the issue to be prerefunded "is usually available within a few days of the new issue being priced… [but that the] new issue's settlement date is usually several weeks later,… [and] it is not until that date that funds will be available to establish the escrow to refund the bonds." You ask whether the outstanding issue of securities is considered prerefunded upon the final pricing of the refunding issue or upon settlement of that issue.

Rule G-15 governs the items of disclosure required on customer confirmations. This rule provides that, if securities are called or prerefunded, dealers must note this fact (along with the call price and the maturity date fixed by the call notice) on the customer's confirmation.[1] In situations where an issuer has indicated its intent to prerefund an outstanding issue, it is the Board's position that the issue is not, in fact, prerefunded until the issuer has taken the necessary official actions to prerefund the issue, which would include, for example, closing of the escrow arrangement. We note further that until such official action occurs, the fact that the issuer intends to prerefund the issue may well be "material" information under rule G-17, the Board's fair dealing rule.[2] *MSRB interpretation of February 17, 1998.*

[1] Rule G-12(c), on uniform practice, applies to confirmations of inter-dealer transactions, and requires similar disclosures. Transactions submitted to a registered clearing agency for comparison, however, are exempt from the confirmation requirements of section (c). Since almost all inter-dealer transactions are eligible for automated comparison in a system operated by a registered clearing agency, very few dealers exchange confirmations.

[2] Rule G-17 requires each dealer, in the conduct of its municipal securities business, to deal fairly with all persons and prohibits the dealer from engaging in any deceptive, dishonest or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a **customer**, all material facts concerning the transaction which could affect the customer's investment decision, including a complete description of the security, and must not omit any material facts which would render other statements misleading. Dealers also must fulfill their obligations under rule G-19, on suitability, and rule G-30, on pricing.

See also:

Rule G-12 Interpretive Letters — Confirmation disclosure: put option bonds, *MSRB interpretation of April 24, 1981.*

- **Confirmation disclosure: put option bonds,** *MSRB interpretation of May 11, 1981.*
- **Confirmation disclosure: advance refunded securities,** *MSRB interpretation of January 4, 1984.*
- **Confirmation disclosure: tender option bonds with adjustable tender fees,** *MSRB interpretation of October 3, 1984.*
- **Confirmation disclosure: tender option bonds with adjustable tender fees,** *MSRB interpretation of March 5, 1985.*
- **Confirmation requirements for partially refunded securities,** *MSRB interpretation of August 15, 1989.*

Rule G-17 Interpretive Letter — Put option bonds: safekeeping, pricing, *MSRB interpretation of February 18, 1983.*

Rule G-15 Amendment History (since 2003)

Release No. 34- 79347 (November 17, 2016), 81 FR 84637 (November 23, 20016); MSRB Notice 2016-28 (November 29, 2016)

Release No. 34-77744 (April 29, 2016), 81 FR 26851 (May 4, 2016); MSRB Notice 2016-15 (May 2, 2016)

Release No. 34- 60690 (September 18, 2009), 74 FR 49049 (September 25, 2009); MSRB Notice 2009-50 (September 15, 2009)

Rule G-16
Periodic Compliance Examination

At least once each four calendar years, each broker, dealer and municipal securities dealer that is a member of a registered securities association, and at least once each two calendar years, each municipal securities dealer that is a bank or subsidiary or department or division of a bank, shall be examined in accordance with Section 15B(c)(7) of the Act to determine, at a minimum, whether such broker, dealer or municipal securities dealer and its associated persons are in compliance with applicable rules of the Board and applicable provisions of the Act and rules and regulations of the Commission thereunder.

Rule G-16 Interpretations

Interpretive Letters

Periodic compliance examinations. This will acknowledge receipt of your letter dated February 2, 1978 in which you request a clarification of Board rule G-16 relating to periodic compliance examinations.

In your letter you express your understanding that rule G-16 does not apply to bank dealers. This understanding is incorrect. Rule G-16 applies to all municipal securities brokers and municipal securities dealers and requires that all such organizations be examined at least once each [two calendar years] to determine compliance with, among other things, rules of the Board. Under section 15B(c)(7) of the Securities Exchange Act of 1934, as amended (the "Act"), such examinations of bank dealers will be conducted by the appropriate federal bank regulatory agency. The Office of the Comptroller of the Currency is designated by the Act as the appropriate agency for national banks. *MSRB interpretation of February 17, 1978*.

NOTE: revised to reflect subsequent amendments.

