(a) verifies the certifications described in subparagraph (d)(ii)(B)(2)(b) of this rule G-15;

(b) contains a risk analysis of all aspects of the entity's information technology systems including, computer operations, telecommunications, data security, systems development, capacity planning and testing, and contingency planning and testing; and

(c) contains the written response of the entity's management to the information provided pursuant to (a) and (b) of this subparagraph (d)(ii)(B)(3) of rule G-15.

(C) Disqualification of Vendor. A broker, dealer or municipal securities dealer using a Qualified Vendor that ceases to be qualified under the definition in rule G-15(d)(ii)(B)(2) shall not be deemed in violation of this rule G-15(d)(ii) if it ceases using such vendor promptly upon receiving notice that the vendor is no longer qualified.

(iii) Notwithstanding the provisions of section (c) of this rule, no broker, dealer or municipal securities dealer shall effect a delivery vs. payment or receipt vs. payment (DVP/RVP) customer transaction that is eligible for book-entry settlement in a depository registered with the Securities and Exchange Commission (depository) unless the transaction is settled through the facilities of a depository or through the interface between the two depositories. Each broker, dealer and municipal securities dealer settling such a customer transaction on a DVP/RVP basis shall:

(A) ensure that the customer has the capability, either directly or through its clearing agent, to settle transactions in a depository; and

(B) submit or cause to be submitted to a depository all information and instructions required from the broker, dealer or municipal securities dealer by the depository for book-entry settlement of the transaction to occur; provided that, if a party to a DVP/RVP customer transaction has made arrangements, through its clearing agent or otherwise, to use one or more depositories exclusively, a transaction by that party shall not be subject to the requirements of this paragraph (iii) if the transaction is ineligible for settlement at all such depositories with which such arrangements have been made; and further provided that purchases made by trustees or issuers to retire securities shall not be subject to this paragraph (iii).

(e) *Interest Payment Claims*. A broker, dealer or municipal securities dealer that receives from a customer a claim for the payment of interest due the customer on securities previously delivered to (or by) the customer shall respond to the claim no later than 10 business days following the date of the receipt of the claim or 20 business days in the case of a claim involving an interest payment scheduled to be made more than 60 days prior to the date of the claim.

(f) *Minimum Denominations*.

(i) Except as provided in this section (f), a broker, dealer or municipal securities dealer shall not effect a customer transaction in municipal securities issued after June 1, 2002 in an amount lower than the minimum denomination of the issue.

(ii) The prohibition in subsection (f)(i) of this rule shall not apply to the purchase of securities from a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the customer's position in the issue already is below the minimum denomination and that the entire position would be liquidated by the transaction. In determining whether this is the case, a broker, dealer or municipal securities dealer may rely either upon customer account information in its possession or upon a written statement by the customer as to its position in an issue.

(iii) The prohibition in subsection (f)(i) of this rule shall not apply to the sale of securities to a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the securities position being sold is the result of a customer liquidating a position below the minimum denomination, as described in subsection (f)(ii) of this rule. In determining whether this is the case, a broker, dealer or municipal securities dealer may rely upon customer account records in its possession or upon a written statement provided by the party from which the securities are purchased. A broker, dealer or municipal securities dealer effecting a sale to a customer under this subsection (iii) shall at or before the completion of the transaction, give or send to the customer a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. Such written statement may be included on the customer's confirmation or may be provided on a document separate from the confirmation.

(g) *Forwarding Official Communications*.

(i) If a broker, dealer or municipal securities dealer receives an official communication to beneficial owners applicable to an issue of municipal securities that the broker, dealer or municipal securities dealer has in safekeeping along with a request to forward such official communication to the applicable beneficial owners, the broker, dealer or municipal securities dealer shall use reasonable efforts to promptly retransmit the official communication to the parties for whom it is safekeeping the issue.

(ii) In determining whether reasonable efforts have been made to retransmit official communications, the following considerations are relevant:

(A) *CUSIP Numbers*. If CUSIP numbers are included on or with the official communication to beneficial owners, the broker, dealer or municipal securities dealer shall use such CUSIP numbers in determining the issue(s)

to which the official communication applies. If CUSIP numbers are not included on or with the official communication, the broker, dealer or municipal securities dealer shall use reasonable efforts to determine the issue(s) to which the official communication applies; provided however, that it shall not be a violation of this rule if, after reasonable efforts are made, the issue(s) to which the official communication applies are not correctly identified by the broker, dealer or municipal securities dealer.

(B) *Compensation*. A broker, dealer or municipal securities dealer shall not be required by this rule to retransmit official communications without an offer of adequate compensation. If compensation is explicitly offered in or with the official communication, the broker, dealer or municipal securities dealer shall effect the retransmission and seek compensation concurrently; provided, however, that if total compensation would be more than $500.00, the broker, dealer or municipal securities dealer may, in lieu of this procedure, promptly contact the party offering compensation, inform it of the amount of compensation required, obtain specific agreement on the amount of compensation and wait for receipt of such compensation prior to proceeding with the retransmission. In determining whether compensation is adequate, the broker, dealer or municipal securities dealer shall make reference to the suggested rates for similar document transmission services found in "Suggested Rates of Reimbursement" for expenses incurred in forwarding proxy material, annual reports, information statements and other material referenced in FINRA Rule 2251(g), taking into account revisions or amendments to such suggested rates as may be made from time to time.

