-entry through the facilities of such depository); as of August 15, 1982, approximately 25,000 issues of municipal securities will be "depository-eligible."

*In certain of these systems both parties to the transaction submit data which is compared via computer by the clearing corporation.

**The Board understands that the systems for the confirmation and acknowledgement of municipal securities transactions through the facilities of a securities depository have been available and in use for several years. The systems for the book-entry settlement of transactions in bearer municipal securities are relatively newer, with the older of the currently-available systems having been in operation for approximately one year (book-entry settlement of transactions in certain registered municipal securities has been available for a longer period.)

***The rule would not apply to inter-dealer transactions.

****The draft amendment contains a definition of "securities depository" that clarifies that, for purposes of the draft amendment, the term includes other registered clearing corporations, not normally referred to as "depositories," who offer automated confirmation, acknowledgement, and/or book entry settlement systems for municipal securities transactions.

The application of the draft amendment is also contingent upon both parties to the transaction being participants in a securities depository, whether "direct participants" (*i.e.*, organizations who are themselves participants in the depository) or "indirect participants" (*i.e.*, organizations who clear through an entity* that is a direct participant). If one of the two parties is not a participant, and does not use a clearing agent that is a participant, the draft amendment would not apply, and the transaction could be effected on a DVP or RVP basis without the use of a depository for confirmation or clearance purposes. However, the requirements of the draft amendment would apply, even if both parties are not themselves direct participants in a depository, if the clearing agents used by both parties are participants. Further, the requirements would apply even if the entities having the direct clearing relationships with the parties are not participants, as long as these entities themselves clear through clearing agents which are participants. For example, if a dealer (a participant in a depository) effects a transaction in a depository-eligible security for the account of a customer (a non-participant) and the customer directs that the securities be delivered to a bank clearing agent (a participant) for the account of another agent (a non-participant) which maintains an account for the customer, the transaction would be subject to the requirements of the draft amendment.

The requirements of the draft amendment would also apply if the dealer and the customer are participants, whether directly or indirectly, in different depositories, as long as the two depositories are interfaced or otherwise linked (so that confirmation, acknowledgement and settlement instructions can be transmitted between the two), and the municipal security involved in the transaction is eligible in both depositories. In addition, if the conditions stated in the amendment are met, the requirements of the draft amendment would apply, even in the event that the customer is obliged, under state law or other legal requirements, to safekeep securities in specified locations. In such circumstances, the customer could withdraw physical securities from the depository upon completion of book entry settlement.

Examples of the application of the draft amendment may clarify its scope:

Example one—Dealer A and Customer B, both participants in a depository, effect a transaction in XYZ municipal security, a depository-eligible security. The requirements of the draft amendment would apply, and, if the transaction is effected on a DVP basis, the transaction must be confirmed, acknowledged, and settled via book-entry through the facilities of the depository.

Example Two—Dealer A and Customer B, both participants in a depository, effect a transaction in ABC municipal security, a security **not** eligible in a depository. The requirements of the draft amendment would not apply (since the securities are not depository-eligible), and the transaction could be effected for physical settlement.

Example Three—Dealer A and Customer C effect a DVP transaction in a depository-eligible municipal security. Customer C is a depository participant; Dealer A is not a direct participant, but clears securities transactions through Clearing Agent D (*e.g.*, a clearing bank, or a national or regional clearing corporation), who is a depository participant. The transaction would be subject to the requirements of the draft amendment.

Example Four—Dealer B and Customer E effect a DVP transaction in a depository-eligible municipal security. Dealer B and Customer E are not direct depository participants. Dealer B uses a clearing agent that is a depository participant; Customer E clears for itself. The transaction would **not** be subject to the requirements of the draft amendment (since one of the parties to the transaction, Customer E, is not, either directly or indirectly, a depository participant).

Example Five—Dealer C and Customer F effect a DVP transaction in a depository-eligible municipal security. Dealer C is a depository participant; Customer F is not a direct participant, nor is its safekeeping agent. However, Customer F directs that the securities be delivered to Clearing Agent G, a depository participant, for the account of its safekeeping agent (who will hold the securities for Customer F's account). The requirements of the draft amendment would apply.

July 26, 1982

Text of Draft Amendment

With respect to a municipal security which is eligible for book-entry clearance through a securities depository registered with the Securities and Exchange Commission, a municipal securities broker or municipal securities dealer who is, or whose clearing agent is, a participant in such securities depository shall not effect a transaction in the security on a delivery-versus-payment or receipt-versus-payment basis for the account of a customer who is, or whose agent is, a participant in such securities depository (or in a securities depository interfaced or otherwise linked with such securities depository in which the municipal security is also eligible) unless the facilities of such securities depository (or the facilities of a securities depository interfaced or otherwise linked with such securities depository, as necessary) are used for the confirmation, acknowledgement, and book-entry settlement of such transaction.

For purposes of this rule, a "securities depository" shall mean a clearing agency, as defined in Section 3(a)(23) of the Securities Exchange Act of 1934, that is registered with the Securities and Exchange Commission pursuant to Section 17A(b)(2) of the Act.

*Such entities include bank clearing agents, registered clearing agencies, national clearing corporations, clearing corporations associated with regional exchanges, and others.

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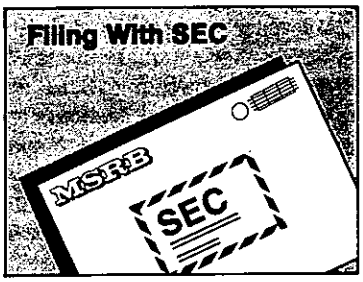

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Rule G-34

Proposed Rule on CUSIP Numbers Filed

On July 23, 1982 the Board filed with the Securities and Exchange Commission proposed rule G-34 on "CUSIP Numbers". Under the provisions of the proposed rule, a municipal securities broker or dealer managing the underwriting of a new issue of municipal securities is required to ensure that application is made for the assignment of CUSIP numbers to the new issue, and that assigned CUSIP numbers are affixed to or imprinted on the certificates of the new issue. The proposed rule would apply to any municipal new issue eligible for CUSIP number assignment.

The Board has adopted the proposed rule due to its belief that the generalized use of the CUSIP numbering system in the processing and clearance activities of the municipal securities industry will contribute to improving the efficiency of such activities. The Board is of the view that, if all eligible municipal securities have CUSIP numbers assigned to and printed on them, dealers will be able to place greater reliance on the CUSIP identification of these securities in receiving, delivering, and safekeeping physical municipal instruments. Further, the municipal securities industry's development of greater facility in the use of the CUSIP system to identify municipal securities issues will clearly foster the industry's progress toward the adoption of automated technologies for the comparison, settlement and book-entry clearance of transactions in municipal securities. Therefore, the Board has concluded that the adoption of the proposed rule is an important step in improving the efficiency of municipal clearance procedures.