Rule G-16 Amendment History (since 2003)

Release No. 34-65992 (December 16, 2011), 76 FR 79738 (December 22, 2011); MSRB Notice 2011-69 (December 19, 2011)

Rule G-17

Conduct of Municipal Securities and Municipal Advisory Activities

In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

Rule G-17 Interpretations

Notice of Interpretation of Rule G-17 Concerning Prompt Delivery of Securities

October 13, 1983

From time to time the Board has received inquiries from purchasers of municipal securities concerning the duty of municipal securities brokers and dealers to deliver securities to customers under the Board's rules. In particular, customers have asked what, if any, remedies are available when long delays occur between the purchase, payment and delivery of municipal securities. The Board has advised such individuals that under rule G-17, the Board's fair dealing rule, a municipal securities broker or dealer has a duty to deliver securities sold to customers in a prompt fashion.

The Board is mindful that a dealer's failure to deliver municipal securities often is caused by its failure to receive delivery of the securities from another dealer or by other circumstances beyond its control. It nevertheless believes that a dealer's duty to deliver securities promptly to customers is inherent in rule G-17.[1] A violation of that duty could occur, for example, if a dealer sells securities to a customer when it knows that it cannot effect delivery by the specified settlement date or within a reasonable length of time thereafter and does not disclose that fact to its customer.

The Board notes that customers who fail to receive securities are not entitled to take advantage of the Board's procedures to close out a failed transaction which are available only for inter-dealer transactions under rule G-12. However, if a customer sustains a loss or otherwise is damaged by his dealer's failure to deliver securities, he may seek recovery through the Board's arbitration program or through litigation. These remedies may accrue to the customer whether or not a dealer's failure to deliver violates rule G-17.

[1] The duty of a securities professional to complete promptly transactions with customers also has been found to flow from the federal securities laws by the SEC and the courts.

Application of Board Rules to Transactions in Municipal Securities Subject to Secondary Market Insurance or Other Credit Enhancement Features

March 6, 1984

It has come to the Board's attention that insurance companies are offering to insure whole maturities of issues of municipal securities outstanding in the secondary market. The Board understands that municipal securities professionals must apply for the insurance which, once issued, will remain in effect for the life of the security. The Board further understands that other credit enhancement devices also may be developed for secondary market issues.

The Board wishes to remind the industry of the application of rule G-17, the Board's fair dealing rule, in connection with transactions with customers in securities that are subject to secondary market insurance or other credit enhancement devices or in securities for which arrangements for such insurance or device have been initiated.[1] The Board is of the view that facts, for example, that a security has been insured or arrangements for insurance have been initiated, that will affect the market price of the security are material and must be disclosed to a customer at or before execution of a transaction in the security. In addition, the Board believes that a dealer should advise a customer if evidence of insurance or other credit enhancement feature must be attached to the security for effective transference of the insurance or device.[2]

The Board also wishes to remind the industry that under rule G-13, concerning quotations, all quotations relating to municipal securities made by a dealer must be based on the dealer's best judgment of the fair market value of the securities at the time the quotation is made. Offers to buy securities that are insured or otherwise have a credit enhancement feature, or for which arrangements for insurance or other credit enhancement have been initiated, must comply with rule G-13. Similarly, the prices at which these securities are purchased or sold by a municipal securities dealer must be fair and reasonable to its customers under Board rule G-30 on prices and commissions.

[1] Rule G-17 provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

[2] The Board has adopted amendments to rule G-15 which, among other things, require that deliveries to customers of insured securities be accompanied by some evidence of the insurance.

Notice Concerning Application of Rule G-17 to Use of Lotteries to Allocate Partial Calls to Securities Held in Safekeeping

March 6, 1984

The Board has received inquiries concerning the duty of municipal securities brokers and dealers to allocate partial calls fairly among customer securities held in safekeeping. In

particular, it has come to the Board's attention that certain municipal securities dealers use lottery systems that include only customer positions and exclude the dealer's proprietary accounts when the call is exercised at a price below the current market value.

The Board recognizes that lottery systems are a proper method of allocating the results of a partial call. Principles of fair dealing require that all such lotteries treat dealer and customer account alike. The Board is of the view that a municipal securities dealer which uses a lottery that excludes the dealer's proprietary accounts when the call is exercised at a price below the current market value is acting in violation of rule G-17, the Board's fair dealing rule.[1]

[1] Rule G-17 provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

Syndicate Manager Selling Short for own Account to Detriment of Syndicate Account

December 21, 1984

The Board has received an inquiry concerning a situation in which a municipal securities dealer that is acting as a syndicate manager sells bonds "short" for its own account to the detriment of the syndicate account. In particular, the Board has been made aware of allegations that certain syndicate managers, with knowledge that the syndicate account on a particular new issue of securities is not successful, have sold securities of the new issue "short" for their own accounts and then required syndicate members to take their allotments of unsold bonds. The syndicate managers allegedly have subsequently covered their short positions when the syndicate members attempt to sell their allotments at the lower market price.