(C) *Sufficient Copies of Official Communications*. A broker, dealer or municipal securities dealer is not required to provide duplication services for official communications but may elect to do so. If sufficient copies of official communications are not received, and the broker, dealer or municipal securities dealer elects not to offer duplication services, the broker, dealer or municipal securities dealer shall promptly request from the party requesting the forwarding of the official communication the correct number of copies of the official communication.

(D) *Non-Objecting Beneficial Owners*. In lieu of retransmitting official communications to beneficial owners who have indicated in writing that they do not object to the disclosure of their names and security positions, a broker, dealer or municipal securities dealer may instead promptly provide a list of such non-objecting beneficial owners and their addresses.

(E) *Beneficial Owners Residing Outside of the United States*. A broker, dealer or municipal securities dealer shall not be required to send official communications to persons outside of the United States of America, although brokers, dealers and municipal securities dealers may voluntarily do so.

(F) *Investment Advisors*. A broker, dealer or municipal securities dealer shall send official communications to the investment advisor for a beneficial owner, rather than to the beneficial owner, when the broker, dealer or municipal securities dealer has on file a written authorization for such documents to be sent to the investment advisor in lieu of the beneficial owner.

(iii) *Definitions*

(A) The terms "official communication to beneficial owners" and "official communication," as used in this section (g), mean any document or collection of documents pertaining to a specific issue or issues of municipal securities that both:

(1) is addressed to beneficial owners and was prepared or authorized by: (a) an issuer of municipal securities; (b) a trustee for an issue of municipal securities in its capacity as trustee; (c) a state or federal tax authority; or (d) a custody agent for a stripped coupon municipal securities program in its capacity as custody agent; and

(2) contains official information about such issue or issues including, but not limited to, notices concerning monetary or technical defaults, financial reports, material event notices, information statements, or status or review of status as to taxability.

Rule G-15 Interpretations

Interpretive Notice on Rule G-12 on Uniform Practice and Rule G-15 on Customer Confirmations

November 28, 1977

This notice addresses several questions that have arisen concerning Board rules G-12 and G-15. Board rule G-12 establishes uniform industry procedures for the processing, clearance, and settlement of transactions in municipal securities... Board rule G-15 requires municipal securities professionals to send written confirmations of transactions to customers, and specifies the information required to be set forth on the confirmation.

Settlement Dates

In order to establish uniform settlement dates for "regular way" transactions in municipal securities, rule G-12(b)(i)(B) de-fines the term "business day" as "a day recognized by the National Association of Securities Dealers, Inc. [the "NASD"] as a day on which securities transactions may be settled." The practice of the NASD has been to exclude from the category of "business day," any day widely designated as a legal bank holiday, and to notify the NASD membership accordingly. Such notices set forth the NASD's trade and settlement date schedules for periods which include a legal holiday.

"Catastrophe" Call Features

Rules G-12 and G-15 require that confirmations of transactions set forth a "description of the securities, including at a minimum… if the securities are subject to redemption prior to maturity (callable)… an indication to such effect…" (paragraphs G-12(c)(v)(E) and G-15(a)(v)[*]). Both rules also require that in transactions in callable securities effected on a yield basis, dollar price must be shown and "the calculation of dollar price shall be to the lower of price to call or price to maturity" (paragraphs G-12(c)(v)(I) and G-15(a)(viii)[†]).

The references to "callable" securities and pricing to call in rules G-12 and G-15 do not refer to "catastrophe" call features, such as those relating to acts of God or eminent domain, which are beyond the control of the issuer of the securities.

[*] [Currently codified at rule G-15(a)(i)(C)(2)(a).]

[†] [Currently codified at rule G-15(a)(i)(A)(5).]

Interpretive Notice on Confirmation Requirements

March 25, 1980

Rule G-12(c)(v)(E) requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including "…in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities…."

Rule G-15(a)(v)[*] imposes the identical requirement with respect to customer confirmations. The Board has recently received an inquiry regarding whether these provisions require confirmations of transactions in Los Angeles Department of Water and Power bonds to distinguish between bonds secured by revenues of the electric power system and bonds secured by revenues of the waterworks system.

The Board is of the view that, if securities of a particular issuer are secured by separate sources of revenue, the source of revenue of the securities involved in a transaction is a material element of the description of the securities which should be set forth on customer and inter-dealer confirmations. Confirmations of transactions in Los Angeles Department of Water and Power bonds must therefore indicate whether the securities are "electric revenue" or "water revenue" bonds.

[*] [Currently codified at rule G-15 (a)(i)(C)(1)(a).]

Interpretive Notice Concerning Confirmation Disclosure Requirements Applicable to Variable-Rate Municipal Securities

December 10, 1980

The Municipal Securities Rulemaking Board has recently received inquiries concerning the application of the Board's confirmation disclosure requirements, which are contained in Board rules G-12 and G-15, to municipal securities with variable or "floating" interest rates.

