MSRB REPORTS

Volume 5, Number 2 | Municipal Securities Rulemaking Board | February 1985

In This Issue

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Important Reminders

The Board nomination process for selecting new Board members to serve three-year terms beginning October 1, 1985, has begun. Send recommendations for nomination by March 15, 1985, to John L. Glenn, Jr., Chairman of the Nominating Committee, c/o Municipal Securities Rulemaking Board, Suite 800, 1818 N Street, N.W., Washington, DC 20036-2491.

The Board arbitration program is now being administered from the Board offices. Documents required for filing an arbitration claim should be sent to the Director of Arbitration, Municipal Securities Rulemaking Board, 1818 N Street, N.W., Suite 800, Washington, DC 20036-2491. Requests for information and materials should also be directed to the Board offices.

MSRB REPORTS (ISSN-0277-0911) is published by the Municipal Securities Rulemaking Board, 1818 N Street, N.W., Suite 800, Washington, DC 20036-2491. POSTMASTER: send address changes to Municipal Securities Rulemaking Board, 1818 N Street, N.W., Suite 800, Washington, DC 20036-2491.

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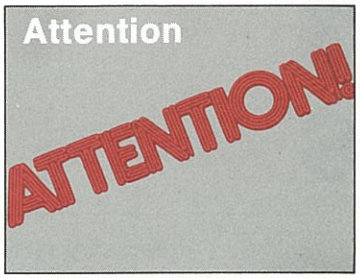

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Publications

Third Edition of the *Manual on Close-Out Procedures* Now Available

The Board has published a new edition (dated January 1985) of its *Manual on Close-Out Procedures*. The new edition of the *Manual* contains, in addition to the previously published material, new sections reviewing amendments to the close-out rules effective in June 1983 which—

- established an extension of time in the event the securities which are the subject of the close-out notice have been submitted for transfer, and
- made provision for the use of the close-out procedures in the event of certain types of reclamations.

The new edition also contains other new material covering recent interpretations of the general close-out rules. A copy of the *Manual* has been mailed to each municipal securities broker and dealer. Additional copies may be obtained from the Board offices at a cost of $3.00 per copy.

Arbitration: Two New Pamphlets Published

Two arbitration pamphlets have been published to facilitate the in-house administration of the Board arbitration program:

- "Arbitration Information and Rules" reprints the Board rules and two publications, prepared by the Securities Industry Conference on Arbitration, which discuss arbitration procedures in general and small-claim arbitration for investors;
- "Instructions for Beginning an Arbitration" sets forth the step-by-step procedure and includes the forms for filing an arbitration claim.

Calendar

January 8 —Effective date of G-17 interpretation on syndicate manager practices

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

Pending —SEC approval of amendments to:

- A-12 on payment of initial fee
- G-3 on loss of qualification as principal
- G-12 on use of post-original-comparison procedures of registered clearing agencies
- G-12 and G-15 on delivery of called securities

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Tender Option Programs: SEC Response to Board Letter

In September, the Board advised the SEC that questions had arisen whether municipal securities with secondary market tender options attached (units) are "municipal securities" under the Securities Exchange Act of 1934, and, if not, what their status is under the Act. The SEC has sent the Board a letter stating that—

- **transactions in the units are transactions in municipal securities and subject to Board rules;**
- **transactions in the units are also transactions in "nonmunicipal option securities" and subject to NASD rules on options, which include options qualification requirements; and**
- **transactions in the options alone are subject to NASD options rules, but may also be subject to Board rules under cited case law.**

Securities and Exchange Commission
Washington, D.C. 20549

October 25, 1984

Donald F. Donahue
Deputy Executive Director
Municipal Securities Rulemaking Board
1150 Connecticut Avenue, N.W.
Suite 507
Washington, D.C. 20036

Dear Don:

I am responding to your letter of September 21, 1984, in which you asked several questions regarding the regulatory status of municipal bond "tender options" or "put options" offered by broker-dealers or other entities other than municipalities (generally, "tender options"). Such tender options are attached to municipal bonds in secondary market issues of these bonds. You specifically requested that the Commission concur in the MSRB's view that a transaction in a municipal bond with such a tender option attached is a transaction in a municipal security for purposes of the Securities Exchange Act of 1934 ("Act"),[1] and therefore subject to MSRB's rules. You also requested the Commission's views regarding whether the tender options by themselves are municipal securities under the Act, and if not, what regulatory scheme applies to these tender options.

The Division of Market Regulation believes that municipal securities with such tender options attached fall within the definition of the term "municipal securities" in Section 3(a)(29) of the Act. Despite the attachment of tender options, the underlying securities continue to be municipal securities which are direct obligations (or obligations guaranteed by) a state or agency, instrumentality, or political subdivision thereof, as defined in Section 3(a)(29). Consequently, these municipal securities with tender options attached are subject to the MSRB's rules.

However, when a municipal security and a secondary market tender option are traded together as a unit, the Division believes that this unit constitutes a municipal security with a nonmunicipal element. Transactions in these units must be regarded as transactions in both municipal securities and nonmunicipal option securities. As a result, the rules of both the MSRB and the NASD, including options qualifications requirements, would apply to transactions in these securities. We recognize, however, that there are important distinctions between municipal units with nonseverable tender options and units with severable tender options, where a separate secondary market for the tender option can devleop. Accordingly, the Division would be willing to consider a no-action position regarding the application of NASD options rules to municipal units with nonseverable tender options.

With respect to the tender options themselves, the Division does not believe that the tender options in question are themselves municipal securities, as they are not issued or guaranteed by a state or instrumentality thereof. The Division believes, however, that the purchase or sale of tender options may very well constitute transactions in municipal securities for purposes of Section 15B(b)(2) of the Act,[2] and thus may be subject to MSRB rules regarding transactions in municipal securities.[3] Nonetheless, the Division recognizes that the MSRB's rules were not adopted with application to tender

[1]The Division expresses no view with respect to the applicability of the Securities Act of 1933 to reofferings of municipal securities with put options attached.

