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[Rule G-12](#)

SEC Approves Amendments to MSRB Rule G-12 on Close-Out Procedures

Overview

The Municipal Securities Rulemaking Board (MSRB) received approval from the Securities and Exchange Commission (SEC) on August 18, 2016 to amend MSRB Rule G-12, on uniform practice, regarding close-out procedures for municipal securities, to mandate that inter-dealer failed transactions be closed-out within 10 calendar days with an allowance for an additional 10-calendar day extension at the buyer's discretion.¹ The amendments become effective on November 16, 2016.

Background and Regulatory Justification

Rule G-12(h)² and the MSRB's Manual on Close-Out Procedures³ provide optional procedures that can be used by brokers, dealers, or municipal securities dealers ("dealers") to close out open inter-dealer fail transactions. The rule currently allows the purchasing dealer to issue a notice of close-out to the selling dealer on any business day from five to 90 business days after the scheduled settlement date.⁴ If the selling dealer does not deliver the securities owed on the transaction within 10 business days after receipt of

¹ See Securities Exchange Act Release No. 78611 (Aug. 18, 2016), File No. SR-MSRB-2016-07.

² See [MSRB Rule G-12](#)

³ See [Manual on Close-Out Procedures](#), which is being retired with the adoption of the amendments discussed herein. The following interpretive notices are also being retired: "Notice Concerning Calendar of Procedures Under Rule G-12 on Uniform Practice" October 1, 1981; "Use of PEX System for Close-Outs: Rule G-12" March 31, 1993; "Use of Facsimile Transmissions for Close-Outs: Rule G-12(h)" December 20, 1996; "Close-Out Procedures: Timing of Payments on Retransmittals" September 23, 1983; and "Close-Out Procedures: Transactions Involving Introducing Broker" March 5, 1984.

⁴ The purchasing dealer may initiate a close-out within 15 business days after a reclamation made under Rule G-12(g)(iii)(C) or G-12(g)(iii)(D), even though more than 90 business days have elapsed since the original settlement date.



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the close-out notice (15 business days for retransmitted notices), then the purchasing dealer may execute a close-out procedure using one of three options: (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 that provide for the seller to pay an amount which includes accrued interest and bear the burden of any change in market price or yield.⁵

Rule G-12(h) includes a 90-business day time limit for close-outs to encourage dealers to resolve open transactions in a timely manner, but there is no requirement that open transactions be closed out within 90 business days. Currently, a purchasing dealer is not required to initiate a close-out or to execute a close-out notice if one is initiated, nor does the selling dealer have a right to force a close-out of the transaction. If the purchasing dealer chooses not to initiate a close-out within 90 business days of the original contract settlement date (and ultimately execute the close-out), then that dealer loses its right to use the Rule G-12(h) procedure and the transaction remains open until it is resolved by agreement of the parties or through arbitration. During this period, the selling dealer is subject to market risk for any increase in the price of the securities.

Summary of the Amendments

The amendments to Rule G-12(h), regarding close-outs, will 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 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. By mandating the close-out of inter-dealer fails and shortening the close-out period to 10 calendar days the cost associated with inter-dealer fails and the systemic risk created by the inter-dealer fails will be reduced.

⁵ For example, if the purchasing dealer executes a buy-in or a mandatory repurchase in a rising market, the selling dealer is liable for the increase in the market value of the securities. The selling dealer must pay any monies owed on a close-out within 10 business days of execution of the close-out.

The amendments to Rule G-12(h)(i)(B) will 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.

Under the amendments, a purchasing dealer notifying the selling dealer of an intent to close out an inter-dealer fail will continue to prompt Depository Trust & Clearing Corporation (“DTCC”) to “exit” the position from 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 that firms will not solely rely upon the CNS system or the services of a registered clearing agency to resolve inter-dealer fails and will take prompt action to close out inter-dealer fails in a timely manner. Under the amendments, regardless of the date the positions are exited from CNS, the inter-dealer fail must be resolved within 10 calendar days of the purchasing dealer’s original settlement date.