Rule G-12(c)(v)(E)[*] requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including the interest rate. Rule G-15(a)(i)(E)[*] imposes the same requirement with respect to customer confirmations. The Board is of the view that these provisions require that the security description appearing on customer and inter-dealer confirmations for securities with variable interest rates include a clear indication that the interest rates are variable or "floating."

The Board also notes that due to the variability of the interest rates on these securities, it is not possible to derive a yield to a future call or maturity date. Therefore, the Board has concluded that the provision of rule G-15 which requires that customer confirmations for transactions effected at a dollar price set forth the yield resulting from such dollar price is not applicable to transactions in variable-rate municipal securities.

[*] [Currently codified at rule G-15(a)(1)(B)(4).]

Notice Concerning "Zero Coupon" and "Stepped Coupon" Securities

April 27, 1982

The Municipal Securities Rulemaking Board has recently received inquiries concerning the application of the confirmation disclosure requirements of Board rules G-12 and G-15 to transactions in municipal securities with "zero coupons" or "stepped coupons." Certain recent new issues of municipal securities have had several maturities paying 0% interest; securities of these maturities are sold at deep discounts, with the investor's return received in the form of an accretion of this discount to par. Other issues have been sold which have "stepped coupons;" that is, all outstanding bonds pay the same interest rate each year, with the interest rate periodically rising, on a pre-established schedule, on all securities yet to be redeemed. Interested persons have inquired concerning how the description requirements of the rules apply to such securities, and whether the yield disclosure requirements of rule G-15 apply to confirmations of transactions in such securities for the accounts of customers.

Rule G-12(c)(v)(E) requires a municipal securities dealer to set forth on an inter-dealer confirmation a description of the securities which are the subject of the transaction, including the interest rate. Rule G-15(a)(i)(E)[*] imposes the same requirement with respect to customer confirmations. Further, rule G-15(a)(i)(I)(2)[†] requires that customer confirmations of transactions effected at dollar prices (except for transactions at par) state the lowest of the resulting yield to call, yield to par option, or yield to maturity.

A confirmation of a transaction in a "zero coupon" security must state that the interest rate on the security is "0%." A customer confirmation of such a transaction must state the lowest of the yield to call or yield to maturity resulting from the dollar price of the transaction.[1] The Board believes that

the disclosure of the resulting yield is particularly important on such transactions, since it provides the only indication to the investor of the return he or she can expect from the investment.

A confirmation of a transaction in a "stepped coupon" security must state the interest rate currently being paid on the securities, and must identify the securities as "stepped coupon" securities. A customer confirmation of such a transaction must also state the lowest of the yield to call, yield to par option, or yield to maturity resulting from the dollar price of the transaction.[2] In view of the wide variation in the coupon interest rates that will be received over the life of a "stepped coupon" security, the Board believes that the disclosure of yield will assist customers in determining the actual return to be received on the investment.

In addition to the specific confirmation disclosure requirements of Board rules G-12 and G-15 discussed above, the Board is of the view that persons selling such securities to the public have an obligation to adequately disclose the special characteristics of such securities so as to comply with the Board's fair practice rules. For example, although the details of the increases to the interest rates on "stepped coupon" securities need not be provided on confirmations, such information is, of course, material information regarding the securities, and municipal securities dealers would be obliged to inform customers about this feature of the securities at or before the time of trade.

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[1] The Board notes that, upon the effectiveness of Board rule G-33, such yield must be computed on a basis that presumes semi-annual compounding.

[2] In the case of both "zero coupon" and "stepped coupon" securities, if the transaction is effected in a yield basis, the confirmation must show the yield price and the resulting dollar price, computed to the lowest of price to premium call, price to par option, or price to maturity.

[*] [Currently codified at rule G-15(a)(i)(B)(4).]

[†] [Currently codified at rule G-15 (a)(i)(A)(5).]

Notice Concerning Pricing to Call

December 10, 1980

Board rules G-12 on uniform practice and G-15 on customer confirmations set forth certain requirements concerning the computations of yields and dollar prices to premium call or par option features. Both rules currently require that, in the case of a transaction in callable securities effected on the basis of a yield price, the dollar price should be calculated to the lowest of the price to premium call, price to par option, or price to maturity. Further, confirmations of transactions on which the dollar price has been computed to a call or option feature must state the call date and price used in the computation. Amendments to rule G-15 which will become effective on October 1, 1981, generally require that confirmations of transactions in callable securities effected at a dollar price in excess of par must set forth the lowest of the yield to premium call, yield to par option, or yield to maturity resulting from such dollar price.[1]

Since the December 1977 effective dates of rule G-12 and G-15, the Board has received numerous inquiries concerning these provisions and their application to different issues of municipal securities. In view of the general interest in this subject, the Board is issuing this notice to provide guidance with respect to the general criteria to be used in selecting the appropriate call feature for yield or dollar price computations.

The requirement for the computation of dollar price to the lowest of price to premium call, par option, or maturity reflects the long-established practice of the industry in pricing transactions. This practice assures a customer that he or she will realize, at a minimum, the stated yield, even in the event that a call provision is exercised. The pending amendment to rule G-15, which requires the presentation of information concerning the lowest yield on confirmations of dollar price transactions, will provide investors with the equivalent information on these types of transactions.