[2]*See LTV v. UMIC Government Securities, Inc.*, 523 F. Supp. 819, 835 (N.D. Tex 1981), *aff'd*, 704 F.2d 199 (5th Cir. 1982), *cert. denied*, ___U.S. ___, 104 S. Ct. 163 (1983), which held that a standby commitment in GNMA's constituted a purchase or sale of GNMA's for purposes of the antifraud provisions of the securities laws. *See also Abrams v. Oppenheimer Government Securities, Inc. et al.*, 1983 Fed. Sec. L. Rep. (CCH) ¶99,409 (N.D. Ill. Jan. 3, 1983), *aff'd*, 737 F.2d 582 (7th Cir. 1983); *ABM Industries Inc. v. Oppenheimer Government Securities, Inc. et al.* 1983 Fed. Sec. L. Rep. (CCH) ¶99,435 (N.D. Ill. Mar. 14, 1983); *Plymouth-Home National Bank v. Oppenheimer & Co., Inc.*, 1983 Fed. Sec. L. Rep. (CCH) ¶99,265 (N.D. Ill. June 24, 1983).

[3]Because these tender options are not exempt securities, they also are subject to the rules of the NASD.

options in mind, and accordingly we would be willing to consider taking a no-action position regarding the application of existing MSRB rules to tender options traded separately from the underlying security.

I hope this letter is responsive to your questions. I would be happy to further discuss any of the matters discussed in this letter with you if you so desire.

Sincerely,
[s] Richard G. Ketchum
Director

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Use of Nonqualified Individuals to Solicit New Account Business: Rule G-3

Summary of Interpretation

An individual who solicits new account business from potential customers for a municipal securities dealer must be qualified as a municipal securities representative.

The Board has received inquiries whether individuals who solicit new account business on behalf of municipal securities dealers must be qualified under the Board's rules. In particular, it has come to the Board's attention that nonqualified individuals are making "cold calls" to individuals and, by reading from prepared scripts, introduce the services offered by a municipal securities dealer, prequalify potential customers, or suggest the purchase of specific securities currently being offered by a municipal securities dealer.

Board rule G-3(a)(iii) defines municipal securities representative activities to include any activity which involves communication with public investors regarding the sale of municipal securities but exempts activities that are solely clerical or ministerial. In the past, the Board has permitted nonqualified individuals, under the clerical or ministerial exemption, to contact existing customers in very limited circumstances. In an interpretive notice on rule G-3, the Board permitted certain ministerial and clerical functions to be performed by nonqualified individuals when municipal securities representatives and principals who normally handle the customers' accounts are unavailable, subject to strict supervisory requirements. These functions are: the recording and transmission in customary channels of orders, the reading of approved quotations and the giving of reports of transactions. In this notice, the Board added that solicitation of orders by clerical personnel is not permitted.[1] The Board is of the view that individuals who solicit new account business are not engaging in clerical or ministerial activities but rather are communicating with public investors regarding the sale of municipal securities and thus are engaging in municipal securities representative activities which require such individuals to be qualified as representatives under the Board's rules.

Finally, under rule G-3(i), a person serving an apprenticeship period prior to qualification as a municipal securities representative may not communicate with public investors regarding the sale of municipal securities. The Board sees no reason to allow nonqualified individuals to contact public investors, except for the limited functions noted above, when persons training to become qualified municipal securities representatives may not do so.

December 21, 1984

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

[1] *See* Interpretive Notice on Professional Qualifications, *MSRB Manual* (CCH) ¶3511 at 3514–15.

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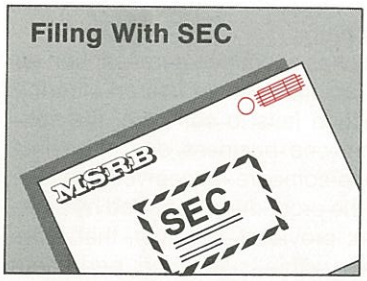

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Use of Post-Original-Comparison Procedures of Registered Clearing Agencies: Rule G-12

Principal Change Proposed

The amendments clarify that transactions submitted for comparison through the automated facilities of a registered clearing agency that do not compare in the initial comparison cycle must be processed according to the post-original-comparison procedures available through the registered clearing agency.

On February 5, 1985, the Board filed with the Securities and Exchange Commission amendments to certain of the provisions of rule G-12 regarding comparison of inter-dealer transactions. The amendments would make clear that municipal securities brokers and dealers submitting transactions to be cleared by the automated facilities of a registered clearing agency must use the post-original-comparison procedures available through the registered clearing agency if the transaction submitted does not compare in the initial comparison cycle. The Board has requested the Commission to delay the effective date of the amendments for a period of 60 days following the date of Commission approval.

Background

Board rule G-12 sets forth certain provisions governing the comparison, clearance, and settlement of inter-dealer transactions in municipal securities. Section (f) of the rule provides that, in certain circumstances, municipal securities brokers and dealers which are participants in a registered clearing agency offering automated comparison services must submit transaction information to the registered clearing agency for automated comparison. This provision, which became effective on August 1, 1984, was adopted by the Board as part of its effort to promote the use of automated techniques for the clearance and processing of municipal securities transactions.

The Board is of the view that the implementation of this provision has proceeded to date with a reasonable degree of success. Many of those municipal securities brokers and dealers subject to the rule have adopted the use of automated comparison procedures for a substantial portion of their transactions, and registered clearing agencies have indicated to the Board that the majority of inter-dealer transactions are currently being compared through the automated comparison system.[1] Although the initial rates of comparison of transactions through the system remain unacceptably low, the overall comparison rate as of the third business day following the trade date is at a more acceptable level: 85% or more of submitted transactions are compared by that time.