Rule G-17, the Board's fair dealing rule, provides:

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

Syndicate managers act in a fiduciary capacity in relation to syndicate accounts. Therefore they may not use proprietary information about the account obtained solely as a result of acting as manager to their personal advantage over the syndicate's best interests. The Board is of the view that a syndicate manager that uses information on the status of the syndicate account which is not available to syndicate members to its own benefit and to the detriment of the syndicate account (*e.g.*, by effecting "short sale" transactions for its own account against the interests of other syndicate members) appears to be acting in violation of the fair dealing provisions of rule G-17.

Altering the Settlement Date on Transactions in "When-Issued" Securities

February 26, 1985

The Board has received inquiries concerning situations in which a municipal securities dealer alters the settlement date on transactions in "when-issued" securities. In particular, the Board has been made aware of a situation in which a dealer sells a "when-issued" security but accepts the customer's money prior to the new issue settlement date and specifies on the confirmation for the transaction a settlement date that is weeks before the actual settlement date of the issue. The dealer apparently does this in order to put the customer's money "to work" as soon as possible. The Board is of the view that this situation is one in which a customer deposits a free credit balance with the dealer and then, using this balance, purchases securities on the actual settlement date. The dealer pays interest on the free credit balance at the same rate as the securities later purchased by the customer.

Rule G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

The Board believes that this practice would violate rule G-17 if the customer is not advised that the interest received on the free credit balance would probably be taxable. In addition, the Board notes that a dealer that specifies a fictitious settlement date on a confirmation would violate rule G-15(a) which requires that the settlement date be included on customer confirmations.

Syndicate Managers Charging Excessive Fees for Designated Sales

July 29, 1985

The Board has received inquiries concerning situations in which syndicate managers charge fees for designated sales that do not appear to be actual expenses incurred on behalf of the syndicate or may appear to be excessive in amount. For example, one commentator has described a situation in which the syndicate managers charge $0.25 to $0.40 per bond as expenses on designated sales and has suggested that such a charge seems to bear no relation to the actual out-of-pocket costs of handling such transactions.

G-17 provides that

> In the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice.

The Board wishes to emphasize that syndicate managers should take care in determining the actual expenses involved in handling designated sales and may be acting in violation

of rule G-17 if the expenses charged to syndicate members bear no relation to or otherwise overstate the actual expenses incurred on behalf of the syndicate.

Notice Concerning the Application of Board Rules to Put Option Bonds

September 30, 1985

The Board has received a number of inquiries from municipal securities brokers and dealers regarding the application of the Board's rules to transactions in put option bonds. Put option or tender option bonds on new issue securities are obligations which grant the bondholder the right to require the issuer (or a specified third party acting as agent for the issuer), after giving required notice, to purchase the bonds, usually at par (the "strike price"), at a certain time or times prior to maturity (the "expiration date(s)") or upon the occurrence of specified events or conditions. Put options on secondary market securities also are coming into prominence. These instruments are issued by financial institutions and permit the purchaser to sell, after giving required notice, a specified amount of securities from a specified issue to the financial institution on certain expiration dates at the strike price. Put options generally are backed by letters of credit. Secondary market put options often are sold as an attachment to the security, and subsequently are transferred with that security. Frequently, however, the put option may be sold separately from that security and re-attached to other securities from the same issue.

Of course, the Board's rules apply to put option bonds just as they apply to all other municipal securities. The Board, however, has issued a number of interpretive letters on the specific application of its rules to these types of bonds. These interpretive positions are reviewed below.

Fair Practice Rules.

1. Rule G-17

Board rule G-17, regarding fair dealing, imposes an obligation on persons selling put option bonds to customers to disclose adequately all material information concerning these securities and the put features at the time of trade. In an interpretive letter on this issue,[1] the Board responded to the question whether a dealer who had previously sold put option securities to a customer would be obligated to contact that customer around the time the put option comes into effect to remind the customer that the put option is available. The Board stated that no Board rule would impose such an obligation on the dealer.

In addition, the Board was asked whether a dealer who purchased from a customer securities with a put option feature at the time of the put option exercise date at a price significantly below the put exercise price would be in violation of any Board rules. The Board responded that such dealer may well be deemed to be in violation of Board rules G-17 on fair dealing and G-30 on prices and commissions.

2. Rule G-25(b)

Board rule G-25(b) prohibits brokers, dealers, and municipal securities dealers from guaranteeing or offering to guarantee a customer against loss in municipal securities transactions. Under the rule, put options are not deemed to be guarantees against loss if their terms are provided in writing to the customer with or on the confirmation of the transaction and recorded in accordance with rule G-8(a)(v).[2] Thus, when a municipal securities dealer is the issuer of a secondary market put option on a municipal security, the terms of the put option must be included with or on customer confirmations of transactions in the underlying security. Dealers that sell bonds subject to put options issued by an entity other than the dealer would not be subject to this disclosure requirement.

Confirmation Disclosure Rules.

