

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-78611; File No. SR-MSRB-2016-07)

August 18, 2016

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, Consisting of Proposed Amendments to Rule G-12, on Uniform Practice, Regarding Close-Out Procedures for Municipal Securities

I. Introduction

On May 11, 2016, the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) filed with the Securities and Exchange Commission (the “SEC” or “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change consisting of proposed amendments to Rule G-12, on uniform practice, regarding close-out procedures for municipal securities. The proposed rule change was published for comment in the Federal Register on June 1, 2016.³

The Commission received three comment letters on the proposal.⁴ On July 25, 2016, the MSRB responded to the comments⁵ and filed Amendment No. 1 to the proposed rule change.⁶

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 77903 (May 25, 2016) (the “Proposing Release”), 81 FR 35111 (June 1, 2016).

⁴ See Letters to Secretary, Commission, from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association (“SIFMA”), dated June 22, 2016 (the “SIFMA Letter”); Michael Nicholas, Chief Executive Officer, Bond Dealers of America (“BDA”), dated June 22, 2016 (the “BDA Letter”); and David T. Bellaire, Esq., Executive Vice president and General Counsel, Financial Services Institute (“FSI”), dated June 22, 2016 (the “FSI Letter”).

⁵ See Letter to Secretary, Commission, from Michael Cowart, Deputy Director, Professional Qualifications and Assistant General Counsel, MSRB, dated July 25, 2016 (the “MSRB

The Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change from interested persons and is approving the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

II. Description of the Proposed Rule Change

In the Proposing Release, the MSRB stated that a more timely resolution of inter-dealer fails would ultimately benefit customers by providing greater certainty that their fully paid for securities are in fact owned in their account, not allocated to a firm short, and would benefit dealers by reducing the risk and costs associated with inter-dealer fails.

As further described in the Proposing Release and the MSRB Response and Amendment Letter, the MSRB states that the purpose of the proposed rule change is to significantly compress the timing to initiate and complete a close-out by allowing a close-out notice to be issued the day after the purchaser's original settlement date, with the last day by which the purchasing dealer must complete a close-out on an open transaction being reduced to 10 calendar days, with an option for the buyer to grant the seller a one-time 10 calendar day extension.⁷

With the vast majority of municipal securities in book entry form and the Depository Trust & Clearing Corporation's ("DTCC") continued efforts to promote dematerialization, the MSRB proposed that firms should no longer have to provide a 10-day delivery window before

Response and Amendment Letter"), available at <https://www.sec.gov/comments/sr-msrb-2016-07/msrb201607-4.pdf>.

⁶ Id. In Amendment No. 1, the MSRB partially amended the text of the original proposed rule change to shorten the period in which firms are required to resolve an inter-dealer fail from 20 calendar days to 10 calendar days, and to permit the buyer to grant the seller a one-time 10 calendar day extension.

⁷ See supra notes 3 and 5. The rule as initially proposed in the Proposing Release provided for a period of 20 days in which a close-out must be completed.

implementing an execution period. The MSRB believes a three-day delivery window would be sufficient as the majority of inter-dealer fails are resolved within days of the original settlement and/or a fail situation is known prior to the original settlement date.

Additionally, the current rule requires that the earliest day that can be specified as the execution date is 11 days after telephonic notice. The proposed amendments would amend the current allowable execution time frame from 11 days to four days after electronic notification. Accelerating the execution date could improve a firm's likelihood of finding a security for a buy-in, lower overall counter-party risk and may further reduce accrual, capital and other expenses.

Under the proposed rule change, a purchasing dealer notifying the selling dealer of an intent to close out an inter-dealer fail would continue to prompt DTCC to "exit" the position from DTCC's continuous net settlement ("CNS") and the two parties are responsible for effecting the close-out. Because a municipal security may not be available for purchase, incorporating the buy-in procedures of a registered clearing agency will often not solve the inter-dealer fail. The MSRB expects firms to not solely rely upon the CNS system or the services of a registered clearing agency to resolve inter-dealer fails and take prompt action to close out inter-dealer fails in a timely manner. Under the proposed rule change, regardless of the date the positions are exited from CNS, the inter-dealer fail must be resolved within 20 calendar days of the purchasing dealer's original settlement date. The MSRB is also proposing to retire the Manual on Close-Out Procedures.⁸

⁸ See [Manual on Close-Out Procedures](#). The Manual on Close-Out Procedures will be retired because such procedures would be outdated and, given the proposed rule change's overall simplicity, developing an updated version of the manual is not warranted.