A version of the proposed rule was previously issued by the Board in exposure draft form on January 4, 1982. The Board received many thoughtful comments on the exposure draft from members of the municipal securities industry and other interested persons. Certain of the provisions of the proposed rule reflect a number of the comments received. In addition, several of the comment letters voiced concerns about practical questions regarding the number assignment system contemplated in the rule. As is discussed further in this notice, the Board is taking steps to resolve these concerns prior to the effectiveness of the proposed rule.

The specific provisions of the proposed rule are discussed in this notice. The proposed rule will become effective 30 days after it is approved by the Securities and Exchange Commission, and will apply to all eligible new issues sold on or after that effective date.

* * * * *

The Proposed Rule

Eligibility

The requirements of the proposed rule apply to all new issues of municipal securities which are eligible for CUSIP number assignment. The rules governing eligibility currently specify that CUSIP numbers will be assigned to any municipal issue (with the general exception of issues of local assessment bonds or notes of one year or less to maturity*) which meets one of the following criteria:

- the issue has a par value of $500,000 or more;
- the issue has a par value of $250,000 or more, and the issuer has outstanding debt in excess of $250,000; or
- the issuer has outstanding debt in excess of $500,000, and a CUSIP subscriber requests assignment of a number to an issue (of any par amount).

Certain of the commentators on the January 1982 exposure draft suggested that the one-year-maturity eligibility criterion should be shortened or eliminated, so that issues of municipal notes would be made eligible for CUSIP number assignment and, therefore, covered under the proposed rule. These commentators stated that the exclusion of municipal notes from the CUSIP system causes problems in the clearance of such securities and effectively prevents the use of automated comparison and clearance systems with respect to transactions in notes. These commentators asserted that the inclusion of notes in the CUSIP system was particularly important in view of the fact that note issues constitute a large portion of the municipal new issue market.

The Board is sympathetic to the concerns expressed by these commentators, and is exploring the possibility of shortening the one-year-maturity criterion. The Board is mindful, however, that the inclusion of short-term municipal

Questions or comments concerning the proposed rule may be directed to Donald F. Donahue, Deputy Executive Director. Any written comments received will be available for public inspection.

*Municipal notes of more than one year to maturity are eligible for assignment of CUSIP numbers.

notes in the CUSIP system may cause significant practical problems, particularly with respect to large multi-issuer note issues such as project notes. Therefore the Board has determined not to recommend a change in this eligibility criterion at this time, although the Board may subsequently do so after further consideration. The Board would welcome comments from interested persons, particularly those active in the municipal note industry, concerning the inclusion of short-term notes in the CUSIP system.

Application

The proposed rule requires that, if no other person has previously arranged for the assignment of CUSIP numbers to a new issue, the managing underwriter of such new issue must make application, to an entity designated by the Board, for assignment of the numbers. The proposed rule provides that such application must be made as promptly as possible, but in no event later than the business day following the date of the award, in the case of a competitive sale, or the business day following the date of signing of a bond purchase agreement, in the case of a negotiated sale. The January 1982 exposure draft had proposed simply that application be made as promptly as possible, with no definitive time limit specified in the rule. The commentators generally supported the establishment of a specific time limit, with several proposing the time limit which the Board has set forth in the proposed rule. Several of the commentators stressed the importance of making application for number assignment early in the underwriting process. The Board concurs with these comments, and views the time limits specified in the rule as "outside" time limits. The Board notes that the rule generally requires that managing underwriters make application as promptly as possible, and, therefore, would not permit undue delay in making such application, even though the specific time limits set in the rule have not expired.

The proposed rule requires that the managing underwriter making application for number assignment provide eight specified items of information about the new issue, to ensure that the CUSIP numbers are correctly assigned. The items of information specified in the proposed rule as those which are to be provided at the time of application are essentially the same as those specified in the January 1982 exposure draft; certain clarifying modifications have been made to this list.

The proposed rule also requires that, at the time of making the application, the managing underwriter must provide to the entity designated by the Board a copy of a document prepared by or on behalf of the issuer (*e.g.*, a notice of sale, official statement, legal opinion, or other similar document), or of portions of such document, which evidences the eight items of information specified in the rule. The managing underwriter may provide a document in preliminary form (*e.g.*, a preliminary official statement); if it does so, however, it must provide a copy of any portions of the final document which reflect any changes to the eight items of information made after the preliminary document was prepared. If no document, either in preliminary or final form, is available at the time application for the number assignment is made, the managing underwriter must still submit a written application stating the eight specified items, and must submit a copy of a document, or the relevant portions of such document, at the time such document becomes available. The Board believes that requiring that applications include copies of official documents or portions of official documents describing the issue is important to ensure that CUSIP numbers are assigned on the basis of accurate and complete information about the new issue.

Certain of the commentators on the January 1982 exposure draft expressed concern that a manager of a new issue underwriting might be required to submit an application for assignment of numbers to a new issue on which an application had already been submitted by the issuer or some other person (such as a bond attorney or financial advisor) acting on the issuer's behalf. The proposed rule makes clear that, if the managing underwriter is advised by the party assigning the numbers that the issuer or its agent has already made application for the number assignment, then a duplicate application need not be made.

Affixture

The proposed rule requires that the managing underwriter of a new issue must affix, or arrange to have affixed, to the certificates of the new issue the CUSIP number assigned on the new issue. If more than one CUSIP number is assigned, each number shall be affixed to the certificates of that portion of the issue to which it relates—for example, on a serial issue, the CUSIP number assigned to a particular serial maturity shall be affixed to the certificates of that serial maturity. As a practical matter the Board expects that the numbers will be imprinted on the certificates during the normal certificate-printing process.

This provision of proposed rule G-34 is essentially the same as that in the January 1982 exposure draft. One of the commentators indicated that a growing number of municipal securities dealers and clearing agencies have adopted the practice of microfilming all certificates which come into their possession. To facilitate this practice, this commentator suggested that the Board require that the CUSIP number be affixed to the face of each certificate (that portion of the certificate facing the printed side of the coupons), in lieu of or perhaps in addition to affixing the number on the filing back (where the numbers typically are imprinted on certificates at this time). While the Board is not adopting a requirement similar to that suggested by this commentator at this time, the Board encourages and urges managing underwriters to arrange, wherever possible, for placement of the numbers on both the filing back and the face of new issue certificates. The Board may revisit this question in the future.