1. Description of Security

Rules G-12(c)(v)(E) and G-15(a)(i)(E)[*] require inter-dealer and customer confirmations to set forth

> a description of the securities, including… if the securities are… subject to redemption prior to maturity, an indication to such effect.

Confirmations of transactions in put option securities, therefore, would have to indicate the existence of the put option (*e.g.*, by including the designation "puttable" on the confirmation), much as confirmations concerning callable securities must indicate the existence of the call feature. The confirmation need not set forth the specific details of the put option feature.[3]

Rules G-12(c)(v)(E) and G-15(a)(i)(E)[†] also require confirmations to contain

> a description of the securities including at a minimum… if necessary for a materially complete description of the securities, the name of any company or other person in addition to the issuer obligated, directly or indirectly, with respect to debt service…

The Board has stated that a bank issuing a letter of credit which secures a put option feature on an issue is "obligated… with respect to debt service" on such issue. Thus, the identity of the bank issuing the letter of credit securing the put option also must be indicated on the confirmation.[4]

Finally, rules G-12(c)(v)(E) and G-15(a)(i)(E)[‡] require that dealer and customer confirmations contain a description of the securities including, among other things, the interest rate on the bonds. The Board has interpreted this provision as it pertains to certain tender option bonds with adjustable tender fees to require that the net interest rate (*i.e.*, the current effective interest rate taking into account the tender fee) be disclosed in the interest rate field and that dealers include elsewhere in the description field of the confirmation the stated interest rate with the phrase "less fee for put."[5]

2. Yield Disclosure

Board rule G-12(c)(v)(I) requires that inter-dealer confirmations include the

> yield at which transaction was effected and resulting dollar price, except in the case of securities which are traded on the basis of dollar price or securities sold at par, in which event only dollar price need be shown (in cases in which securities are priced to call or to par option, this must be stated and the call or option date and price used in the calculation must be shown, and where a transaction is effected on a yield basis, the dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity);

Rule G-15(a)(i)(I)[#] requires that customer confirmations include information on yield and dollar price as follows:

(1) for transactions effected on a yield basis, the yield at which transaction was effected and the resulting dollar price shall be shown. Such dollar price shall be calculated to the lowest of price to call, price to par option, or price to maturity.

(2) for transactions effected on the basis of dollar price, the dollar price at which transaction was effected, and the lowest of the resulting yield to call, yield to par option, or yield to maturity shall be shown.

(3) for transactions at par, the dollar price shall be shown.

In cases in which the resulting dollar price or yield shown on the confirmation is calculated to call or par option, this must be stated, and the call or option date and price used in the calculation must be shown.

Neither of these rules requires the presentation of a yield or a dollar price computed to the put option date as a part of the standard confirmation process. In many circumstances, however, the parties to a particular transaction may agree that the transaction is effected on the basis of a yield to the put option date, and that the dollar price will be computed in this fashion. If that is the case, the yield to the put date must be included on confirmations as the yield at which the transaction was effected and the resulting dollar price computed to the put date, together with a statement that it is a "yield to the [date] put option" and an indication of the date the option first becomes available to the holder.[6] The requirement for transactions effected on a yield basis of pricing to the lowest of price to call, price to par option or price to maturity, applies only when the parties have not specified the yield on which the transaction is based.

In addition, in regard to transactions in tender option bonds with adjustable tender fees, even if the transaction is not effected on the basis of a yield to the tender date, dealers must include the yield to the tender date since an accurate yield to maturity cannot be calculated for these securities because of the yearly adjustment in tender fees.[7]

Delivery Requirements.

In a recent interpretive letter, the Board responded to an inquiry whether, in three situations, the delivery of securities subject to put options could be rejected.[8] The Board responded that, in the first situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date but delivered after the option expiration date, such delivery could be rejected since the securities delivered were no longer "puttable" securities. In the second situation in which securities subject to a "one time only" put option were purchased for settlement prior to the option expiration date and delivered prior to that date, but too late to permit the recipient to satisfy the conditions under which it could exercise the option (*e.g.*, the trustee is located too far away for the recipient to be able to present the physical securities by the expiration date), the Board stated that there might not be a basis for rejecting delivery, since the bonds delivered were "puttable" bonds, depending on the facts and circumstances of the delivery. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

Finally, in the third situation, securities which were the subject of a put option exercisable on a stated periodic basis (*e.g.*, annually) were purchased for settlement prior to the annual exercise date so that the recipient was unable to exercise the option at the time it anticipated being able to do so. The Board stated that this delivery could not be rejected since "puttable" bonds were delivered. A purchasing dealer who believed that it had incurred some loss as a result of the delivery would have to seek redress in an arbitration proceeding.

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1 *See* [Rule G-17 Interpretive Letter — Put option bonds: safekeeping, pricing,] MSRB interpretation of February 18, 1983. [Reprinted in *MSRB Rule Book*].