Proposed Amendments to MSRB Rule G-12(h)

Rule G-12, on uniform practice, establishes uniform industry practices for processing, clearance and settlement of transactions in municipal securities between a broker, dealer or municipal securities dealer and any other broker, dealer or municipal securities dealer. The proposed amendments would amend Rule G-12(h) by requiring close-outs to be settled no later than 20 calendar days after the settlement date. The proposed amendments to G-12(h)(i)(B) would allow for the close-out process to continue to provide three options to the purchasing dealer. The three options include: (1) purchase (“buy-in”) at the current market all or any part of the securities necessary to complete the transaction for the account and liability of the seller; (2) accept from the seller in satisfaction of the seller’s obligation under the original contract (which shall be concurrently cancelled) the delivery of municipal securities that are comparable to those originally bought in quantity, quality, yield or price, and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller; or (3) require the seller to repurchase the securities on terms which provide that the seller pay an amount which includes accrued interest and bear the burden of any change in market price or yield.

Firms must coordinate internally to determine which of the three close-out options are appropriate for any given fail-to-deliver situation. While a buy-in may be the most preferred method, Rule G-12(h) provides two other options to a purchaser in the event a buy-in is not feasible. Firms are reminded that, regardless of the option agreed upon by the counterparties, including a cancellation of the original transaction, the close-out transaction is reportable to the Real-time Transaction Reporting System (“RTRS”) as currently required pursuant to Rule G-14.

Additionally, the proposed amendments to Rule G-12(h)(i)(A) would allow a purchaser to notify the seller of the purchaser’s intent to close-out the transaction the first business day

following the purchaser's original transaction settlement date, instead of waiting five business days as currently required in Rule G-12(h)(i)(A).

Currently Rule G-12(h) references use of the telephone and mail as part of the notification process. The proposed amendments would update Rule G-12(h) throughout, to reflect modern communication methods and widely-used industry practices that would facilitate more timely and efficient close-outs. For example, DTCC's SMART/Track is available for use by any existing NSCC clearing firm or DTCC settling member, allowing users to create, retransmit, respond, update, cancel and view a notice.

The proposed amendments to Rule G-12(h)(i)(D) would require sellers to use their best efforts to locate the securities that are subject to a close-out notice from a purchaser. The proposed amendments to Rule G-12(h)(i)(E)(1) would also require the seller to bear any burden in the market price, with any benefit from any change in the market price remaining with the purchaser.

The proposed amendments would also require a purchasing dealer that has multiple counterparties, to utilize the FIFO (first-in-first-out) method for determining the contract date for the failing quantity. Amendments to Rule G-12(h)(iv) would require dealers to maintain all records regarding the close-out transaction as part of the firm's books and records.

III. Summary of Comments Received and the MSRB's Response

As noted previously, the Commission received three comment letters on the proposed rule change and a response letter from the MSRB.⁹ The commenters generally support the proposed rule change.¹⁰ However, some commenters asked for further clarification and provided

⁹ See supra notes 4 and 5.

¹⁰ Id.

suggested amendments to the proposed rule change.¹¹ The MSRB has responded to the commenters, as discussed below.¹²

1. Shorter Close-Out Deadline

As noted above, the original proposed rule change provided for a close-out deadline of 20 calendar days. Both BDA and SIFMA commented that they would support an even shorter close-out period, with both suggesting a period of 10 calendar days, with an option for the buyer to consent to a 10-day extension, for a maximum aggregate total of 20 days.¹³

In response to comments, the MSRB proposed, in Amendment No. 1, to amend the original proposed rule change to require firms to resolve an inter-dealer fail from 20 calendar days to 10 calendar days and permit the buyer to grant the seller a one-time 10 calendar day extension, which would allow the buyer flexibility, while still ensuring that inter-dealer fails would be closed-out in a maximum of 20 calendar days. The MSRB stated in the Proposing Release that “a more timely resolution of inter-dealer fails would ultimately benefit customers by providing greater certainty that their fully paid for securities are in fact owned in their account and not allocated to a firm short, and would also benefit dealers by reducing the risk and costs associated with inter-dealer fails.”¹⁴ The MSRB states in the MSRB Response and Amendment Letter that shortening the close-out period from 20 calendar days, as stated in the original proposed rule change, to 10 calendar days will further reduce the risk and cost associated with inter-dealer fails.