In view of the variety of call provisions applicable to different kinds of municipal securities, there is often uncertainty concerning the selection of the appropriate call feature for use in the computation of yield or dollar price. Issues of municipal securities often have several different call features, ranging from calls associated with mandatory sinking fund requirements to optional calls from the proceeds of a refunding or funds in excess of debt service requirements. Certain issues have additional call provisions in the event that funds designated for specific purposes are not expended or obligations securing the issue are prepaid.[2] Most of the inquiries which the Board has received concerning the provisions of rules G-12 and G-15 focus on this question of selection of the call provisions to be used for computation purposes.

The Board is of the view that a distinction should be drawn between "in whole" call provisions, (*i.e.*, those under which all outstanding securities of a particular issue may be called) and "in part" call provisions (*i.e.*, those under which part of an issue, usually selected by lot or in inverse maturity or numerical order, may be called for redemption). The Board is of the view that for computation purposes only "in whole" calls should be used; sinking fund calls and other "in part" calls should not be used in making the computations required by rules G-12 and G-15.

Several inquiries have raised the question of which "in whole" call should be used in the case of issues which have more than one such call. The earlier call features of such issues are often subject to restrictions on the proceeds which may be used to redeem securities (*e.g.*, a restriction that only unexpended funds from the original issue may be used for redemption purposes). Since such call features operate as a practical matter as "in part" calls, the Board is of the view that the "in whole" call feature which would be exercised in the event of a refunding is the call feature which should generally be used for purposes of the computation of yields and dollar prices.

Other concerned persons have inquired regarding the application of the "pricing to call" requirements in the case of an issue with a sequence of call dates at gradually declining premiums. The Board believes that, as a general matter, a trial computation to the first date on which a security is callable "in whole" at a premium will be sufficient to determine whether the price to the premium call is the lowest dollar price. However, in the rare instance where the price to an intermediate premium call (*i.e.*, a call in the "middle" of a sequence of calls at declining premiums) is the lowest dollar price, such price should be used. The Board notes that, in such cases, the structure of the call schedule is sufficiently unusual (*e.g.*, with sharp declines in the premium amount over a very short period of time) that dealers should be alerted to the need to take the intermediate calls into consideration.

[1] Effective December 1, 1980, customer confirmations of transactions in callable securities effected at a dollar price less than par must set forth the yield to maturity resulting from such dollar price. Confirmations of dollar-price transactions in non-callable securities, or securities which have been called or prerefunded, must set forth the resulting yield to maturity (or to the date for redemption of the securities, in the case of called or prerefunded securities).

[2] Other issues are also callable in the event that the financed project is damaged or destroyed, or the tax exempt status of the issue is revoked. Since the possibility of such a call being exercised is extremely remote, and beyond the control of the issuer of the securities, the Board does not believe that these "catastrophe" calls need be considered for computation purposes.

Interpretive Notice Concerning Yield Disclosure Requirements for Purchases from Customers

September 1, 1981

Certain amendments to Board rule G-15 on customer confirmations became effective on December 1, 1980. Among other matters, these amendments require that customer confirmations of transactions effected on the basis of dollar price, including confirmations of purchases from customers, set forth certain yield information concerning the transaction. Confirmations of dollar price transactions in non-callable securities, or in callable securities traded at prices below par, must set forth the yield to maturity resulting from the dollar price. Confirmations of dollar price transactions in securities which have been called or prerefunded must show the yield to the maturity date established by the call or prerefunding. Confirmations of transactions in callable securities traded at dollar prices in excess of par are exempt from yield disclosure requirements until October 1, 1981; after that date such confirmations must show the lowest of the yield to premium call, yield to par option, or yield to maturity resulting from such dollar price.[1]

Since the effective date of these amendments, the Board has received several inquiries as to whether all confirmations of purchases from customers, including purchases effected at a price derived from a yield price less a spread or concession, must show the yield resulting from the actual unit dollar price of the transaction.

The Board is of the view that all confirmations of purchases from customers (except for purchases at par) must set forth the net or effective yield resulting from the actual unit dollar price of the transaction. The yield disclosure on confirmations of purchases from customers is intended to provide customers with a means of assessing the merits of alternative investment strategies (such as different possible reinvestment transactions) and the merits of the particular transaction being confirmed. The Board believes that the disclosure of the net or effective yield (*i.e.*, that derived from the actual unit dollar price of the transaction) best serves these purposes.

[1] Confirmations of transactions effected at a dollar price of par ("100") continue to be exempt from any yield disclosure requirements.

Sending Confirmations to Customers Who Utilize Dealers to Tender Put Option Bonds

September 30, 1985

The Board has received inquiries whether a municipal securities dealer must send a confirmation to a customer when the customer utilizes the dealer to tender bonds pursuant to a put option. Board rule G-15(a)(i) requires dealers to send confirmations to customers at or before the completion of a transaction in municipal securities. The Board believes that whether a dealer that accepts for tender put bonds from a customer is engaging in "transactions in municipal securities" depends on whether the dealer has some interest in the put option bond.