The January 1982 exposure draft requested comment on the possibility of arranging for the affixture of previously-assigned CUSIP numbers to certificates of outstanding municipal issues. The commentators were unanimously opposed to this suggestion, asserting that such a program would give rise to serious practical problems and impose substantial burdens on the industry. In light of these comments the Board has determined not to implement this suggestion at this time. The Board remains of the view, however, that the continued circulation of certificates that do not have CUSIP numbers printed on them will to some extent impede the full use of the CUSIP system. Therefore, the Board will consider implementing a program to arrange for such affix-

ture of numbers at some future time, if developments indicate that the potential burden of such a program would be reduced.

* * * * *

Designation of Party to Assign Numbers

The Board is currently discussing with the CUSIP Service Bureau and the CUSIP Board of Trustees the terms on which it will designate the Service Bureau to perform the function of assigning CUSIP numbers to new issues of municipal securities. In these discussions the Board is seeking to resolve many of the concerns expressed by commentators about the assignment of numbers and the dissemination of such numbers to all interested persons. The Board is confident that these concerns will be satisfactorily resolved. Upon completion of this arrangement the Board will notify the industry.

* * * * *

The text of the proposed rule follows.

July 26, 1982

Text of Proposed Rule

Rule G-34. CUSIP Numbers

(a)(i) Except as otherwise provided in this section (a), each municipal securities broker or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall apply in writing to the Board or its designee for assignment of a CUSIP number or numbers to such new issue. The municipal securities broker or municipal securities dealer shall make such application as promptly as possible, but in no event later than, in the case of competitive sales, the business day following the date of award, or, in the case of negotiated sales, the business day following the date on which the contract to purchase the securities from the issuer is executed. The municipal securities broker or municipal securities dealer shall provide to the Board or its designee the following information:

(A) complete name of issue and series designation, if any;

(B) interest rate(s) and maturity date(s) (provided, however, that, if the interest rate is not established at the time of application, it may be provided at such time as it becomes available);

(C) dated date;

(D) type of issue (*e.g.*, general obligation, limited tax or revenue);

(E) type of revenue, if the issue is a revenue issue;

(F) details of all redemption provisions;

(G) the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to the debt service on all or part of the issue (and, if part of the issue, an indication of which part); and

(H) any distinction(s) in the security or source of payment of the debt service on the issue, and an indication of the part(s) of the issue to which such distinction(s) relate.

(ii) The information required by paragraph (i) of this section shall be provided in accordance with the provisions of this paragraph. At the time application is made the municipal securities broker or municipal securities dealer making such application shall provide to the Board or its designee a copy of a notice of sale, official statement, legal opinion, or other similar documentation prepared by or on behalf of the issuer, or portions of such documentation, reflecting the information required by this section. Such documentation may be submitted in preliminary form if no final documentation is available at the time of application. In such event the final documentation, or the relevant portions of such documentation, reflecting any changes in the information required by this section shall be submitted when such documentation becomes available. If no such documentation, whether in preliminary or final form, is available at the time application for CUSIP number assignment is made, such copy shall be provided promptly after the documentation becomes available.

(iii) The provisions of this section shall not apply with respect to any new issue of municipal securities on which the issuer or a person acting on behalf of the issuer has submitted an application for assignment of a CUSIP number or numbers to such issue to the Board or its designee.

(b) Each municipal securities broker or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall, prior to the delivery of such securities to any other person, affix to, or arrange to have affixed to, the securities certificates of such new issue the CUSIP number assigned to such new issue. If more than one CUSIP number is assigned to the new issue, each such number shall be affixed to the securities certificates of that part of the issue to which such number relates.

(c) In the event a syndicate or similar account has been formed for the purchase of a new issue of municipal securities, the managing underwriter shall take the actions required under the provisions of this rule.

(d) The provisions of this rule shall not apply to a new issue of municipal securities which does not meet the eligibility criteria for CUSIP number assignment.

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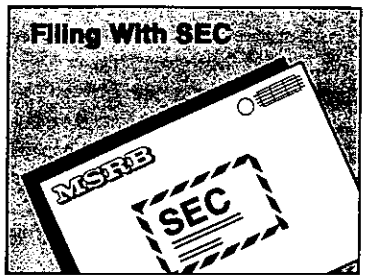

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Rule G-12

Amendments Filed Concerning Fungibility and Specific Identification of Municipal Securities Issues

On July 23, 1982, the Board filed with the Securities and Exchange Commission certain amendments to Board rule G-12 on uniform practice. The amendments incorporate into the rule two provisions relating to the fungibility (interchangeablity) of municipal securities with different dated dates and the delivery on a transaction of municipal securities with an assigned CUSIP number other than that reflected on the inter-dealer confirmation of the transaction. The amendments are the result of the Board's consideration of several issues related to the use of the CUSIP numbering system for municipal securities transactions and the development of more efficient clearance mechanisms in the municipal securities industry.

The provisions of the proposed amendments are discussed more fully below. The text of the amendments is attached to this notice. The Board has requested that the Commission delay the effective date of the second of the two amendments, that pertaining to the effect of CUSIP number differences on a delivery of securities, to January 23, 1983, six months from the date of this filing.

* * * * *

January 1982 Notice

On January 4, 1982 the Board released a "Notice Concerning Specific Identification of Municipal Securities" which discussed certain issues and proposals concerning the fungibility standards applying to deliveries of municipal securities and the use of CUSIP numbers in the comparison and clearance of municipal securities transactions. Concerning the fungibility standards applicable to municipal securities, the notice advised that the Board had promulgated rule changes specifying those elements of the securities description which must be identical on all securities delivered with respect to a transaction.* The notice pointed out that the "dated date" of an issue was a description detail reflected in the CUSIP number assignment, and proposed that delivered securities should be identical with respect to the dated date.**

With respect to the use of the CUSIP numbering system, the January 1982 notice stated that the Board favored the development of greater specificity in the identification of the issue of securities involved in a transaction, so as to permit the accurate selection of the proper CUSIP number on all transactions. The notice indicated that a significant number of dealers had adopted a "specific identification" approach on all securities traded and safekept; that is, such dealers were identifying all municipal securities issues sufficiently accurately to permit selection of the correct CUSIP number for each securities position. The notice proposed to mandate the industry-wide adoption of this practice of specific identification through authorizing the rejection of a delivery of securities if the CUSIP number pertaining to the delivered securities was different from that agreed upon at the time of trade (and reflected on the inter-dealer confirmations.)***

The January 1982 notice emphasized that these proposals were being raised in the context of the current developments

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

*These elements are:
(1) the issuer, interest rate, and maturity date of the securities;
(2) whether the securities are subject to redemption prior to maturity;
(3) whether the securities are general obligation, limited tax, or revenue securities;
(4) the type of revenue, if the securities are revenue securities;
(5) the identity of any company or other person (in addition to the issuer) obligated on the debt service of the issue;
(6) the specific provisions of a call or advance refunding, if the securities have been called or advance refunded;
(7) the dated date and first coupon date, if the securities have an "odd" (short or long) first coupon; and
(8) the details of the call provisions (optional, mandatory, and extraordinary redemption features), if any, applicable to the securities.