¹¹ Id.

¹² See MSRB Response and Amendment Letter.

¹³ See BDA Letter and SIFMA Letter.

¹⁴ See supra note 3.

2. Requests for Clarification and Guidance

BDA commented that its member firms still have outstanding questions about how the proposed rule change would impact close-out processes related to accounts transferred to a broker-dealer via the Automated Customer Account Transfer Service (“ACATS”), and requested additional guidance from the MSRB regarding close-outs through ACATS.¹⁵ SIFMA requested further guidance from the MSRB regarding close-outs with respect to self-directed customer accounts, in which broker-dealers are not allowed to use discretion.¹⁶

The MSRB responded that both of these requests for guidance are beyond the scope of the proposed rule change, both as originally proposed and as amended by Amendment No. 1.¹⁷

IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, as modified by Amendment No. 1, as well as the three comment letters received and the MSRB’s response. The Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the MSRB.

In particular, the proposed rule change is consistent with Section 15B(b)(2)(C) of the Act. Section 15B(b)(2)(C) of the Act requires that the MSRB’s rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal

¹⁵ See BDA Letter.

¹⁶ See SIFMA Letter.

¹⁷ See MSRB Response and Amendment Letter.

financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, in general, to protect investors, municipal entities, obligated persons, and the public interest.¹⁸

The MSRB states that the proposed rule change would benefit investors, dealers and issuers. Specifically, the MSRB states that dealers may benefit from clarifications and revisions that more closely reflect actual market practices. In addition, dealers may be able to more quickly and efficiently resolve inter-dealer fails, which may reduce dealer risk, reduce the likelihood and duration that dealers are required to pay "substitute interest" to customers and reduce systemic risk. The MSRB further states that the proposed rule change may also reduce the likelihood and duration of firm short positions that allocate to customer long positions, reduce investor tax exposure and increase investor confidence in the market. According to the MSRB, issuers and the market as a whole may benefit from increased investor confidence.

In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation.¹⁹ The Commission believes the proposed rule change will improve efficiency in the municipal securities market. The Commission notes that all of the commenters stated that the proposed rule change would have positive effects on municipal market efficiency.²⁰ The Commission does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

As noted above, the Commission received three comment letters on the filing. The

¹⁸ See 15 U.S.C. 78o-4(b)(2)(C).

¹⁹ 15 U.S.C. 78c(f).

²⁰ See supra note 4.

Commission believes that the MSRB, through its responses and through proposed changes in Amendment No. 1, has addressed commenters' concerns.

For the reasons noted above, including those discussed in the MSRB Response and Amendment Letter, the Commission believes that the proposed rule change, as amended by Amendment No. 1, is consistent with the Act.

V. Solicitation of Comments on Amendment No. 1

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 1 to the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2016-07 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-MSRB-2016-07. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be

withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2016-07 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

VI. Accelerated Approval of Proposed Rule Change as Modified by Amendment No. 1

The Commission finds good cause for approving the proposed rule change, as amended by Amendment No. 1, prior to the 30th day after the date of publication of notice in the Federal Register. As discussed above, Amendment No. 1 amends the proposed rule change by shortening the required time frame for firms to resolve an inter-dealer fail from 20 calendar days to 10 calendar days, and permitting the buyer to grant the seller a one-time 10 calendar day extension.

The MSRB has proposed the revisions included in Amendment No. 1 to further reduce the risk and cost associated with inter-dealer fails. As noted by the MSRB, the only substantive change to the proposed amendment, the shortening of the close-out period, was made to address concerns raised during the comment period. The MSRB has further noted that, in light of the stated goal of the original proposal to compress the timing for initiating and completing a close-out, the revisions are consistent with the original proposal and are unlikely to be controversial.

For the foregoing reasons, the Commission finds good cause for approving the proposed

rule change, as modified by Amendment No. 1, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²¹ that the proposed rule change (SR-MSRB-2016-07), as modified by Amendment No. 1, be, and hereby is, approved on an accelerated basis.

For the Commission, pursuant to delegated authority.²²

Robert W. Errett
Deputy Secretary

²¹ 15 U.S.C. 78s(b)(2).

²² 17 CFR 200.30-3(a)(12).