2 Rule G-8(a)(v) requires dealers to record, among other things, oral or written put options with respect to municipal securities in which such municipal securities broker or dealer has any direct or indirect interest, showing the description and aggregate par value of the securities and the terms and conditions of the option.

3 *See* [Rule G-12 Interpretive Letter — Confirmation disclosure: put option bonds,] MSRB interpretation of April 24, 1981. [Reprinted in *MSRB Rule Book*].

4 *See* [Rule G-15 Interpretive Letter — Securities description: securities backed by letters of credit,] MSRB interpretation of December 2, 1982. [Reprinted in *MSRB Rule Book*].

5 *See* [Rule G-12 Interpretive Letter — Confirmation disclosure: tender option bonds with adjustable tender fees,] MSRB interpretation of March 5, 1985. [Reprinted in *MSRB Rule Book*].

6 *See* [Rule G-12 Interpretive Letter — Confirmation disclosure: put option bonds,] MSRB interpretation of April 24, 1981. [Reprinted in *MSRB Rule Book*].

7 *See* fn. 5.

8 *See* [Rule G-12 Interpretive Letter — Delivery requirements: put option bonds,] MSRB interpretation of February 27, 1985. [Reprinted in *MSRB Rule Book*].

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

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

[‡] [Currently codified at rule G-15(a)(i)(B)(4). See also current rule G-15(a)(i)(B)(4)(c).]

[#] [Currently codified at rule G-15(a)(i)(A)(5). See also current rule G-15(a)(i)(A)(5)(c)(iv)(D).]

Notice of Interpretation Requiring Dealers to Submit to Arbitration as a Matter of Fair Dealing

March 6, 1987

Section 2 of the Board's Arbitration Code, rule G-35, requires all dealers to submit to arbitration at the instance of a customer or another dealer. From time to time, a dealer will refuse to submit to arbitration or will delay or even refuse to make payment of an award. Such acts constitute violations of rule G-35. The Board believes that it is a violation of rule G-17, on fair dealing, for a broker, dealer or municipal securities dealer or its associated persons to fail to submit to arbitration as required by Rule G-35, or to fail to comply with the procedures therein, including the production of documents, or to fail to honor an award of arbitrators unless a timely motion to vacate the award has been made according to applicable law.[1]

[1] A party typically has 90 days to seek judicial review of an arbitration award; after that the award cannot be challenged. Challenges to arbitration awards are heard only in limited, egregious circumstances such as fraud or collusion on the part of the arbitrators.

Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15

September 21, 1987

The Board is concerned that the market for escrowed-to-maturity securities has been disrupted by uncertainty whether these securities may be called pursuant to optional redemption provisions. Accordingly, the Board has issued the following interpretations of rule G-17, on fair dealing, and rules G-12(c) and G-15(a), on confirmation disclosure, concerning escrowed-to-maturity securities. The interpretations are effective immediately.

Background

Traditionally, the term escrowed-to-maturity has meant that such securities are not subject to optional redemption prior to maturity. Investors and market professionals have relied on this understanding in their purchases and sales of such securities. Recently, certain issuers have attempted to call escrowed-to-maturity securities. As a result, investors and market professionals considering transactions in escrowed-to-maturity securities must review the documents for the original issue, for any refunding issue, as well as the escrow agreement and state law, to determine whether any optional redemption provisions apply. In addition, the Board understands that there is uncertainly as to the fair market price of such securities which may cause harm to investors.

On March 17, 1987, the Board sent letters to the Public Securities Association, the Government Finance Officers Association and the National Association of Bond Lawyers expressing its concern. The Board stated that it is essential that issuers, when applicable, expressly note in official statements and defeasance notices relating to escrowed-to-maturity securities whether they have reserved the right to call such securities. It stated that the absence of such express disclosure would raise concerns whether the issuer's disclosure documents adequately explain the material features of the issue and would severely damage investor confidence in the municipal securities market. Although the Board has no rulemaking authority over issuers, it advised brokers, dealers and municipal securities dealers (dealers) that assist issuers in preparing disclosure documents for escrowed-to-maturity securities to alert these issuers of the need to disclose whether they have reserved the right to call the securities since such information is material to a customer's investment decision about the securities and to the efficient trading of such securities.

Application of Rule G-17 on Fair Dealing

In the intervening months since the Board's letter, the Board has continued to receive inquiries from market participants concerning the callability of escrowed-to-maturity securities. Apparently, some dealers now are describing all escrowed-to-maturity securities as callable and there is confusion how to price such securities. In order to avoid confusion with respect to issues that might be escrowed-to-maturity in the future, the Board is interpreting rule G-17, on fair dealing,[1] to require that municipal securities dealers that assist in the preparation of refunding documents as underwriters or financial advisors alert issuers of the materiality of information relating to the callability of escrowed-to-maturity securities. Accordingly, such dealers must recommend that issuers clearly state when the refunded securities will be redeemed and whether the issuer reserves the option to redeem the securities prior to their maturity.