The smooth and efficient implementation of the automated comparison system has been somewhat hindered by several problems which became apparent as the industry began to adopt the automated comparison procedures. Certain of these problems have been addressed by Board interpretations or by suggestions for alternative procedures.[2] In another case, the Board has concluded that the current provisions of rule G-12(f), together with an apparent conflict between these provisions and one of the provisions of rule G-12(d) (the section of the rule setting forth the requirements for comparison of physical confirmations), has caused confusion among industry members as to the proper way of handling transactions which are not compared in the original comparison cycle; accordingly, the Board adopted the rule amendments to eliminate this confusion.

In adopting the automated comparison requirements of rule G-12(f) the Board intended that the parties to a transaction submitted for comparison through the automated system would continue to attempt to compare the transaction through the system until the transaction was successfully composed or formal notification of a failure to compare was received. In circumstances in which the transaction was not compared during its original submission into the comparison system, this would necessitate the use of the post-orig-

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

[1]The bulk of those transactions which are not being submitted for comparison through the system at this time are types of transactions which currently are not eligible for comparison through the system (*e.g.*, transactions effected on a "when, as and if issued" basis), but which will be included in the system within the near future.

[2]*See, e.g.*, interpretive notice entitled "Specific Transactions—Determining whether Contra-Party is Inter-Dealer or Customer" and letter of interpretation on the use of automated comparison services, *MSRB Reports*, vol. 5, no. 2, discussing several of these problem areas.

inal-comparison procedures provided by the system.[3] The Board believes that this is appropriate and in accordance with its objectives of promoting efficiency in the comparison process through the use of automated comparison systems.

The Board understands that many system participants are following this procedure: that is, in cases where a transaction is not compared as a result of its original submission, these participants are using an "as of" or "demand as of" procedure to accomplish comparison. Other system participants, however, have not pursued comparison of transactions through the system once the original attempt proves unsuccessful, but rather have initiated physical comparison procedures, or the physical "failure to confirm" procedures found in Board rule G-12(d)(iii), with respect to these transactions. Some of these participants apparently believe that this action is permitted by Board rule G-12(d)(vii).[4] These persons are misconstruing the intent of the automated comparison requirements of section (f) of the rule. The Board therefore has adopted the rule amendments to clarify the requirements of section (f) in circumstances where a transaction is not compared in the original comparison cycle.

Requirements of the Proposed Amendment

The amendments adopted by the Board clarify the rule by incorporating into section (f) language which explicitly requires the use of post-original-comparison procedures on transactions which have been submitted but not compared in the original comparison cycle. The amendments specify that such procedures should be used until the transaction is successfully compared or until a formal notification of failure to compare the transaction (*i.e.*, a "DK" notification) is received from the contra-party. The amendments also delete the provisions of present paragraph (d)(vii) of the rule to eliminate the apparent conflict between these provisions and the requirements of section (f) of the rule. The Board believes that the amendments will allow increased numbers of transactions to compare through the automated comparison system, eliminate substantial numbers of manual comparison procedures and give clear guidance to industry members who may be confused about whether the use of post-original-comparison procedures offered by registered clearing agencies is required under Board rules.

February 5, 1985

Text of Proposed Amendments*

Rule G-12. Uniform Practice

(a) through (c) No change.

(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) ~~(viii)~~ [Paragraph (viii) renumbered (vii); no change in text.]

(e) No change.

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

(i) Notwithstanding the provisions of sections (c) and (d) of this rule, with respect to a transaction in municipal securities which are eligible for comparison through the facilities of a clearing agency registered with the Securities and Exchange Commission, if both parties to such transaction are members in one or more of such clearing agencies (and such clearing agencies are interfaced or linked for comparison purposes), each party to the transaction shall submit to its clearing agency information concerning the transaction, as required by the clearing agency's rules, for purposes of automated trade comparison. In the event that a transaction submitted to a registered clearing agency for comparison in accordance with the requirements of this paragraph (i) shall fail to compare, the party submitting such transaction shall use the post-original-comparison procedures provided by the registered clearing agency in connection with such transaction until such time as the transaction is compared or final notification of a failure to compare the transaction is received from the contra-party. The provisions of this paragraph (i) shall apply to transactions effected on or after August 1, 1984; provided, however, that transactions in federally guaranteed public housing authority project notes effected prior to January 1, 1985 shall not be subject to the provisions of this paragraph.

(g) through (l) No change.

[3]Dealers who are participants in registered clearing agencies may enter transactions into the automated comparison system on an "as of" basis, which permits use of the system to compare transactions for settlement earlier than the fifth business day after submission of the transaction. In addition to this procedure, the "demand as of" procedure is available to a dealer who has previously submitted a transaction to the system for comparison, which has failed to compare. Under the "demand as of" procedure, the dealer may resubmit such transaction, not earlier than the fourth business day following the trade date, on a basis which provides that, if the named contra-party does not respond on the transaction within a specified time period, the transaction will be deemed compared as submitted by the confirming dealer. If the named contra-party does not know the transaction, it must submit instructions to the comparison system advising that it "DK's" the trade. The "demand as of" procedure provides an automated process similar to the Board's "failure to confirm" procedure prescribed under rule G-12(d)(iii).

[4]Rule G-12(d)(vii) provides 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 [manual failure to confirm procedures]; 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.

The rule was adopted by the Board in the initial stages of operation of the automated comparison system for municipal transactions as a way of integrating the use of the automated comparison system with the Board's comparison rules, and has been superseded by the adoption of the automated comparison requirements of section (f) of the rule.

*Underlining indicates new language; broken rule indicates deletions.