**The notice also stated that the Board had concluded that the security or source of payment on a general obligation issue was sufficiently material to require that securities delivered be identical with respect to this element; however, given that differences in the security or source of payment were not reflected in the CUSIP numbers currently assigned to such issues, the notice advised that the Board would not adopt such a requirement until the CUSIP system is adjusted to reflect such differences. At the Board's request, CUSIP numbers are being assigned, as of February 1, 1982, to reflect such security or source of payment differences on new issues sold on or after that date.

***The notice also discussed the issue of "specific description," *i.e.*, the extent to which all of the identifying details pertaining to a particular security need to be reflected on the confirmation. In this regard the notice solicited comment on the desirability of a requirement that customer confirmations contain CUSIP numbers; an exposure draft of such a requirement is being released concurrently with this notice.

in the processing and clearance area, particularly the adoption of automated comparison and clearance techniques for municipal securities transactions. The notice pointed out that more advanced systems for the comparison, clearance, and settlement of transactions in municipal securities depend heavily on the use of the CUSIP security identification numbering system for purposes of data entry, comparison, and generation of instructions. The notice asserted that, if the industry is to adapt successfully to the use of such systems, some means must be found of coordinating the industry's current trading and delivery practices with the need to identify securities by their appropriate CUSIP number. Therefore, the notice stated, trading must be conducted in a manner that is sufficiently specific to permit identification of the precise security identification number needed for proper instructions to these advanced comparison and clearance systems, and that deliveries must also be made in accordance with this identification of securities. The Board continues to be of the view that such changes in trading and delivery practices must be made, and, accordingly, has adopted the proposed amendments.

Certain developments since the release of the January 1982 notice have reemphasized the importance of these proposals to progress in the clearance area. In May 1982, in a release adopting certain amendments to the Commission's net capital rule, the Securities and Exchange Commission placed great stress on the need to "bring the municipal securities clearance and settlement system into parity with the rest of the securities industry," and indicated that it expected the Board and the industry to take steps to foster timely progress toward this end.* Also, the securities industry has generally begun to focus on the implementation of rule amendments proposed or adopted by the National Association of Securities Dealers, Inc., and the national securities exchange that would mandate a significant increase in the use of securities depositories for the confirmation and settlement of transactions with customers.** In the Board's view, both of these developments further emphasize the need for progress in the clearance area and the importance of the adoption of the Board's January 1982 proposals as a major step toward this goal.

The Proposed Amendments

In response to the January 1982 notice the Board received a number of thoughtful comments from members of the municipal securities industry, several of the registered clearing agencies, and other interested persons. Many of these comments included suggestions which have been helpful to the Board in finalizing the proposed amendments.

A. Amendment Regarding Fungibility

The first of the proposed rule changes amends paragraph (e)(ii) of rule G-12 to include the dated date of the securities in the list of elements which must be identical on all securities delivered with respect to a transaction. Upon SEC approval of the rule, therefore, securities with different dated dates will no longer be includable in a single delivery. The Board notes that, with the addition of the dated date of the securities to the list of descriptive elements set forth in the rule, the criteria governing the fungibility of municipal securities, as stated in the rule, become essentially congruent with the criteria used to assign CUSIP numbers to issues of municipal securities. Therefore, as a general rule, all securities delivered with respect to a transaction will have to have the same CUSIP number.

The Board believes that the inclusion of the dated date of the securities in the list of fungibility criteria will simplify the task of determining the fungibility of municipal securities. Persons engaged in processing and clearance can more readily identify a distinction in the dated dates of securities than the other types of distinctions, such as differences in the call provisions, that usually accompany such dated date differences. The adoption of the dated date as a fungibility criterion also fosters the use of the CUSIP system, since the CUSIP numbering system reflects dated date distinctions, as well as all other relevant fungibility distinctions, in assigning CUSIP numbers to new issues.

Certain commentators on the January 1982 notice suggested that the list of fungibility criteria in the rule include certain other descriptive elements, in addition to the dated date. The Board has determined not to adopt any of these additional criteria, inasmuch as certain of them are hypothetical in nature at this time (*i.e.*, no existing issue of municipal securities exhibits such features), and others would introduce an excessively refined set of fungibility standards that might unduly impede the trading and delivery of municipal securities and impose unwarranted burdens on the functioning of the market.

B. Amendment Regarding Specific Identification

The second of the proposed rule changes amends paragraph (e)(ii) to require, in new subparagraph (e)(ii)(B), that the securities delivered on an inter-dealer transaction must have the same CUSIP number as that set forth on the confirmation of such transaction. If the securities delivered have a CUSIP number different from that specified on the inter-dealer confirmations, the delivery may be rejected (except in the two cases discussed below). The amendment provides that the provisions of subparagraph (e)(ii)(B) will not become effective until January 23, 1983.

Certain of the commentators on the January 1982 notice expressed concern that this provision would appear to authorize rejections of deliveries even if the CUSIP number difference is attributable to a transposition, or other clerical error in the transcription of the number. Further, in a limited number of cases there may be CUSIP number discrepancies resulting from the fact that, in certain circumstances, the CUSIP number originally assigned to an issue may subsequently be changed, *e.g.*, in the event of an advance refunding of a part of the issue.*** The Board has included in proposed subparagraph (e)(ii)(B) a provision indicating that

*Excerpts from this release were published in *MSRB Reports*, Vol. 2, no. 4 at pages 3–10.

**An exposure draft of an amendment which would adopt a similar requirement with respect to municipal securities transactions is also being released concurrently with this notice.

***Such numbers are identified in publications providing CUSIP numbers.

CUSIP number differences resulting from either of these causes shall not be sufficient to authorize a rejection of a delivery.