In the situation in which a customer puts back a bond through a municipal securities dealer either because he purchased the bond from the dealer or he has an account with the dealer, and the dealer does not have an interest in the put option and has not been designated as the remarketing agent for the issue, there seems to be no "transaction in municipal securities" between the dealer and the tendering bondholder and no confirmation needs to be sent. The Board suggests, however, that it would be good industry practice to obtain written approval of the tender from the customer, give the customer a receipt for his bonds and promptly credit the customer's account. Of course, if the dealer actually purchases the security and places it in its trading account, even for an instant, prior to tendering the bond, a confirmation of this sale transaction should be sent.[1]

If a dealer has some interest in a put option bond which its customer has delivered to it for tendering, a confirmation must be sent to the customer. A dealer that is the issuer of a secondary market put option on a bond has an interest in the security and is deemed to be engaging in a municipal securities transaction if the bond is put back to it.

In addition, a remarketing agent, (*i.e.*, a dealer which, pursuant to an agreement with an issuer, is obligated to use its best efforts to resell bonds tendered by their owners pursuant to put options) who accepts put option bonds tendered by customers also is deemed to be engaging in a "transac-

tion in municipal securities" with the customer for purposes of sending a confirmation to the customer because of the remarketing agent's interest in the bonds.[2] The Board's position on remarketing agents is based upon its understanding that remarketing agents sell the bonds that their customers submit for tendering, as well as other bonds tendered directly to the trustee or tender agent, pursuant to the put option. The customers and other bondholders, pursuant to the terms of the issue, usually are paid from the proceeds of the remarketing agents' sales activities.[3]

[1] This would apply equally in circumstances in which the dealer has an interest in the put option bond.

[2] Of course, remarketing agents also must send confirmations to those to whom they resell the bonds.

[3] If these funds are not sufficient to pay tendering bondholders, such bond-holders usually are paid from certain funds set up under the issue's indenture or from advances under the letter of credit that usually backs the put option.

Notice Concerning Confirmation Disclosure Requirements for Callable Municipal Securities

February 20, 1986

Recently, the Board has received inquiries concerning the application of its inter-dealer and customer confirmation rules, rules G-12(c) and G-15(a) respectively, to municipal securities subject to call features. In particular, the Board has been made aware of instances in which dealers note one call date and price, usually the first in-whole call, on inter-dealer and customer confirmations without noting that the call information relates to the first in-whole call or that the bonds are otherwise callable.

Rules G-12(c) and G-15(a) require that confirmations set forth a

> description of the securities, including… if the securities are… subject to redemption prior to maturity (callable)…, an indication to such effect…

Thus, municipal securities subject to in-whole or in-part calls must be described as callable. Rules G-12(c) and G-15(a) also require dealers, when securities transactions are effected on a yield basis, to set forth a dollar price that has been computed to the lowest of the price to call, price to par option, or price to maturity; rule G-15 requires that confirmations of customer transactions effected on a dollar price disclose a yield in a similar manner. These rules provide that when a price or yield is calculated to a call, this must be stated, and the call date and price used in the calculation must be shown.[1] These are the only instances in which specific call features must be identified on a confirmation.

The Board understands that confusion may arise when specific call features are noted on confirmations without an adequate description of such information. The Board has determined that confirmations that include specific call information not required to be included under the Board's confirmation rules also must include a notation that other call features exist and must provide clarifying information about the noted call, *e.g.* "first in-whole call." These disclosures should be sufficient to ensure that purchasing dealers and customers will be alerted to the need to obtain additional information.

The Board cautions dealers to ensure that confirmations of municipal securities with call features clearly describe the securities as "callable." If this information is erroneously noted on the confirmation, purchasing dealers have the right to reclaim the securities under rule G-12(g)(iii)(C)(3).

[1] In addition, rule G-15(a)(iii)(D)[currently codified at rule G-15(a)(i)(C)(2)(a)] requires a legend to be placed on customer confirmations of transactions in callable securities which notes that "[additional] call features ... exist... [that may] affect yield; complete information will be provided upon request." **[Note: Revised to reflect subsequent amendments.]**

Notice Concerning Confirmation, Delivery and Reclamation of Interchangeable Securities

August 10, 1988

In March 1988, the Securities and Exchange Commission approved amendments to rules G-12 and G-15 concerning municipal securities that may be issued in bearer or registered form (interchangeable securities).[1] These amendments will become effective for transactions executed on or after September 18, 1988. The amendments revise rules G-12(e) and G-15(c) to allow inter-dealer and customer deliveries of interchangeable securities to be either in bearer or registered form, ending the presumption in favor of bearer certificates for such deliveries. The amendments also delete the provision in rule G-12(g) that allows an inter-dealer delivery of interchangeable securities to be reclaimed within one day if the delivery is in registered form. In addition, the amendments remove the provisions in rules G-12(c) and G-15(a) that require dealers to disclose on inter-dealer and customer confirmations that securities are in registered form.

The Board has received inquiries on several matters concerning the amendments and is providing the following clarifications and interpretive guidance.