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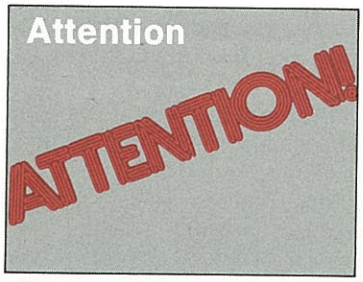

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Specific Transactions—Determining Whether Contra-Party is Inter-Dealer or Customer: Rules G-12 and G-15

Summary of Interpretation

The Board has determined that for purposes of the automated comparison requirements

- **transactions by a bank are inter-dealer if the transactions are for the trading account of a dealer bank and are customer transactions if made by the bank's trust department, and**
- **transactions involving dealer purchases for UIT accumulation accounts are inter-dealer transactions.**

The interpretive notice also reminds dealers of the need to include all inter-dealer transactions in the inter-dealer comparison system.

The Board recently has been advised that some members of the municipal securities industry are experiencing difficulties in determining the proper classification of a contra-party as a dealer or customer for purposes of automated comparison and confirmation. In particular, questions have arisen about the status of banks purchasing for their trust departments and dealers buying securities to be deposited in accumulation accounts for unit investment trusts. Because a misclassification of a contra-party can cause significant difficulty to persons seeking to comply with the automated clearance requirements of rules G-12 and G-15, the Board believes that guidance concerning the appropriate classification of contra-parties in certain transactions would be helpful to the municipal securities industry.

Background

Rule G-12(f) requires transactions between municipal securities brokers or dealers to be compared through a registered clearing agency when both parties to the transaction are members, directly or indirectly (*i.e.*, through their own clearing agent) of a registered clearing agency. Similarly, rule G-15(d) requires that dealers trading with customers must confirm delivery vs. payment or receipt vs. payment transactions in securities assigned a CUSIP number through a registered clearing agency when both parties are direct or indirect members of a registered clearing agency.

The systems available for the automated confirmation or comparison of these two types of transactions are separate and distinct. As a result, misclassification of a contra-party may create a problem in the use of these systems for confirmation or comparison. For example, in circumstances in which the selling party to an inter-dealer transaction misclassifies its contra-party as a customer, the purchaser (correctly considering itself to be a dealer) would seek to compare the transaction through the inter-dealer comparison system, whereas the selling dealer would submit the trade for confirmation through the automated dealer-to-customer confirmation system. Since the automated systems for inter-dealer and customer transactions are entirely separate, the transaction will not be successfully compared or acknowledged through either automated system. In this case, one of the two parties would have to research and identify the problem, properly identify the transaction as an inter-dealer transaction and take steps to ensure that both parties resubmit the transaction for inter-dealer comparison. As a consequence of the misclassification, therefore, the expeditious use of the inter-dealer comparison system has been frustrated, the parties have been obliged to take additional steps to ensure agreement on the transaction, and the settlement of the trade has been delayed.

Transactions Effected by Banks

The Board has received certain questions about the proper classification of contra-parties in the context of transactions effected by banks. A bank may be the purchaser or seller of municipal securities either as a dealer or as a customer. For example, a bank's trust department may purchase securities for various trust accounts. Such purchases by a bank in a fiduciary capacity would not constitute "municipal securities dealer activities" under the Board's rules.[1] Therefore, these transactions are properly classified and confirmed as customer transactions. A second type of transaction by a bank

Questions concerning this notice may be directed to Harold L. Johnson, Assistant General Counsel.

[1]Section 3(a)(30) of the Securities Exchange Act of 1934 defines a bank to be a municipal securities dealer if it "is engaged in the business of buying and selling municipal securities for its own account *other than in a fiduciary capacity*" (emphasis added). For purposes of the Board's rule G-1, defining a separately identifiable department or division of a dealer bank, purchase and sale of municipal securities by a trust department would not be considered to be "municipal securities dealer activities."

is the purchase or sale of securities for the trading account of a dealer bank. The bank in this instance is clearly acting in its capacity as a municipal securities dealer. Thus, a transaction effected by a dealer bank acting in a dealer capacity would be an inter-dealer transaction and should be compared in the inter-dealer system.

A municipal securities broker or dealer effecting a transaction with a dealer bank may not know whether the bank is acting in its capacity as a dealer or as a customer. The Board is of the view that, in such a case, the municipal securities broker or dealer should ascertain the appropriate classification of the bank at the time of trade in order to ensure that the transaction can be compared or confirmed appropriately. The Board anticipates that dealer banks will assist in this process by informing contra-parties whether the bank is acting as a dealer or customer in transactions where the bank's role may be unclear to the contra-party.

Transactions by Dealer Purchasing Municipal Securities for Transfer to UIT

The Board has also received several inquiries concerning the appropriate classification of a dealer who purchases municipal securities to be deposited into an accumulation account for ultimate transfer to a unit investment trust ("UIT"). The dealer buying for a UIT accumulation account may purchase and hold municipal securities over a period of several days before depositing them with the trustee of the UIT in exchange for all of the units of the trust; during this time the dealer is exposed to potential market risk on these securities positions. The subsequent deposit of the securities with the trustee of the UIT in exchange for the units of the trust may be viewed as a separate, customer transaction between the dealer buying for the accumulation account and the trust. The original purchase of the securities by the dealer for the account must then be considered an inter-dealer transaction since the dealer is purchasing for its own account in order to ultimately execute a customer transaction. The Board notes that the SEC has taken this approach in applying its net capital and customer protection rules to such transactions.

The Board is of the view that, for purposes of its automated comparison requirements, transactions involving dealers purchasing for UIT accumulation accounts should be considered inter-dealer transactions. The Board also notes the distinction between this situation, in which a dealer purchases for ultimate transfer to a trust or fund, and situations where purchases or sales of municipal securities are made directly by the fund, as is the case with purchases or sales by some open-end mutual funds. These latter transactions should be considered as customer transactions and confirmed accordingly.