Other commentators questioned whether the Board's proposal required traders to exchange CUSIP numbers at the time of trade, and suggested that such a requirement would impose a significant burden on the trading process. The Board does not believe that this proposal will require traders effecting a transaction to agree on the nine-digit CUSIP number during their conversation regarding the transaction. The Board notes, however, that this proposal will require that, when executing a transaction, traders must identify the securities involved in the transaction with sufficient accuracy (in most cases presumably through the identification of a dated date) to permit other personnel to select the correct CUSIP number.

The Board believes that this amendment will ensure that the industry adopts a general practice of specifically identifying all securities involved in transactions and will facilitate the use of the CUSIP numbering system as the means of security identification. The industry's adoption of the CUSIP numbering system as an integral part of trading and delivery practices will facilitate the development of more efficient clearance procedures and remove a major impediment to the use of automated comparison and book-entry delivery systems.

* * *

The proposed amendments must be approved by the Securities and Exchange Commission prior to effectiveness. As indicated previously, the Board has requested the Commission to delay the effectiveness of the second of the two amendments to January 23, 1983, to permit municipal securities brokers and municipal securities dealers sufficient time to adjust their trading, delivery, and safekeeping practices to facilitate the more accurate identification of securities involved in transactions that will be necessary under this provision.

July 26, 1982

Text of Proposed Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

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

(i) No change.

(ii) Securities Delivered.

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

(B) The securities delivered on a transaction shall have the same CUSIP number as that set forth on the confirmation of such transaction pursuant to the requirements of subparagraph (c)(v)(F) of this rule; provided, however, that, for purposes of this subparagraph, a security shall be deemed to have the same CUSIP number as that specified on the confirmation (1) if the number assigned to the security and the number specified on the confirmation differ only as a result of a transposition or other transcription error, or (2) if the number specified on the confirmation has been assigned as a substitute or alternative number for the number reflected on the security. The provisions of this subparagraph (B) shall become effective on January 23, 1983.

(iii) through (xvi) No change.

(f) through (l) No change.

*Underlining indicates additions.

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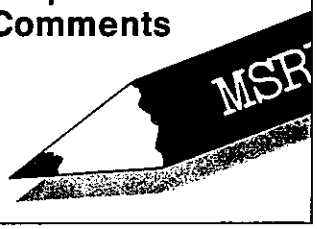
Request For Comments



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Rule G-15

Comments Requested Concerning Draft Amendment Requiring CUSIP Numbers on Customer Confirmations

The Board is circulating for public comment a draft amendment to the provisions of Board rule G-15 on customer confirmations. The amendment is being circulated for comment prior to further consideration by the Board and filing with the Securities and Exchange Commission.

Board rule G-15 requires that a customer confirmation set forth certain information concerning the transaction being confirmed, including descriptive information regarding the securities involved in the transaction. In its January 1982 notice concerning "Specific Identification of Municipal Securities" the Board requested comment on the desirability of including the assigned CUSIP number as a descriptive item of information on the customer confirmation. Certain commentators expressed support for such a requirement. Accordingly, the Board proposes to amend rule G-15 to require that the customer confirmation set forth the "CUSIP number, if any, assigned to the securities" as an additional item of security description.

The Board believes that inclusion of the appropriate CUSIP number on the customer confirmation may be of significant benefit to institutional and individual customers, as well as municipal securities brokers and dealers. Institutional investors, historically an important segment of the population investing in municipal securities, typically utilize CUSIP numbers in their systems for recording and safekeeping their securities holdings*; hence, the more precise identification of specific issues made possible by the use of the CUSIP numbering system could be of value to these investors in determining the nature of the securities they hold. Further, the Board anticipates that institutional investors will become important participants in automated confirmation and book-entry delivery systems for municipal securities transactions (as has been the case with respect to corporate securities). The inclusion of CUSIP numbers on confirmations sent to these investors could, in the Board's view, foster this development as well.

The Board notes that inclusion of the number on the confirmation will provide the individual investor easy access to it should he or she need to know the number at some future time. Since CUSIP number identification of issues is important to the municipal securities industry, the Board believes that the ability of an individual investor to correctly identify the securities he or she holds through the accurate CUSIP number identification may assist that investor at the time of a future sale of such securities.

The text of the draft amendment follows. All interested persons are invited to submit written comments to the Board on the draft amendment. Written comments will be available for public inspection.

August 2, 1982

Letters of comment should be submitted to the Board on or before October 15, 1982, and should be sent to the attention of Donald F. Donahue, Deputy Executive Director, Municipal Securities Rulemaking Board, Suite 507, 1150 Connecticut Avenue, N.W., Washington, D.C. 20036.

* * * * *

Text of Draft Amendment

Rule G-15. Customer Confirmations**

(a) At or before the completion of a transaction in municipal securities with or for the account of a customer, each broker, dealer or municipal securities dealer shall give or send to the customer a written confirmation of the transaction containing the following information:

(i) through (v) No change.

(vi) CUSIP number, if any, assigned to the securities;

(vi) through (xiii) renumbered as (vii) through (xiv). No substantive change.

(b) through (i) No change.

*The Board notes that this is also generally true for bank trust accounts, which are often classed in the "individual investor" category.

**Underlining indicates new language.

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Rule G-25

Comments Requested on Proposed Amendments to Prohibitions of Guarantees Against Loss

The Board is circulating for comment certain amendments to rule G-25(b) concerning guarantees against loss. Rule G-25(b) generally prohibits a municipal securities dealer from guaranteeing a customer against loss. The rule provides that "bona fide put options" and "repurchase agreements issued in the ordinary course of business" are not deemed to be guarantees against loss for purposes of the rule. The Board is considering whether to adopt amendments that would exempt from the general prohibition guarantees, including put options, repurchase agreements and remarketing agreements, if the terms of such guarantees are provided in writing to a customer with delivery of the final confirmation and are recorded on the dealer's books in accordance with Board rule G-8(a)(v) concerning books and records. The full text of the draft amendment follows this notice.

The rule, which became effective in 1978, is intended in part to prevent a municipal securities representative from inducing customers to purchase or sell securities by making guarantees on behalf of the dealer which the dealer is not aware of or does not intend to recognize. The Board believes the draft amendments by requiring that the details of all guarantees be disclosed in writing to a customer may be effective in assuring the customer protections the rule is designed to achieve and, at the same time, would allow the industry sufficient flexibility to enter into legitimate financing and other business arrangements in the conduct of municipal securities business. If the draft amendment is adopted, oral put options, repurchase or remarketing agreements and other guarantees that are not disclosed in writing as required by the draft amendment would be deemed to be a guarantee against loss prohibited by the rule.