Compliance Date

The MSRB has provided 90-calendar days after the amendments become effective on November 16, 2016 to resolve all outstanding inter-dealer fails. The MSRB understands that many of the outstanding fails have been open for years and is concerned that such fails could continue to exist until maturity unless dealers are mandated to close-out all outstanding inter-dealer fails. While firms may be reluctant to seek a solution other than a buy-in, the amendments provide alternative solutions that should be considered as part of an inter-dealer fail resolution.

Questions about these amendments should be directed to Barbara Voute’, Director, Market Practices, or Michael Cowart, Deputy Director, Professional Qualifications – Assistant General Counsel at 202-838-1500.

August 19, 2016

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Text of Amendments*

Rule G-12: Uniform Practice

(a) – (g) No change.

(h) *Close-Out*. Transactions which have been ~~confirmed~~ compared or otherwise agreed upon by both parties but which have not been completed ~~may~~ shall be closed out in accordance with this section, or ~~as otherwise agreed~~ cancelled by the parties, no later than 10 calendar days after settlement date.

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

(A) *Notice of Close-Out*. If the purchaser elects to close out a transaction ~~in accordance with this paragraph (i)~~, the purchaser shall, not earlier than the ~~fifth~~ first business day following the purchaser's original transaction settlement date, notify the seller ~~by telephone of the purchaser's intention to close out the transaction~~ via an inter-dealer communication system of the registered clearing agency through which the transaction was compared of the purchaser's intention to close out the transaction ("notice").

(1) The purchaser's notice shall state ~~that unless the transaction is completed by a specified:~~

(a) the date and time, by which the transaction must be completed, which shall not be earlier than 5:15 p.m. EST the close of the ~~tenth~~ third business day following the date ~~the telephonic notice is given (the fifth first business day, in the case of a second or subsequent notice);~~

(b) ~~the transaction may be closed out in accordance with this section at any time during~~ the period of time, during which the purchaser intends to execute the close-out transaction, provided that the close-out transaction initiated by the notice (or subsequent notices) must be completed and settled no later than the tenth calendar day following the purchaser's original transaction settlement date; and which shall not be more than five business days, specified by the purchaser for such purpose. The purchaser shall ~~immediately thereafter send, return receipt requested, a written notice of close-out to the seller. Such notice shall~~

(c) contain the information specified in item (1) of subparagraph (C) below.

* Underlining indicates new language; strikethrough denotes deletions.

(B) *Retransmittal*. Any party receiving a notice of close-out may retransmit the notice to another ~~party~~ broker, dealer or municipal securities dealer from whom the securities are due (“obliged party”). The retransmitting party shall, not later than 5:15 p.m. EST of the first business day following its receipt of the telephone notice from the originating party:

(1) provide the obliged party of close-out, notify the party to whom it is retransmitting by telephone of its intention to retransmit such notice, specifying the name of the originating party and note the dates applicable to the notice are extended by one business day;

(2) retransmit the notice to the obliged party, which shall contain the requirements specified in section (C)(2) below; and ~~originator and the applicable dates for delivery and effectiveness of the notice. The retransmitting party shall immediately thereafter send, return receipt requested, a written notice of retransmittal which shall contain the information specified in item (2) of subparagraph (C) below. The first such retransmittal shall extend the dates for close-out by five business days, and the first retransmitting party shall specify the extended dates on its notice of retransmittal.~~

(3) notify the originating party, of the retransmittal notice of extension dates, which shall include the information specified in section (C)(3) below. ~~The first retransmitting party shall, on the date telephone notice of the retransmittal is given, notify the purchaser originating the notice by telephone of the extended dates and immediately thereafter send, return receipt requested, a notice of extension of dates which shall contain the information specified in item (3) of subparagraph (C) below. Any party subsequently retransmitting such notice shall, on the date telephonic notice of the retransmittal is given, notify the purchaser originating the notice by telephone of such retransmittal, and immediately thereafter send a copy of the retransmittal notice to such originating purchaser.~~