Other Inter-Dealer Transactions

In addition to questions on the status of bank dealers and dealers purchasing for accumulation accounts, the Board has received information that a few large firms are sometimes submitting trades with regional securities dealers into the customer confirmation system. The Board is aware that these firms may classify transactions with regional dealers or dealer banks as "customer" transactions for purposes of internal accounting and compensation systems. The Board reminds industry members that transactions with other municipal securities dealers will *always* be inter-dealer transactions and should be compared in the inter-dealer automated comparison system without regard to how the transactions are classified internally within a dealer's accounting systems. The Board believes it is incumbent upon those firms who misclassify transactions in this fashion to promptly make the necessary alterations to their internal systems to ensure that this practice of misclassifying transactions is corrected.

December 13, 1984

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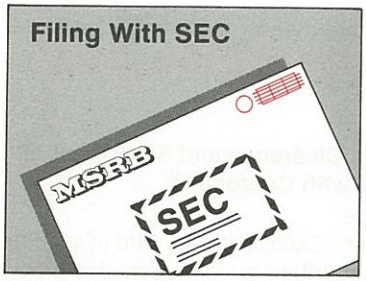

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Delivery of Called Securities: Rules G-12 and G-15

Principal Change Proposed

The proposed amendments clarify the application of the delivery provisions to a delivery of securities for which a notice of call applicable to an entire issue of securities has been published on or prior to the trade.

On February 5, 1985, the Board filed with the Securities and Exchange Commission proposed amendments to certain of the provisions of rules G-12(e)(x) and G-15(c)(viii) regarding delivery of municipal securities for which a notice of call has been published and rule G-12(g)(iii) regarding inter-dealer reclamations. The proposed amendments will not become effective until they are approved by the Commission.

Background

Board rules G-12(e) and G-15(c) set forth certain requirements concerning deliveries of municipal securities to dealers and customers, respectively. Both rules provide that a delivery which includes a security that has been called under an "in part" call notice published on or prior to the delivery date will not constitute good delivery if the security was not identified as "called" at the time of trade. A delivery of a security that has been the subject of an "in whole" call notice (*i.e.*, a notice applicable to the entire issue or an entire maturity) published on or prior to the delivery date, however, is a good delivery under the rule.

These provisions reflect the Board's judgement that the risk of ownership of an issue of securities passes to the purchaser at the time of trade; therefore, the purchaser bears the risk of an "in whole" call announced after the date of trade but prior to delivery date. The Board also is of the view, however, that when a notice of call for less than the entire issue of securities occurs on or before delivery date the seller should not be allowed to deliver "called" securities in satisfaction of the contract unless the securities are specified as "called" at the time of trade. Accordingly, the Board's rules require that, in this situation, the seller must deliver uncalled securities to satisfy the contract.

Requirements of Proposed Rule

These provisions of rules G-12 and G-15 do not clearly address the question whether delivery of a security for which an "in whole" call notice had been published *on or prior to trade date* would constitute good delivery if the security had not been identified as "called" at the time of trade.[1] Therefore, the proposed rule amendments revise these provisions to state that delivery of a security for which a notice of call applicable to the entire issue of securities has been published on or prior to the trade date is not good unless the security was identified as "called" at the time of trade. The amendments also make a comparable clarification in the parallel reclamation provisions of rule G-12(g), and a technical change to refer to a security's "interest rate" (rather than "coupon rate"), consistent with other provisions of the rules.

February 5, 1985

Questions concerning the proposed amendments may be directed to Harold L. Johnson, Assistant General Counsel.

Text of Proposed Rule Amendments*

Rule G-12. Uniform Practice

(a) through (d) No change.

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

(i) through (ix) No change.

(x) Delivery of Certificates Called for Redemption.

(A) A certificate for which a notice of call applicable to less than the entire issue of securities has been published on or prior to the delivery date shall not constitute good delivery unless the securities are identified as "called" at the time of trade ~~or the notice of call is applicable to the entire issue of securities~~.

(B) A certificate for which a notice of call applicable to the entire issue of securities has been published on or prior to the trade date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

[1]Rules G-12(c)(vi)(C) and G-15(a)(iii)(C) would require that the confirmation of a trade of a security that has been called state this fact as well as the date of maturity fixed by the call notice and the amount of the call price.

*Underlining indicates new language; broken rule indicates deletions.

(C) For purposes of this subparagraph (x) and Items (D)(2) and (D)(3) of subparagraph G-12(g)(iii), the term ~~an~~ "entire issue of securities" shall mean securities of the same issuer having the same date of issue, maturity date and ~~coupon~~ interest rate.

(xi) through (xvi) No change.

(f) No change.

(g) Rejections and Reclamations.

(i) through (ii) No change.

(iii) Basis for Reclamation and Time Limits. A reclamation may be made by the receiving party or a demand for reclamation may be made by the delivering party if, subsequent to delivery, information is discovered which, if known at the time of the delivery, would have caused the delivery not to constitute good delivery, provided such reclamation or demand for reclamation is made within the following time limits:

(A) through (C) No change.

(D) Reclamation or demand for reclamation by reason of the following may be made without any time limitation:

(1) the security delivered is reported missing, stolen, fraudulent or counterfeit; ~~or~~

(2) ~~not good delivery because~~ the security delivered is the subject of a notice of call applicable to ~~for~~ less than the entire issue of securities that was published on or prior to the delivery date and the security was ~~the securities were~~ not identified as "called" at the time of trade; or

(3) the security delivered is the subject of a notice of call applicable to the entire issue of securities that was published on or prior to trade date and the security was not identified as "called" at the time of trade.