The Board wishes to emphasize that rule G-17 prohibits municipal securities dealers from making untrue or misleading statements of material fact to customers concerning municipal securities they are considering purchasing. Therefore, issuing a guarantee against loss that a dealer does not intend to honor or otherwise cannot honor would violate rule G-17 regardless of whether it was disclosed in writing.

The Board welcomes written comments from all interested persons on the draft amendments. Such comments will assist the Board in determining whether to adopt the amendments for filing with the Securities and Exchange Commission.

July 14, 1982

Comments on the draft amendments should be directed to Angela Desmond, Deputy General Counsel, no later than October 15, 1982, and will be made available for public inspection.

* * * * *

Text of Amendment*

Rule G-25. Improper Use of Assets

(a) No change.

(b) Guaranties. No broker, dealer, or municipal securities dealer shall guarantee or offer to guarantee a customer against loss in

(i) No change.

(ii) a transaction in municipal securities with or for a customer;

~~Bona fide put options and repurchase agreements issued in the ordinary course of business shall not be deemed to be guaranties against loss.~~ unless the terms of such guarantee (including any bona fide put option, repurchase agreement and remarketing agreement) are provided in writing to the customer with delivery of the confirmation of the transaction and are recorded in accordance with rule G-8(a)(v).

(c) No change.

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

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Rule G-12

Amendments Approved Concerning Use of a Registered Clearing Agency

The Securities and Exchange Commission approved on June 22, 1982 certain amendments to Board rule G-12 concerning the use of the facilities of a registered clearing agency for the comparison, clearance, and settlement of transactions in municipal securities. The text of the amendments follows this notice. The amendments were effective upon approval by the Commission.

Prior to approval of the amendments rule G-12 had contained a general exclusion from its application for transactions which are "compared, cleared, and settled through the facilities of a clearing agency registered with the Commission." In view of the increasing role played by registered clearing agencies in the comparison, clearance and settlement of municipal securities transactions, the Board reviewed this exclusion and concluded that it was inappropriately broad in its scope and did not provide sufficient guidance as to the applicability of certain sections of the rule (*e.g.*, the reclamation provisions on the close-out procedures). The Board also concluded that certain additional changes to other provisions of the rule would be helpful in clarifying the relationship between the requirements of the Board's rule and those of registered clearing agency rules.

The amendments accomplish these results as follows:

- Rule G-12(a)(i) has been amended to clarify that the exclusion from the rule for transactions processed through a registered clearing agency applies only to those functions—comparison, clearance and/or settlement—actually performed by the clearing agency. Accordingly, the rule now provides that transactions submitted to a registered clearing agency for comparison are exempt from the confirmation requirements of rule G-12(c) and, to the extent such transactions are successfully compared, the comparison and verification procedures required under G-12(d). Transactions which are submitted to a registered clearing agency for clearance and settlement are exempt from the "good delivery" provisions of rule G-12(e). The remaining provisions of the rule remain applicable to such transactions.*
- Rule G-12(d) has been amended to include a new paragraph (vii) containing requirements for the verification of transactions which are submitted to a registered clearing agency for comparison but fail to compare. A detailed discussion of the provisions of new paragraph (d)(vii) is set forth in the interpretive letter which follows this notice.
- Rule G-12(e)(i) has been amended to clarify that the use of envelope delivery services or other services offered by registered clearing agencies that involve the physical delivery of securities constitutes good delivery when the parties to the transaction so agree.
- Rule G-12(e)(iv) on partial deliveries has been amended to emphasize that the rule's restrictions on the deliveries of partials do not apply to deliveries pursuant to balance orders or other similar instructions issued by registered clearing agencies.

July 8, 1982

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

Text of Amendments**

Rule G-12. Uniform Practice

(a) Scope and Notice

(i) All transactions in municipal securities between any broker, dealer or municipal securities dealer shall be subject to the provisions of this rule, ~~except to the extent that such transactions are compared, cleared and settled through the facilities of a clearing agency registered with the Commission, in which event the rules of such clearing agency shall apply~~ provided, however, that a transaction submitted to a registered clearing agency for comparison shall be exempt from the provisions of section (c) and, to the extent such transaction is compared by the clearing agency, section (d) of this rule, and a transaction which is settled or cleared through the facilities of a registered clearing agency shall be exempt from the provisions of section (e) of this rule.

(ii) through (iii) No change.

(b) and (c) No change.

*The Board notes, however, that certain of these provisions may be altered by agreement of the parties to the transaction. Therefore, the two parties to a transaction submitted to a registered clearing agency for clearance may, for example, elect, by mutual agreement, to use the clearing agency's close-out procedures rather than the Board's close-out procedures.

**Underlining indicates additions; material which is lined through has been deleted.

(d) Comparison and Verification of Confirmations; Unrecognized Transactions

(i) through (vi) No change.

(vii) In the event a party has submitted a transaction for comparison through the facilities of a registered clearing agency but such transaction fails to compare, the submitting party shall, within one business day after final notification of the failure to compare is received from the clearing agency, initiate the procedures required by paragraph (iii) of this section; provided, however, that if the submitting party initiates within such time period, in accordance with the rules of a registered clearing agency, a post-original-comparison procedure on the uncompared transaction, which requires affirmative action of the contraparty, the submitting party shall not be required to follow the procedures required by paragraph (iii) of this section.

(vii) and (viii) renumbered as (viii) and (ix). No substantive change.

(e) Delivery of Securities. The following provisions govern the delivery of securities:

(i) Place and Time of Delivery. Delivery shall be made at the office of the purchaser, or its designated agent, between the hours established by rule or practice in the community in which such office is located. If the parties so agree, book entry or other delivery through the facilities of a registered clearing agency ~~or delivery by other means which do not involve the physical delivery of securities~~ will constitute good delivery for purposes of this rule.

(ii) and (iii) No change.

(iv) Partial Delivery. The purchaser shall not be required to accept a partial delivery with respect to a single trade in a single security. For purposes of this paragraph, a "single security" shall mean a security of the same issuer having the same maturity date, coupon rate and price. The provisions of this paragraph shall not apply to deliveries made pursuant to balance orders or other similar instructions issued by a registered clearing agency.

(v) through (xvi) No change.

(f) through (l) No change.