Application of Rules G-12(c) and G-15(a) on Confirmation Disclosure of Escrowed-to-Maturity Securities

Rules G-12(c)(vi)(E) and G-15(a)(iii)(E)[*] require dealers to disclose on inter-dealer and customer confirmations, respectively, whether the securities are "called" or "prerefunded," the date of maturity which has been fixed by the call notice, and the call price. The Board has stated that this paragraph would require, in the case of escrowed-to-maturity securities, a statement to that effect (which would also meet the requirement to state "the date of maturity which has been fixed") and the amount to be paid at redemption. In addition, rules G-12(c)(v)(E) and G-15(a)(i)(E)[†] require dealers to note on confirmations if securities are subject to redemption prior to maturity (callable).

The Board understands that dealers traditionally have used the term escrowed-to-maturity only for non-callable advance refunded issues the proceeds of which are escrowed to original maturity date or for escrowed-to-maturity issues with mandatory sinking fund calls. To avoid confusion in the use of the term escrowed-to-maturity, the Board has determined that

dealers should use the term escrowed-to-maturity to describe on confirmations only those issues with no optional redemption provisions expressly reserved in escrow and refunding documents. Escrowed-to-maturity issues with no optional or mandatory call features must be described as "escrowed-to-maturity." Escrowed-to-maturity issues subject to mandatory sinking fund calls must be described as "escrowed-to-maturity" and "callable." If an issue is advance refunded to the original maturity date, but the issuer expressly reserves optional redemption features, the security should be described on confirmations as "escrowed (or prerefunded) to [the actual maturity date]" and "callable."[2]

The Board believes that the use of different terminology to describe advance refunded issues expressly subject to optional calls will better alert dealers and customers to this important aspect of certain escrowed issues.[3]

[1] Rule G-17 states that "[i]n the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

[2] This terminology also would be used for any issue prerefunded to a call date, with an earlier optional call expressly reserved.

[3] The Board believes that, because of the small number of advance refunded issues that expressly reserve the right of the issuer to call the issue pursuant to an optional redemption provision, confirmation systems should be able to be programmed for use of the new terminology without delay.

[*] [Currently codified at rule G-15(a)(i)(C)(3)(a). See also current rule G-15(a)(i)(C)(3)(b).]

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

Notice of Interpretation Concerning Priority of Orders for New Issue Securities: Rule G-17

This interpretive notice was revoked on October 12, 2010. See Interpretation on Priority of Orders for Securities in a Primary Offering under Rule G-17 (October 12, 2010)

December 22, 1987

The Board is concerned about reports that senior syndicate managers may not always be mindful of principles of fair dealing in allocations of new issue securities. In particular, the Board believes that the principles of fair dealing require that customer orders should receive priority over similar dealer or certain dealer-related account[1] orders, to the extent that this is feasible and consistent with the orderly distribution of new issue securities.

Rule G-11(e) requires syndicates to establish priority provisions and, if such priority provisions may be changed, to specify the procedure for making changes. The rule also permits a syndicate to allow the senior manager, on a case-by-case basis, to allocate securities in a manner other than in accordance with the priority provisions if the senior manager determines in its discretion that it is in the best interests of the syndicate. Senior managers must furnish this information, in writing, to the syndicate members. Syndicate members must promptly furnish this information, in writing, to others upon request. This requirement was adopted to allow prospective purchasers to frame their orders to the syndicate in a manner that would enhance their ability to obtain securities since the syndicate's allocation procedures would be known.

The Board understands that senior managers must balance a number of competing interests in allocating new issue securities. In addition, a senior manager must be able quickly to determine when it is appropriate to allocate away from the priority provisions and must be prepared to justify its actions to the syndicate and perhaps to the issuer. While it does not appear necessary or appropriate at this time to restrict the ability of syndicates to permit managers to allocate securities in a manner different from the priority provisions, the Board believes senior managers should ensure that all allocations, even those away from the priority provisions, are fair and reasonable and consistent with principles of fair dealing under rule G-17.[2] Thus, in the Board's view, customer orders should have priority over similar dealer orders or certain dealer-related account orders to the extent that this is feasible and consistent with the orderly distribution of new issue securities. Moreover, the Board suggests that syndicate members alert their customers to the priority provisions adopted by the syndicate so that their customers are able to place their orders in a manner that increases the possibility of being allocated securities.

[1] A dealer-related account includes a municipal securities investment portfolio, arbitrage account or secondary trading account of a syndicate member, a municipal securities investment trust sponsored by a syndicate member, or an accumulation account established in connection with such a municipal securities investment trust.