The running of any of the time periods specified in this paragraph shall not be deemed to foreclose a party's right to pursue its claim via other means, including arbitration.

(iv) No change.

(h) through (l) No change.

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

(a) through (b) No change.

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

(i) through (vii) No change.

(viii) Delivery of Certificates Called for Redemption.

(A) A certificate for which a notice of call applicable to less than the entire issue of securities has been published on or prior to the delivery date shall not constitute good delivery unless the securities are identified as "called" at the time of trade ~~or the notice of call is applicable to the entire issue of securities.~~

(B) A certificate for which a notice of call applicable to the entire issue of securities has been published on or prior to the trade date shall not constitute good delivery unless the securities are identified as "called" at the time of trade.

(C) For purposes of this subparagraph (viii) the term ~~an~~ "entire issue of securities" shall mean securities of the same issuer having the same date of issue, maturity date and ~~coupon~~ interest rate.

(ix) through (xii) No change.

(d) No change.

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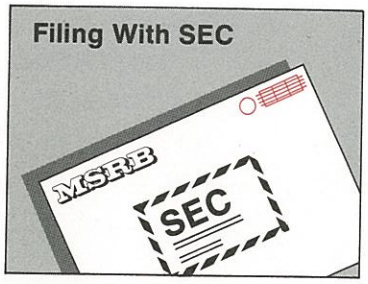

Route To:

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- ☒ Compliance
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Payment of Initial Fee: Rule A-12

Principal Changes Proposed

The proposed amendment—

- **clarifies that the initial fee requirement applies to all brokers, dealers, and municipal securities dealers engaged in municipal securities activities and**
- **requires that the fee be paid prior to initiating municipal securities activities.**

On February 5, 1985, the Board filed with the Securities and Exchange Commission an amendment to rule A-12 concerning the initial fee paid by municipal securities brokers and municipal securities dealers. The proposed amendment will not become effective until approved by the Commission.

Board rule A-12 requires municipal securities brokers and municipal securities dealers to pay to the Board an initial $100 fee to defray, in part, the costs and expenses of operating and administering the Board. In connection with payment of the fee, the rule also requires the filing of certain identifying information with the Board. The rule is intended to apply to all municipal securities brokers and municipal securities dealers, as defined in the Securities Exchange Act of 1934, as amended, including those engaged in lines of business in addition to municipal securities activities and those effecting only occasional municipal securities transactions.

The rule currently states that municipal securities brokers and dealers must pay the initial assessment before December 15, 1975, or within 10 days of registration with the Securities and Exchange Commission, whichever is later. The reference to the December 15, 1975, deadline in the rule relates to the situation as it existed in 1975, when the activities of municipal securities brokers and dealers first came under the jurisdiction of the Board. The 10-day period from Commission registration within which to comply with rule A-12 was originally adopted as a "grace period" for municipal securities-only firms and dealer banks, which were first required to register with the Commission in 1975. Since this initial period of registration is now over, the amendment deletes the references to the December 15, 1975, deadline and the 10-day "grace period" and makes clear that any broker, dealer, or municipal securities dealer must comply with rule A-12 before initiating municipal securities activities.

February 5, 1985

Questions concerning the proposed amendment may be directed to Harold L. Johnson, Assistant General Counsel.

Text of Proposed Amendment*

Rule A-12. Initial Fee ~~for Municipal Securities Brokers and Municipal Securities Dealers~~

~~Every municipal~~ securities ~~broker and municipal securities dealer presently or hereafter registered with the Commission shall, not later than (1) December 15, 1975 or (2) the date which is ten days from the date of registration of such municipal securities broker or municipal securities dealer with the Commission, whichever shall last occur,~~ Prior to effecting any transaction in or inducing or attempting to induce the purchase or sale of any municipal security, a broker, dealer, or municipal securities dealer shall pay to the Board an initial fee of $100, accompanied by a written statement setting forth the name, address and Securities and Exchange Commission registration number of the ~~municipal securities~~ broker, dealer, or municipal securities dealer on whose behalf such fee is paid. The Commission registration number shall also be set forth on the face of the remittance. Such fee shall be payable at the offices of the Board in Washington, D.C. In the event any person subject to this rule shall fail to pay the required fee, the Board may recommend to the Commission that the registration of such person with the Commission be suspended or revoked.

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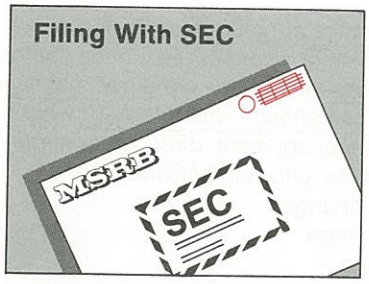

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Qualification of Municipal Securities Principals: Rule G-3

Principal Change Proposed

The proposed amendment clarifies that a municipal securities principal associated with a municipal securities broker or dealer who has not complied with Rule A-12 is not considered to be acting as a municipal securities principal for purposes of maintaining the grandfathering exemption from examination.

On February 5, 1985, the Board filed with the Securities and Exchange Commission an amendment to rule G-3 regarding the professional qualification of municipal securities principals. The amendment states that a municipal securities principal associated with a municipal securities broker or dealer that has not complied with the Board's rule A-12 (regarding payment of initial fee and filing of certain identifying information) will not be considered to be acting as a municipal securities principal. An otherwise qualified municipal securities principal would therefore lose principal qualifications after two years' association with such a municipal securities broker or dealer. The proposed amendment will not become effective until approved by the Commission.