Deliveries of Interchangeable Securities

Several dealers have asked whether the amendments apply to securities that can be converted from bearer to registered form, but that cannot then be converted back to bearer form. These securities are "interchangeable securities" because they originally were issuable in either bearer or registered form. Therefore, under the amendments, physical deliveries of these certificates may be made in either bearer or registered form, unless a contrary agreement has been made by the parties to the transaction.[2]

The Board also has been asked whether a mixed delivery of bearer and registered certificates is permissible under the amendments. Since the amendments provide that either bearer

or registered certificates are acceptable for physical deliveries, a delivery consisting of bearer and registered certificates also is an acceptable delivery under the amendments.

Fees for Conversion

Transfer agents for some interchangeable securities charge fees for conversion of registered certificates to bearer form. Dealers should be aware that these fees can be substantial and, in some cases, may be prohibitively expensive. Dealers, therefore, should ascertain the amount of the fee prior to agreeing to deliver bearer certificates. A dealer may pass on the costs of converting registered securities to bearer form to its customer. In such a case, the dealer must disclose the amount of the conversion fee to the customer at or prior to the time of trade, and the customer must agree to pay it.[3] In addition, rule G-15(a)(iii)(J)[*] requires that the dealer note such an agreement (including the amount of the conversion fee) on the confirmation.[4] The conversion fee, however, should not be included in the price when calculating the yield shown on the confirmation.[5] In collecting this fee, the dealer merely would be passing on the costs imposed by a third party, voluntarily assumed by the customer, relating to the form in which the securities are held. The conversion fee thus is not a necessary or intrinsic cost of the transaction for purposes of yield calculation.[6]

Continued Application of the Board's Automated Clearance Rules

The Board's automated clearance rules, rules G-12(f) and G-15(d), require book-entry settlements of certain inter-dealer and customer transactions.[7] The amendments on interchangeable securities address only physical deliveries of certificates and, therefore, apply solely to transactions that are not required to be settled by book-entry under the automated clearance rules.

When a physical delivery is permitted under Board rules (*e.g.*, because the securities are not depository eligible), dealers may agree at the time of trade on the form of certificates to be delivered. When such an agreement is made, this special condition must be included on the confirmation, as required by rules G-12(c)(vi)(I) and G-15(a)(iii)(J).[8] [*] Dealers, however, may not enter into an agreement providing for a physical delivery when book-entry settlement is required under the automated clearance rules, as this would result in a violation of the automated clearance rules.[9]

Need for Education of Customers on Benefits of Registered Securities

Dealers should begin planning as soon as possible any internal or operational changes that may be needed to comply with the amendments. The Depository Trust Company (DTC) has announced plans for a full-scale program of converting interchangeable securities now held in bearer form to registered form beginning on September 18, 1988.[10] When possible, DTC plans to retain a small supply of bearer certificates in interchangeable issues to accommodate withdrawal requests for bearer certificates.[11] The general effect of the amendments and DTC's policy, however, will make it difficult for dealers, in certain cases, to ensure that their customers will receive bearer certificates. Dealers should educate customers who now prefer bearer certificates on the call notification and interest payment benefits offered by registered certificates and dealer safekeeping and advise them when it is unlikely that bearer certificates can be obtained in a particular transaction. Dealers safekeeping municipal securities through DTC on behalf of such customers also may wish to review with those customers DTC's new arrangements for interchangeable securities.

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1 *See* SEC Release No. 34-25489 (March 18, 1988); MSRB Reports Vol. 8, no. 2 (March 1988), at 3.

2 The amendments should substantially reduce delays in physical deliveries that result because of dealer questions about whether specific certificates should be in bearer form. This efficiency would be impossible if these "one-way" interchangeable securities were excluded from the amendments since dealers would be required to determine, for each physical delivery of registered securities, whether the securities are "one-way" interchangeable securities.

3 Rule G-17, on fair dealing, requires dealers to disclose all material facts about a transaction to a customer at or before the time of trade. In many cases, the conversion fee is as much as $15 for each bearer certificate. The Board also has been made aware of some cases in which the transfer agent must obtain new printing plates or print new bearer certificates to effect a conversion. The conversion costs then may be in excess of several hundred or a thousand dollars. Therefore, it is important that the customer be aware of the amount of the conversion costs prior to agreeing to pay for them.

4 This rule requires that, in addition to any other information required on the confirmation, the dealer must include "such other information as may be necessary to ensure that the parties agree on the details of the transaction."

5 Rule G-15(a)(i)(I) [currently codified at rule G-15(a)(i)(A)(5)] requires the yield of a customer transaction to be shown on the confirmation.

6 Some customers, for example, may ask dealers to convert registered securities to bearer form even though the customers also may be willing to accept registered certificates if this is more economical.

7 Rule G-12(f)(ii) requires book-entry settlement of an inter-dealer municipal securities transaction if both dealers (or their clearing agents for the transaction) are members of a depository making the securities eligible and the transaction is compared through a registered securities clearing agency. Rule G-15(d)(iii) requires book-entry settlement of a customer transaction if the dealer grants delivery versus payment or receipt versus payment privileges on the transaction and both the dealer and the customer (or the clearing agents for the transaction) are members of a depository making the securities eligible.

8 These rules require that, in addition to the other information required on interdealer and customer confirmation, confirmations must include "such other information as may be necessary to ensure that the parties agree to the details of the transaction."