(C) Contents of Notices. ~~Written~~ Written notices sent in accordance with the requirements of subparagraphs (A) or (B) above shall contain the following information:

(1) The notice of close-out required under subparagraph (A) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being sent;

(c) the ~~name of the person~~ contact to whom the originator provided the required ~~telephonic~~ notice;

(d) the date of such ~~telephonic~~ notice;

(e) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;

(f) the trade date and settlement date of the transaction;

(g) the price and total dollar amount of the transaction;

(h) the date by which the securities must be received by the originating dealer, which shall be completed within 10 calendar days of the purchaser's original transaction settlement date;

(i) the date or dates during which the notice of close-out may be executed; and

(j) the name and telephone number of the person at the broker, dealer, or municipal securities dealer originating the notice to contact concerning the close-out.

(2) The notice of retransmittal required under subparagraph (B) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer retransmitting the notice;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(c) the ~~name~~ identity of the broker, dealer or municipal securities dealer originating the notice;

(d) the ~~name of the person~~ contact to whom the retransmitting party provided the required ~~telephonic~~ notice;

(e) the date of such ~~telephonic~~ notice;

(f) the par value and description of the securities involved in the transaction with respect to which the retransmittal notice is given;

(g) the trade date and settlement date of the transaction;

(h) the price and total dollar amount of the transaction;

(i) the date by which the securities must be received by the dealer originating the notice (as extended due to the retransmittal);

(j) the date or dates during which the notice of close-out may be executed (as extended due to the retransmittal); and

(k) the name and telephone number of the person at the broker, dealer, or municipal securities dealer retransmitting the notice to contact concerning the retransmittal.

(3) The notice of extension of dates required under subparagraph (B) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice of close-out;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer retransmitting the notice;

(c) the ~~name~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(d) the ~~name of the person~~ contact to whom the retransmitting party provided the required telephonic notice of the extension of dates;

(e) the date of such ~~telephonic~~ notice;

(f) the par value and description of the securities involved in the transaction with respect to which the notice is given;

(g) the date specified by the originating dealer as the date by which delivery of such securities must be made;

(h) the date by which such delivery must be made, as extended due to the retransmittal;

(i) the effective date or dates for the notice of close-out, as extended due to the retransmittal; and

(j) the name and telephone number of the person at the broker, dealer, or municipal securities dealer retransmitting the notice to contact concerning the close-out.

(D) Seller's Responsibilities. Once the seller receives a notice it is required to use its best efforts to locate the securities referenced in the notice.

(DE) Purchaser's Options. If the securities described in the notice of close-out are not delivered to the originating purchaser by the date specified in the original notice, or the extended date resulting from a retransmittal, such purchaser may, ~~close out the transaction in accordance with the terms of the notice.~~ at its discretion, grant the seller one 10 calendar day extension. To close out a transaction in accordance with the terms of the notice as provided herein the purchaser may, at its option, take one of the following actions:

(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; with the seller bearing any burden from any change in the market price, and any benefit from any change in the market price remaining with the purchaser; or

(2) accept from the seller in satisfaction of the seller's obligation under the original contract (which shall be concurrently cancelled) a transaction in the delivery of municipal securities which 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 in a transaction 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.

A purchaser executing a close-out shall, upon execution, notify the selling dealer for whose account and liability the transaction was closed out ~~by telephone~~, stating the means of close-out utilized. The purchaser shall immediately thereafter confirm such notice in writing, sent return receipt requested, and forward a copy of the confirmation of the executed transaction. A retransmitting party shall give immediate notice of the execution of the close-out, in accordance with the procedure set forth herein, to the party to whom it retransmitted the notice.

A close-out will operate to close out all transactions covered under retransmitted notices. Any moneys due on the transaction, or on the close-out of the transaction, shall be forwarded to the appropriate party within ~~ten~~ five business days of the date of execution of the close-out notice. A buy-in may be executed from a long position in customers' accounts maintained with the party executing the buy-in or, with the agreement of the seller, from the purchaser's contra-party. In all cases, the purchaser must be prepared to defend the price at which the close-out is executed relative to market conditions at the time of the execution.