Letter of Interpretation Concerning Rule G-12(d)(vii)

This will confirm the substance of our previous conversations regarding the Board's recent amendments to its uniform practice rule (rule G-12) relating to the use of the facilities of a registered clearing agency to compare, settle, and clear transactions in municipal securities. Our discussions focused on proposed paragraph (d)(vii) of the rule, which, as currently on file with the Commission, reads as follows:

> In the event a party has submitted a transaction for comparison through the facilities of a registered clearing agency but such transaction fails to compare, the submitting party shall, within one business day after final notification of the failure to compare is received from the clearing agency, initiate the procedures required by paragraph (iii) of this section; provided, however, that if the submitting party initiates within such time period, in accordance with the rules of a registered clearing agency, a post-original-comparison procedure on the uncompared transaction, which requires affirmative action of the contra-party, the submitting party shall not be required to follow the procedures required by paragraph (iii) of this section.

The following examples illustrate the effect of this proposed rule, as applied to NSCC's system for the automated comparison of municipal securities transactions:

Given

Dealers A and B effect a transaction in municipal securities. On trade date plus one business day ("T + 1"), only dealer A submits transaction data to NSCC, with dealer B failing to do so. On T + 2 dealer A receives a contract sheet showing the transaction as uncompared; an advisory regarding the transaction is prepared and sent to dealer B.

Example One

On T + 2, dealer B stamps and returns the advisory to NSCC, acknowledging the transaction. On T + 3, dealer A receives a supplemental contract sheet showing the transaction as "compared." Dealer A need not follow the verification procedure required under paragraph (d)(iii) of Board rule G-12.

*Example Two**

On T + 3, dealer A receives a supplemental contract sheet, also showing the transaction as uncompared. Since this is the final notice of the failure to compare which dealer A will receive, dealer A becomes subject to the provisions of paragraph (d)(iii). Dealer A must therefore initiate the verification procedure by telephoning dealer B not later than T + 4 and advising dealer B of its failure to confirm. If, however, dealer B submits a stamped advisory on the transaction on T + 3 (whether as a result of the telephone call or otherwise), A will receive an "added trade" contract sheet on T + 4, showing this transaction as "compared." In this event A need not initiate the verification procedure on T + 4; if A has already done so, A need not complete the procedure by sending the written notification on T + 5.**

Example Three

On T + 3, dealer A receives a supplemental contract sheet, showing the transaction as uncompared. Since this is the final notice of the failure to compare which dealer A will receive, dealer A becomes subject to the provisions of paragraph (d)(iii). Dealer A must therefore initiate the verification procedure by telephoning dealer B on T + 4 and advising B of its failure to confirm. On T + 5, in the absence of any written acknowledgment of the transaction (such as is contemplated in Example Two), dealer A must send the

*We understand that NSCC rules currently require dealers receiving advisories to respond within one business day (as contemplated in example one), but that NSCC plans to extend this response time in the near future to two business days. Example Two assumes that this change has been implemented.

**Given this possibility, dealer A may wish to wait until T + 4 prior to initiating the procedure, so that it may determine whether the transaction is reflected as an "accepted advisory" on the "add trade" contract sheet.

written "failure to confirm" notice required under paragraph (d)(iii).

Should dealer B subsequently acknowledge the transaction, both dealer A and dealer B may resubmit the transaction to NSCC on an "as of" basis. Alternatively, dealer A may resubmit the transaction on a "demand as of" basis.

Example Four

On T + 3 dealer A receives a supplemental contract sheet, showing the transaction as uncompared. Since this is the final notice of the failure to compare which dealer A will receive, dealer A becomes subject to the provisions of paragraph (d)(iii). On T + 4, however, dealer A elects to utilize the "demand as of" procedure,* and submits the transaction data on a "demand as of" basis on that date. In this circumstance dealer A is not required to follow the procedure under paragraph (d)(iii).

Example Five

On T + 3 dealer A receives a supplemental contract sheet, showing the transaction as uncompared. Since this is the final notice of the failure to compare which dealer A will receive, dealer A becomes subject to the provisions of paragraph (d)(iii). On T + 4, dealer A resubmits the transaction data on a "demand as of" basis, thereby averting the need to follow the procedure prescribed in paragraph (d)(iii). On T + 6, however, dealer B rejects the advisory, indicating that it does not agree with the security (CUSIP number) identified by dealer A. Dealer A is therefore again advised that the transaction has failed to compare, and dealer A again becomes subject to the provisions of paragraph (d)(iii). On T + 7, dealer A must telephone dealer B regarding the failure to confirm, and on T + 8, dealer A must send a written "failure to confirm" notice.

Again, should dealer A and dealer B subsequently come to agreement on the transaction, both dealers may resubmit the transaction to NSCC on an "as of" basis. Alternatively, dealer A may resubmit the transaction on a "demand as of" basis.

Example Six

On T + 3 dealer A receives a supplemental contract sheet, showing the transaction as uncompared. Since this is the final notice of the failure to compare which dealer A will receive, dealer A becomes subject to the provisions of paragraph (d)(iii). On T + 4, dealer A elects to resubmit the transaction data on an "as of" basis, so as to retain the transaction in NSCC's system. In view of the fact that the "as of" procedure does not compel a response from dealer B, however, dealer A is not relieved of its obligation to follow the "failure to confirm" procedure required under paragraph (d)(iii), and it must initiate such procedure by the close of business on T + 4.

A slight variation of our "given" situation might arise, and would be handled as described below:

Example Seven

Dealers A and B effect a transaction in municipal securities. On T + 1, however, both dealers inadvertently fail to submit transaction data to NSCC. On T + 4, dealer A discovers the error, and submits the transaction data to NSCC on an "as of" basis. Dealer A would not be required to follow the procedure required under paragraph (d)(iii) until the business day following "final notification of the failure to compare" which would, in the case of this example, be T + 7.

I believe these examples should clear any confusion about the application of the proposed new paragraph.—*MSRB interpretation of April 27, 1982 by Donald F. Donahue, Deputy Executive Director.*

*This example assumes that NSCC has made the "demand as of" procedure available on municipal securities transactions. We understand that this procedure, available only between T + 4 and T + 15, is restricted to those transactions in which the party using the "demand as of" has previously submitted the transaction data. If the "demand as of" matches another resubmission of transaction data, a "compared" trade will be generated. If the "demand as of" does not match, a "demand as of advisory" is generated, and sent to the non-submitting dealer (dealer B, in our example). If the "demand as of" is not accepted, "DK'd," or rejected within a specified time period, a "compared" trade is generated. Further, if the dealer receiving a "demand as of advisory" "DK's" all or part of the transaction, such dealer gives up all future recourse against the submitting dealer for that portion of the transaction "DK'd." The case of a rejected "demand as of advisory" is discussed in Example Five.