9 Of course, dealers may withdraw physical certificates from a depository once a book-entry delivery is accepted.

10 DTC expects this conversion process to take approximately two years. Midwest Securities Trust Company and The Philadelphia Depository Trust Company have not yet announced their plans with regard to interchangeable securities.

11 DTC Notice to Participants on Plans for Comprehensive Conversion of Interchangeable Municipal Bonds to the Registered Form (August 10, 1988).

[*] [Currently codified at rule G-15(a)(i)(A)(8).]

Notice Concerning Stripped Coupon Municipal Securities

March 13, 1989

In 1986, several municipal securities dealers began selling ownership rights to discrete interest payments, principal payments or combinations of interest and principal payments on municipal securities. In 1987, the Board asked the Securities and Exchange Commission staff whether these "stripped coupon" instruments are municipal securities for purposes of the Securities Exchange Act and thus are subject to Board rules. On January 19, 1989, the staff of the Division of Market Regulation of the Commission issued a letter stating that, subject to certain conditions, these instruments are municipal securities for purposes of Board rules (SEC staff letter).

The Board is providing the following guidance on the application of its rules to transactions in stripped coupon instruments defined as municipal securities in the SEC staff letter (stripped coupon municipal securities). Questions whether other stripped coupon instruments are municipal securities and questions concerning the SEC staff letter should be directed to the Commission staff.

Background

A dealer sponsoring a stripped coupon municipal securities program typically deposits municipal securities (the underlying securities) with a barred custodian. Pursuant to a custody agreement, the custodian separately records the ownership of the various interest payments, principal payments, or specified combinations of interest and principal payments. One combination of interest and principal payments sometimes offered is the "annual payment security," which represents one principal payment, with alternate semi-annual interest payments. This results in an annual interest rate equal to one-half the original interest rate on the securities.[1] Stripped coupon municipal securities are marketed under trade names such as Municipal Tax Exempt Investment Growth Receipts (Municipal TIGRs), Municipal Receipts (MRs), and Municipal Receipts of Accrual on Exempt Securities (MUNI RAES).

Application of Board Rules

In general, the Board's rules apply to transactions in stripped coupon municipal securities in the same way as they apply to other municipal securities transactions. The Board's rules on professional qualifications and supervision, for example, apply to persons executing transactions in the securities the same as any other municipal security. The Board's rules on recordkeeping, quotations, advertising and arbitration also apply to transactions in the securities. Dealers should be aware that rule G-19, on suitability of recommendations, and rule G-30, on fair pricing, apply to transactions in such instruments.

The Board emphasizes that its rule on fair dealing, rule G-17, requires dealers to disclose to customers purchasing stripped coupon municipal securities all material facts about the securities at or before the time of trade. Any facts concerning the underlying securities which materially affect the stripped coupon instruments, of course, must be disclosed to the customer. The Board understands that some stripped coupon municipal securities are sold without any credit enhancement to the underlying municipal securities. As pointed out in the SEC staff letter, dealers must be particularly careful in these cases to disclose all material facts relevant to the creditworthiness of the underlying issue.

Confirmation Requirements

Dealers generally should confirm transactions in stripped coupon municipal securities as they would transactions in other municipal securities that do not pay periodic interest or which pay interest annually.[2] A review of the Board's confirmation requirements applicable to the securities follows.

Securities Descriptions. Rules G-12(c)(v)(E) and G-15(a)(i)(E)[*] require a complete securities description to be included on inter-dealer and customer confirmations, respectively, including the name of the issuer, interest rate and maturity date.[3] In addition to the name of the issuer of the underlying municipal securities, the trade name and series designation assigned to the stripped coupon municipal security by the dealer sponsoring the program must be included on the confirmation.[4] Of course, the interest rate actually paid by the stripped coupon security (*e.g.*, zero percent or the actual, annual interest rate) must be stated on the confirmation rather than the interest rate on the underlying security.[†] Similarly, the maturity date listed on the confirmation must be the date of the final payment made by the stripped coupon municipal security rather than the maturity date of the underlying securities.[5]

Credit Enhancement Information. Rules G-12(c)(vi)(D) and G-15(a)(ii)(D)[‡] require confirmations of securities prerefunded to a call date or escrowed to maturity to state this fact along with the date of maturity set by the advance refunding and the redemption price. If the underlying municipal securities are advance-refunded, confirmations of the stripped coupon municipal securities must note this. In addition, rules G-12(c)(v)(E) and G-15(c)(i)(E)[#] require that the name of any company or other person, in addition to the issuer, obligated directly or indirectly with respect to debt service on the underlying issue or the stripped coupon security be included on confirmations.[6]

Quantity of Securities and Denominations. For securities that mature in more than two years and pay investment return only at maturity, rules G-12(c)(v) and G-15(a)(v)[**] require the maturity value to be stated on confirmations in lieu of par value. This requirement is applicable to transactions in stripped coupon municipal securities over two years in maturity that pay investment return only at maturity, *e.g.*, securities representing one interest payment or one principal payment. For securities that pay only principal and that are pre-refunded at a premium price, the principal amount may be stated as the transaction amount, but the maturity value must be clearly

noted elsewhere on the confirmation. This will permit such securities to be sold in standard denominations and will facilitate the clearance and settlement of the securities.