If the purchasing dealer has multiple transactions in fail status with multiple counterparties, the purchasing dealer may utilize the FIFO (first-in-first-out) method for determining the contract date for the failing quantity.

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

at any time during a period of fifteen business days following the date of reclamation. The first such procedure shall be considered an initial procedure for purposes of subparagraph (A) above.

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

~~(G) "Cash" Transactions.~~ The purchaser may close out transactions made for "cash" or made for or amended to include guaranteed delivery at the close of business on the day delivery is due.

(ii) Close-Out by Seller. If a seller makes good delivery according to the terms of the transaction and the requirements of this rule and the purchaser rejects delivery, the seller may close out the transaction in accordance with the following procedures:

(A) *Notice of Close-Out.* If the seller elects to close out a transaction in accordance with this paragraph (ii), the seller shall at any time not later than the close of business on the ~~fifth~~ first business day following receipt by the seller of notice of the rejection, notify the purchaser ~~by telephone~~ via an inter-dealer communication system of the registered clearing agency through which the transaction was compared of the purchaser's intention to close out the transaction of the seller's intention to close out the transaction.

(1) The seller's notice shall state:

(a) the that unless the transaction is completed by a specified date and time, by which the transaction must be completed which shall not be earlier than 5:15 p.m. EST of the close of the business day following the date the telephonic notice is given, the transaction may be closed out in accordance with this section; ~~and The seller shall immediately thereafter send, return receipt requested, a written notice of close-out to the purchaser.~~

(b) Such notice shall contain the information specified in subparagraph (B) below, and shall be accompanied by a copy of the purchaser's confirmation of the transaction to be closed out or other ~~written~~ evidence of the contract between the parties.

(B) *Content of Notice.* The written notice sent in accordance with the requirements of subparagraph (A) above shall set forth:

- (1) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice;
- (2) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being sent;
- (3) the ~~name of the person~~ contact to whom the originator provided the required telephonic notice;
- (4) the date of such ~~telephonic~~ notice;
- (5) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;
- (6) the trade date and settlement date of the transaction;
- (7) the price and total dollar amount of the transaction;
- (8) the date of improper rejection of the delivery;
- (9) the date by which the delivery of the securities must be accepted, which shall be completed within 10 calendar days; and
- (10) the name and telephone number of the person at the broker, dealer, or municipal securities dealer originating the notice to contact regarding the close-out.

(C) *Execution of Close-Out.* Not earlier than the close of the business day following the date ~~telephonic~~ notice of close-out is given to the purchaser, the seller may sell out the transaction at the current market for the account and liability of the purchaser. A seller executing a close-out shall, upon execution, notify the purchaser for whose account and liability the transaction was closed out by telephone. The seller shall immediately thereafter confirm such notice ~~in writing, sent return receipt requested,~~ and forward a copy of the confirmation of the executed transaction. Any moneys with any additional expenses or any additional cost due on the close-out of the transaction shall be forwarded to the appropriate party within ~~ten~~ five business days of the date of execution of the close-out notice.

(D) *Acceptance of Delivery.* In the event the transaction is completed by the date and time specified in the notice of close-out, the seller shall be entitled, upon ~~written~~ demand made to the purchaser, to recover from the purchaser all actual and necessary expenses incurred by the seller by reason of the purchaser's rejection of delivery.

(iii) *Close-Out Under Special Rulings*. Nothing herein contained shall be construed to prevent brokers, dealers or municipal securities dealers from closing out transactions as directed by a ruling of a national securities exchange, a registered securities association or an appropriate regulatory agency issued in connection with the liquidation of a broker, dealer or municipal securities dealer.

(iv) *Recordkeeping*. All records regarding the close-out transaction shall be maintained as part of the firm's books and records.

~~(iv) *Procedures Optional*. Nothing herein contained shall be construed to require the parties to follow the close-out procedures herein specified if they otherwise agree.~~

(i) – (j) No change.