Background

Rule G-3 establishes the standards of professional qualification for various municipal securities professionals, including the municipal securities principal whose functions relate to the supervision and management of the municipal securities activities of a municipal securities broker or dealer. Under the definition of "municipal securities broker" and "municipal securities dealer" contained within the Securities Exchange Act of 1934, a securities firm effecting transactions in municipal securities is considered to be a municipal securities broker or dealer even though the firm may not have filed certain required identifying information with the Board pursuant to rule A-12. A person who supervises municipal securities activities within such a firm, under current Board rules, is considered to function as a municipal securities principal and, in some circumstances, may be able to claim municipal securities principal qualifications.[1] This is possible even though the firm and the person acting as a principal may be or may have been unaware of the application of the Board's rules to municipal securities transactions. In such a case persons acting as principals clearly would not be able to supervise adequately the municipal securities activities of the firm in order to ensure compliance with Board rules.

Requirements of Proposed Rule Amendment

The rule amendment adopted by the Board would require that a person be associated with a municipal securities broker or dealer that has filed with the Board in compliance with rule A-12 in order to be considered as acting as a municipal securities principal. The effect of subsection (c)(iv) of rule G-3[2] and the amendment together would be to require that a person who is otherwise qualified as a municipal securities principal, but who is associated for two or more years with a municipal securities broker or dealer not in compliance with rule A-12, take and pass the Municipal Securities Principal Examination and be qualified as a municipal securities representative in order to re-establish his or her qualifications as a municipal securities principal.

February 5, 1985

Questions concerning the proposed amendment may be directed to Harold L. Johnson, Assistant General Counsel.

Text of Proposed Amendment*

Rule G-3. Classification of Principals and Representatives; Numerical Requirements; Testing

No municipal securities broker or municipal securities dealer or person who is a municipal securities principal, financial and operations principal, municipal securities representative, or municipal securities sales principal (as hereafter defined) shall be qualified for purposes of rule G-2

[1]Although a person acting in such a firm would not necessarily be qualified as a principal, a person who had acted in this capacity since 1979 may be able to claim principal qualifications on the basis of the now-rescinded "grandfather" provisions of rule G-3(c) and his or her prior general securities experience and qualifications.

[2]Subsection (c)(iv) of rule G-3 provides:

Any person who ceases to act as a municipal securities principal for two or more years at any time after having qualified as a municipal securities principal in accordance with this section (c) shall take and pass the Municipal Securities Principal Qualification Examination and be qualified as a municipal securities representative prior to being qualified as a municipal securities principal.

*Underlining indicates new language; broken rule indicates deletions.

unless such municipal securities broker or municipal securities dealer or person meets the requirements of this rule.

(a) Definitions. As used in the rules of the Board, the terms "municipal securities principal," "financial and operations principal," "municipal securities representative," and "municipal securities sales principal" shall have the following respective meanings:

(i) Municipal Securities Principal. The term "municipal securities principal" means a natural person (other than a municipal securities sales principal) associated with a municipal securities broker or municipal securities dealer ~~other than a municipal securities sales principal~~, that has filed with the Board in compliance with rule A-12 who is directly engaged in the management, direction or supervision of one or more of the following activities:

(A) through (G) No change.

(ii) through (iv) No change.

(b) through (i) No change.

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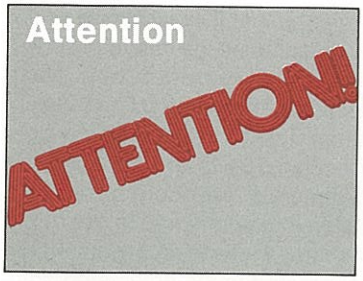

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Letter of Interpretation

Rule G-12—Automated Clearance: Delivery of Securities on the Contractual Settlement Date and Parallel Confirmation Systems

I am writing to confirm the substance of our conversations with you at our meeting on October 3 to discuss certain of the issues that have arisen since the August 1 effective date of the requirements of rule G-12(f) for the use of automated comparison services on certain inter-dealer transactions in municipal securities. In our meeting you explained certain problems that have become apparent since the implementation of these requirements, and you inquired as to our views concerning the application of Board rules to these difficulties or appropriate procedures to remedy them. The essential points of our responses are summarized below.

In particular, you indicated that the use of the "as of" (or "demand as of") feature of the automated comparison system has, in some cases, caused inappropriate rejections of deliveries of securities. This occurs, you explained, because the comparison system is currently programmed to display an alternative settlement date of two business days following the date of successful comparison of the transaction, if such comparison is accomplished through use of the "as of" or "demand as of" feature.[1] As a result, in certain cases involving transactions compared on an "as of" basis dealers have attempted to make delivery of the transaction on the contractual settlement date, and have had those deliveries rejected, since the receiving party recognizes only the later "alternative settlement date" assigned to the transaction by the comparison system. You inquire whether such rejections of deliveries are in accordance with Board rules.

I note that this "alternative settlement date" has significance for clearance purposes only, and does not result in a recomputation of the dollar price or accrued interest on the transaction.

As we advised in our conversation, the receiving dealer clearly cannot reject a good delivery of securities made on or after the contractual settlement date on the basis that the delivery is made prior to the "alternative settlement date" displayed by the comparison system. Both dealers have a contract involving the purchase of securities as of a specified settlement date, and a delivery tendered on or after that date in "good delivery" form must be accepted. A dealer rejecting such a delivery on the basis that it has been made prior to the "alternative settlement date" would be subject to the procedures for a "close-out by seller" due to the improper rejection of a delivery, as set forth in Board rule G-12(h)(ii).[2]

You also advised that some dealers who are using the automated comparison system are using their own delivery tickets, rather than the delivery tickets generated by the system, at the time they make delivery on the transaction. As a result, you indicated, there have been rejections of these deliveries, since the receiving dealer is unable to correlate these deliveries with its records of transactions compared through the system. You suggested that the inclusion of the "control numbers" generated by the comparison system on these self-generated delivery tickets would help to eliminate these unnecessary rejections and facilitate the correlation of receipts and deliveries with records of transactions compared through the system. As I indicated in our conversation, the Board concurs with your suggestion. The Board strongly encourages dealers who choose to use their own delivery tickets for transactions compared through the automated system to display on those tickets the control number or other number identifying the transaction in the system.[3] This would ensure that the receiving dealer can verify that it knows the transaction being delivered and that it was successfully compared through the system.