[2] Rule G-17 provides that:

> [i]n the conduct of its municipal securities business, each broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice.

Notice Concerning Securities that Prepay Principal

March 19, 1991

The Board has become aware of several issues of municipal securities that prepay principal to the bondholders over the life of the issue. These securities are issued with a face value that equals the total principal amount of the securities. However, as the prepayment of principal to bondholders occurs over time, the "unpaid principal" associated with a given quantity of the securities become an increasingly lower percentage of the face amount. The Board believes that there is a possibility of confusion in transactions involving such securities, since most dealers and customers are accustomed to municipal securities in which the face amount always equals the principal amount that will be paid at maturity.

Because of the somewhat unusual nature of the securities, the Board believes that dealers should be alert to their disclosure responsibilities. For customer transactions, rule G-17 requires that the dealer disclose to its customer, at or prior to the time of trade, all material facts with respect to the proposed transaction. Because the prepayment of principal is a material

feature of these securities, dealers must ensure that the customer knows that securities prepay principal. The dealer also must inform the customer of the amount of unpaid principal that will be delivered on the transaction.

For inter-dealer transactions, there is no specific requirement for a dealer to disclose all material facts to another dealer at time of trade. A selling dealer is not generally charged with the responsibility to ensure that the purchasing dealer knows all relevant features of the securities being offered for sale. The selling dealer may rely, at least to a reasonable extent, on the fact that the purchasing dealer is also a professional and will satisfy his need for information prior to entering into a contract for the securities. Nevertheless, it is possible that non-disclosure of an unusual feature such as principal prepayment might constitute an unfair practice and thus become a violation of rule G-17 even in an interdealer transaction. This would be especially true if the information about the prepayment feature is not accessible to the market and is intentionally withheld by the selling dealer. Whether or not non-disclosure constitutes an unfair practice in a specific case would depend upon the individual facts of the case. However, to avoid trade disputes and settlement delays in inter-dealer transactions, it generally is in dealers' interest to reach specific agreement on the existence of any prepayment feature and the amount of unpaid principal that will be delivered.

Educational Notice on Bonds Subject to "Detachable" Call Features

May 13, 1993

New products are constantly being introduced into the municipal securities market. Dealers must ensure that, prior to effecting transactions with customers in municipal securities with new features, they obtain all necessary information regarding these features. The Board will attempt periodically through educational notices to describe new products or features of municipal securities and review the responsibilities of dealers to customers in these transactions. In this notice, the Board will review detachable call features.

Certain recent issues of municipal securities include a new feature called a detachable call right. This feature allows the issuer to sell its right to call the bond. Thus, upon the sale of this call right, the owner of the right has the ability, at certain times, to require the mandatory tender of the underlying municipal bond. The dates of mandatory tender of the underlying bonds generally correlate with the optional call dates. If the holder exercises such rights, the underlying bondholder tenders its bond to the issuer (just as if the issuer had called the bond) and the holder of the call right purchases the bond. In some instances, issuers already have issued municipal call rights and the underlying bonds in such cases are sometimes referred to as being subject to "detached" call rights.

Bonds subject to detachable call rights generally include a provision that permits an investor that owns both the detached call right and the underlying bond to link the two instruments together, subject to certain conditions. Such "linked" municipal securities would not be subject to being called at certain times by holders of call rights or the issuer. They may, however, be subject to other calls, such as sinking fund provisions. If a customer obtains a linked security, thereafter the customer has the option to de-link the security, again subject to certain conditions, into a municipal call right and an underlying bond subject to a right of mandatory tender.

Applicability of Board Rules

Of course, the Board's rules apply to bonds subject to detachable call features and "linked" securities just as they apply to all other municipal securities. The Board, however, would like to remind dealers of certain Board rules that should be considered in transactions involving these municipal securities.

Rule G-15(a) on Customer Confirmations

Rule G-15(a)(i)(E)[*] requires customer confirmations to set forth "a description of the securities, including… if the securities are… subject to redemption prior to maturity…, an indication to such effect." Additionally, rule G-15(a)(iii)(F) [*] requires a legend to be placed on customer confirmations of transactions in callable securities which notes that "Call features may exist which could affect yield; complete information will be provided upon request."

Confirmations of transactions in bonds subject to detachable call rights, therefore, would have to indicate this information.[1] In addition, the details of the call provisions of such securities would have to be provided to the customer upon the customer's request.

Confirmation disclosure, however, serves merely to support — not to satisfy — a dealer's general disclosure obligations. More specifically, the disclosure items required on the confirmation do not encompass "all material facts" that must be disclosed to customers at the time of trade pursuant to rule G-17.