Rules G-12(c)(vi)(F) and G-15(a)(iii)(G)[†††] require confirmations of securities that are sold or that will be delivered in denominations other than the standard denominations specified in rules G-12(e)(v) and G-15(a)(iii)(G)[†††] to state the denominations on the confirmation. The standard denominations are $1,000 or $5,000 for bearer securities, and for registered securities, increments of $1,000 up to a maximum of $100,000. If stripped coupon municipal securities are sold or will be delivered in any other denominations, the denomination of the security must be stated on the confirmation.

Dated Date. Rules G-12(c)(vi)(A) and G-15(a)(iii)(A)[***] require that confirmations state the dated date of a security if it affects price or interest calculations, and the first interest payment date if other than semi-annual. The dated date for purposes of an interest-paying stripped coupon municipal security is the date that interest begins accruing to the custodian for payment to the beneficial owner. This date, along with the first date that interest will be paid to the owner, must be stated on the confirmation whenever it is necessary for calculation of price or accrued interest.

Original Issue Discount Disclosure. Rules G-12(c)(vi)(G) and G-15(a)(iii)(H)[†††] require that confirmations identify securities that pay periodic interest and that are sold by an underwriter or designated by the issuer as "original issue discount." This alerts purchasers that the periodic interest received on the securities is not the only source of tax-exempt return on investment. Under federal tax law, the purchaser of stripped coupon municipal securities is assumed to have purchased the securities at an "original issue discount," which determines the amount of investment income that will be tax-exempt to the purchaser. Thus, dealers should include the designation of "original issue discount" on confirmations of stripped coupon municipal securities, such as annual payment securities, which pay periodic interest.

Clearance and Settlement of Stripped Coupon Municipal Securities

Under rules G-12(e)(vi)(B) and G-15(a)(iv)(B), delivery of securities transferable only on the books of a custodian can be made only by the bookkeeping entry of the custodian.[7] Many dealers sponsoring stripped coupon programs provide customers with "certificates of accrual" or "receipts," which evidence the type and amount of the stripped coupon municipal securities that are held by the custodian on behalf of the beneficial owner. Some of these documents, which generally are referred to as "custodial receipts," include "assignment forms," which allow the beneficial owner to instruct the custodian to transfer the ownership of the securities on its books. Physical delivery of a custodial receipt is not a good delivery under rules G-12(e) and G-15(a) unless the parties specifically have agreed to the delivery of a custodial receipt. If such an agreement is reached, it should be noted on the confirmation of the transaction, as required by rules G-12(c)(v)(N) and G-15(a)(i)(N)[****].

The Board understands that some stripped coupon municipal securities that are assigned CUSIP numbers and sold in denominations which are multiples of $1,000 are eligible for automated comparison and automated confirmation/affirmation and that some of these instruments also are eligible for book-entry delivery through registered securities depositories. The Board reminds dealers that transactions in stripped coupon municipal securities are subject to the automated clearance requirements of rules G-12(f) and G-15(d) if they are eligible in the automated clearance systems. Dealers sponsoring stripped coupon programs also should note that rule G-34(b)(ii) requires CUSIP numbers to be assigned to stripped coupon municipal securities prior to the initial sale of the securities to facilitate clearance and settlement.

Written Disclosures in Connection with Sales of Stripped Coupon Municipal Securities

Dealers sponsoring stripped coupon municipal securities programs generally prepare "offering circulars" or "offering memoranda" describing the securities that have been placed on deposit with the custodian, the custody agreement under which the securities are held, and the tax treatment of transactions in the securities. These documents generally are provided to all customers purchasing the securities during the initial offering of the instruments. The Board strongly encourages all dealers selling stripped coupon municipal securities to provide these documents to their customers whether the securities are purchased during the initial distribution or at a later time.[8] Although the material information contained in these documents, under rule G-17, must be disclosed to customers orally if not provided in writing prior to the time of trade, the Board believes that the unusual nature of stripped coupon municipal securities and their tax treatment warrants special efforts to provide written disclosures. Moreover, if stripped coupon municipal securities are marketed during the underwriting period of the underlying issue, rule G-32 requires distribution of the official statement for the underlying issue prior to settlement of the transaction of the stripped coupon municipal securities.

[1] The Board understands that other types of stripped coupon municipal securities also may be offered with combinations of interest and principal payments providing an interest rate different than the original interest rate of the securities.

[2] Thus, for stripped coupon municipal securities that do not pay periodic interest, rules G-12(c)(v) and G-15(a)(v) require confirmations to state the interest rate as zero and, for customer confirmations, the inclusion of a legend indicating that the customer will not receive periodic interest payments. [See current rule G-15(a)(vi)(D), G-15(a)(i)(B)(4)(a) and G-15(a)(i)(D)(1).] Rules G-12(c)(vi)(H) and G-15(a)(iii)(I) [currently codified at rule G-15(a)(i)(C)(2)(e)] require confirmations of securities paying annual interest to note this fact.

[3] The complete description consists of all of the following information: the name of the issuer, interest rate, maturity date, and if the securities are limited tax, subject to redemption prior to maturity (callable), or revenue