You also noted that many municipal securities dealers have continued the practice of sending physical confirmations of transactions, in addition to submitting such transactions for comparison through the automated system. You advised that this is causing significant problems for certain dealers, since they are required to maintain a duplicate system in order to provide for the review of these physical confirmations.

The Board is aware that certain municipal securities dealers chose to maintain parallel confirmation systems following implementation of the automated comparison requirements on August 1 in order to ensure that they maintained adequate control over their activities, and recognizes that

[1]For example, a transaction of trade date October 19 for settlement October 25 fails to compare through the normal comparison cycle. Due to this failure to compare, the transaction is dropped from the comparison system on October 23; however, due to a resolution of the dispute, both parties resubmit the trade on an "as of" basis on October 24, and it is successfully compared on that date. Due to the delay in the comparison of the transaction, the system will display an "alternative settlement date" on this transaction of October 26 on the system-generated delivery tickets.

[2]I understand that [name of registered clearing agency] is taking steps to have the contractual settlement date reflected on delivery tickets produced with respect to transactions compared on an "as of" or "demand as of" basis. We believe that this will be most helpful in clarifying the receiving dealer's contractual obligation to accept a proper delivery made on or after that date.

[3]I understand that proper utilization of the comparison system control number is a reliable method for identifying and referring to transactions.

for many such dealers this was an appropriate and prudent course of action.[4] However, the Board wishes to emphasize that its rules do not require the sending of a physical confirmation on any transaction which has been submitted for comparison through the system. On the contrary, the continued use of unnecessary physical comparisons increases the risk of the duplication of trades and deliveries and substantially decreases the efficiencies and cost savings available from the use of the automated comparison system. The Board believes that all system participants must understand that the use of the automated comparison system is of primary importance. Accordingly, the Board strongly suggests that the mailing of unnecessary physical confirmations should be discontinued once a dealer is satisfied that it has adequate control over its comparison activities through the system.

You and others have suggested that it would be helpful if dealers which are unable to discontinue the mailing of physical confirmations would identify those transactions which have also been submitted for comparison through the system through some legend or stamp placed on the physical confirmation sent on the transaction. The Board concurs with your suggestion, and recommends that, during the short remaining interim when dealers are continuing to use duplicate physical confirmations, they include on physical confirmations of transactions submitted to the automated comparison system a stamp or legend in a prominent location which clearly indicates that the transaction has been submitted for automated comparison.—*MSRB Interpretation of January 2, 1985, by Donald F. Donahue, Deputy Executive Director.*

[4]The Board is also aware that on certain transactions dealers will need to send physical confirmations to document the terms of a specific agreement concluded at the time of trade (*e.g.*, a specification of a rating). In such circumstances the Board anticipates that physical confirmations will continue to be sent.

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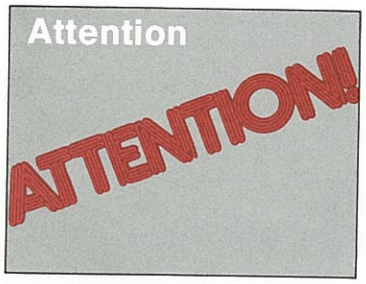

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Publications List

Manuals

MSRB Manual

Soft-cover manual (CCH), updated semi-annually or annually, containing the Board rules; text of the Securities and Exchange Act of 1934 and of the Securities Investor Act of 1979; samples of forms; lists of Board members and staff; and new developments.

April 1, 1984 ..... $5.00

MSRB Rules

Soft-cover text of MSRB rules and interpretations; reprint of the MSRB rules and the forms sections of *MSRB Manual*.

April 1, 1984 ..... $2.00

Professional Qualification Handbook

Analysis of requirements for qualification as a municipal securities representative, principal, sales principal, and financial operations principal; rule text; and glossary (1984).

49 pages ..... 5 copies per year.... (No charge)
Each additional copy $1.50

Manual on Close-Out Procedures

Discussion of the close-out procedures of rule G-12(h)(i) in question-and-answer format, glossary, and rule text (1985).

96 pages $3.00

Arbitration: Rules A-16 and G-35

Text of rules (1984).

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Explanation of arbitration and the procedures for filing arbitration claims with special attention to small claims, text of rules, and glossary.

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Step-by-step instructions and forms for filing an arbitration claim (1984).

9 pages ..... (No charge)

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MSRB Reports

MSRB reporter and newsletter to the municipal securities industry on proposed rule changes, rule changes, notices requesting comment from the industry and public, notices of interpretation, and new items.

Members of the industry and other interested parties listed on the *MSRB Reports* mailing list receive issues as published; additional copies are sent on request.

Examination Study Outlines

Study Outline: Municipal Securities Representative Qualifications Examination

Outline for Test Series 52 (1985).

30 pages ..... (No charge)

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A series of guides outlining subject matter areas a candidate seeking professional qualification is expected to know; each guide includes a list of reference materials and sample questions.

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Report of the Conference on Registered Municipal Securities

Report resulting from the forum organized by the Board's Task Force on Registered Municipal Securities to define problems and to explore solutions to the registration requirement (1982).

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Prospects for Automation of Municipal Clearance and Settlement Procedures: Report to the Securities and Exchange Commission

Special edition of *MSRB Reports* publishing the SEC-requested report on the progress achieved in the development of automated clearance and settlement systems (1983).

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