Rule G-17 on Fair Dealing

Rule G-17 of the Board's rules of fair practice requires municipal securities dealers to deal fairly with all persons and prohibits them from engaging in any deceptive, dishonest, or unfair practice. The Board has interpreted this rule to require that a dealer must disclose, at or before the sale of municipal securities to a customer, all material facts concerning the transaction, including a complete description of the security, and must not omit any material facts which would render other statements misleading. Among other things, a dealer must disclose at the time of trade whether a security may be redeemed prior to maturity in-whole, in-part, or in extraordinary circumstances because this knowledge is essential to a customer's investment decision.

Clearly, bonds subject to detachable calls must be described as callable at the time of the trade.[2] In addition, if a dealer is asked by a customer at the time of trade for specific information regarding call features, this information must be obtained and relayed promptly.

Although the Board requires dealers to indicate to customers at the time of trade whether municipal securities are callable, the Board has not categorized which, if any, specific call features it considers to be material and therefore also must be disclosed. Instead, the Board believes that it is the responsibility of the dealer to determine whether a particular feature is material.

With regard to detachable calls, dealers must decide whether the ability of a third party to call the bond is a material fact that should be disclosed to investors. Dealers should make this determination in the same way they determine whether other facets of a municipal securities transaction are material — is it a fact that a reasonable investor would want to know when making an investment decision? For example, would a reasonable investor who knows a bond is callable base an investment decision on whether someone other than the issuer can call the bond? Does this new feature affect the pricing of the bond?

* * *

The Board is continuing its review of detachable call rights and may take additional related action at a later date. The Board welcomes the views of all persons on the application of Board rules to transactions in securities subject to detachable call rights.

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[1] With regard to the confirmation requirement for linked securities, if these securities are subject to other call provisions such as sinking fund calls, the customer confirmation must indicate that these securities are callable.

[2] Similarly, when considering the application of rule G-17 to transactions in "linked" securities, as with other municipal securities, dealers have the obligation to ensure that investors understand the features of the security. In particular, if a linked security to other call provisions, dealers should ensure that retail customers do not mistakenly believe the bond is "non-callable."

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

Transactions in Municipal Securities with Non-Standard Features Affecting Price/Yield Calculations

June 12, 1995

Rule G-15(a) generally requires that confirmations of municipal securities transactions with customers state a dollar price and yield for the transaction. Thus, for transactions executed on a dollar price basis, a yield must be calculated; for transactions executed on a yield basis, a dollar price must be calculated. Rule G-33 provides the standard formulae for making these price/yield calculations.

It has come to the Board's attention that certain municipal securities have been issued in recent years with features that do not fall within any of the standard formulae and assumptions in rule G-33, nor within the calculation formulae available through the available settings on existing bond calculators. For example, an issue may have first and last coupon periods that are longer than the standard coupon period of six months.

With respect to some municipal securities issues with non-standard features, industry members have agreed to certain conventions regarding price/yield calculations. For example, one of the available bond calculator setting might be used for the issue, even though the calculator setting does not provide a formula specifically designed to account for the non-standard feature. In such cases, anomalies may result in the price/yield calculations. The anomalies may appear when the calculations are compared to those using more sophisticated actuarial techniques or when the calculations are compared to those of other securities that are similar, but that do not have the non-standard feature.

The Board reminds dealers that, under rule G-17, dealers have the obligation to explain all material facts about a transaction to a customer buying or selling a municipal security. Dealers should take particular effort to ensure that customers are aware of any non-standard feature of a security. If price/yield calculations are affected by anomalies due to a non-standard feature, this may also constitute a material fact about the transaction that must be disclosed to the customer.

Interpretive Reminder Notice Regarding Rule G-17, on Disclosure of Material Facts — Disclosure of Original Issue Discount Bonds

January 5, 2005

The MSRB is publishing this notice to remind dealers of their affirmative disclosure obligations when effecting transactions with customers in original issue discount bonds. An original issue discount bond, or O.I.D. bond, is a bond that was sold at the time of issue at a price that included an original issue discount. The original issue discount is the amount by which the par value of the bond exceeded its public offering price at the time of its original issuance. The original issue discount is amortized over the life of the security and, on a municipal security, is generally treated as tax-exempt interest. When the investor sells the security before maturity, any profit realized on such sale is calculated (for tax purposes) on the adjusted book value, which is calculated for each year the security is outstanding by adding the accretion value to the original offering price. The amount of the accretion value (and the existence and total amount of original issue discount) is determined in accordance with the provisions of the Internal Revenue Code and the rules and regulations of the Internal Revenue Service.[1]

Rule G-17, the MSRB's fair dealing rule, encompasses two general principles. First, the rule imposes a duty on dealers not to engage in deceptive, dishonest, or unfair practices. This first prong of Rule G-17 is essentially an antifraud prohibition. In addition to the basic antifraud provisions in the rule, the rule imposes a duty to deal fairly with all persons. As part