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Rule G-3

Notice Concerning Minimum Waiting Periods Required Before Retaking Failed Qualification Examinations

Board rule G-3 requires that municipal securities professionals take and pass examinations prior to being qualified to engage in municipal securities representative activities or to supervise municipal securities activities as principals. Rule G-3(h) establishes minimum waiting periods before persons, who have failed an examination, may retake the examination. The Board wishes to emphasize that in carrying out their supervisory responsibilities municipal securities brokers and municipal securities dealers must assure themselves that their associated persons have complied with these waiting-period provisions before retaking the Board's professional qualification examinations. Further, an examination retaken during these restricted time periods is invalid for purposes of meeting the qualification requirements of the rule.

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Rule G-3(h) requires that

> [a]ny associated person of a municipal securities broker or municipal securities dealer who fails to pass a qualification examination prescribed by the Board shall be permitted to take the examination again after a period of 30 days has elapsed from the date of the prior examination, except that any person who fails to pass an examination three or more times in succession shall be prohibited from again taking the examination until a period of six months has elapsed from the date of such person's last attempt to pass the examination.

An individual who fails (*i.e.*, does not achieve a score of 70% or higher) a qualification examination prescribed by the Board* must wait a minimum period of time from the date of the failed examination before again sitting for that examination. These minimum waiting periods are thirty days after the first and second failed attempts, and six months after the third and all subsequent failed attempts. There is no provision in the rule which allows these restrictions to be waived under any circumstances. This provision of the qualification requirements protects the integrity of the Board's qualification examinations and also serves to help examination candidates by providing a period of time in which to acquire the knowledge necessary for a successful completion of the qualification examination.

The Board recognizes the possibility that violations may occur because the examination candidates' employer may be acting out of ignorance of the rule, and so is taking this opportunity to remind the industry of those provisions.** A qualification examination taken in contravention of rule G-3(h) not only violates this provision of the rule, but also is invalid for purposes of meeting the examination requirements of the rule. Thus, an individual who sits for an examination within 30 days of a failed first or second examination attempt (or within six months of the third and all subsequent failures) does not become qualified by means of that reexamination, regardless of the test score achieved on the examination.***

The Board wishes to emphasize its continuing commitment to the area of professional qualifications. High standards of professional competence facilitate the efficient functioning of the municipal securities markets and promote public confidence in the municipal securities industry. In the Board's view rule G-3(h) is an important tool in achieving these goals.

July 9, 1982

Questions relating to this notice may be directed to Peter H. Murray, Assistant Executive Director

*These are:
Municipal Securities Representative Qualification Examination (Series 52)
Municipal Securities Principal Qualification Examination (Series 53)
Municipal Securities Financial and Operations Principal Qualification Examination (Series 54)

**Since examination candidates are associated persons of a municipal securities broker or municipal securities dealer, supervisory responsibility rests with the candidates' sponsoring firms.

***A municipal securities broker or municipal securities dealer, who fails to appropriately supervise in accordance with the provisions of rule G-3(h), may be held to be in violation of rule G-27.

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Attention

Route To:

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

Rules G-12 and G-15

Interpretations Concerning Requirements Pertaining to Transactions in Registered Securities

The Board has recently received several interpretive inquiries relating to the application of Board rules to transactions in registered mortgage revenue bonds. Pursuant to the provisions of legislation enacted in December 1980 new issues of such securities sold on or after January 1, 1982 must be issued solely in fully-registered form. Members of the industry have inquired as to the confirmation and delivery requirements applicable to transactions in such registered issues.

Board rules G-12(c)(vi)(B) and G-15(c)(ii) require, with respect to inter-dealer and customer confirmations respectively, that the confirmation of a transaction include,

> if the securities are "fully registered" . . . , a designation to such effect . . .

With respect to inter-dealer deliveries, rule G-12(e)(vi) provides that a

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

Rule G-12(g)(iii)(A)(4) provides a right of reclamation for one business day in the event that a dealer mistakenly accepts from another dealer a delivery of registered securities which were not identified as such at the time of trade; this reclamation provision is also limited to securities which are "issuable in both bearer and registered form."*

Therefore, with respect to transactions in mortgage revenue bonds which were issued solely in registered form, the Board's rules require that confirmations of such transactions contain a designation that the securities are in registered form. A delivery of such securities, however, may *not* be rejected on the basis that registered securities, rather than bearer securities, were delivered, even if the fact that the securities were in registered form was not specified at the time of the trade. Similarly, a dealer accepting a delivery of registered securities may not reclaim such delivery on the basis that bearer securities should have been delivered, even though at the time of trade the selling dealer failed to identify the securities as being in registered form.** The provisions of the rule G-12 on deliveries of securities and on reclamations do not apply to transactions in mortgage revenue bonds issued after January 1, 1982, since such securities are not "issuable in both bearer and registered form," but rather are available only in registered form.

The Board is of the view that this result is appropriate. The Board believes that municipal securities brokers and dealers, as professionals, have a responsibility to be knowledgeable concerning the securities in which they are dealing. In the case of mortgage revenue securities the Board believes that municipal securities brokers and dealers should be aware that mortgage revenue securities issued after January 1, 1982 are available solely in registered form.

* * *

The Board has also received inquiries concerning the denominations in which registered securities may be delivered on inter-dealer transactions. Board rule-12(e)(v) specifies that deliveries of registered securities may be made

> in denominations which are multiples of $1000 par value, up to $100,000 par value. . . .

A municipal securities dealer selling a registered security need not specify the denominations of certificates which it will deliver, if such denominations are in accord with the above provision (*i.e.*, if they are in multiples of $1000 and do not exceed $100,000 per certificate). If the denominations of the certificates are not in accord with this provision (*e.g.*, if the denominations include $500 pieces, or are larger than $100,000), this must be specified at the time of trade and such denominations must be indicated on the confirmation.

July 16, 1982

Questions concerning this notice may be directed to Donald F. Donahue, Deputy Executive Director.

*Rule G-12(g)(iii)(C) (2) permits reclamation for up to 18 months in the event that the documentation provided with the registered certificates is not sufficient to permit transfer or deregistration.

**Of course such dealer would be able to reclaim the delivery if the documentation provided with the registered securities was not sufficient for transfer purposes.