demand made to the purchaser, to recover from the purchaser all actual and necessary expenses incurred by the seller by reason of the purchaser's rejection of delivery.

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

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

(i) *Settlement of Secondary Market Trading Account*. Final settlement of a secondary market trading account formed for the purchase of securities shall be made within 30 calendar days following the date all securities have been delivered by the account manager to the account members.

(j) *Interest Payment Claims*. A broker, dealer or municipal securities dealer seeking to claim an interest payment on a municipal security from another broker, dealer or municipal securities dealer may claim such interest payment in accordance with this section. A broker, dealer or municipal securities dealer receiving a claim made under this section shall send to the claimant a draft or bank check for the amount of the interest payment or a statement of its basis for denying the claim no later than 10 business days after the date of receipt of the written notice 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.

(i) *Determining Party to Receive Claim*. A claimant making an interest payment claim under this section shall direct such claim to the party described in this paragraph (i).

(A) *Previously Delivered Registered Securities*. An interest payment claim made with respect to a registered security previously delivered to the claimant which is registered in the name of a broker, dealer or municipal securities dealer at the time of delivery shall be directed to such broker, dealer, or municipal securities dealer. A claim made with respect to a previously delivered registered security not registered in the name of a broker, dealer or municipal securities dealer guaranteeing the signature of the registered owner or, if neither the registered owner nor its signature guarantor is a broker, dealer or municipal securities dealer, to the broker, dealer or municipal securities dealer that first placed a signature guarantee on any assignment or power of substitution accompanying the security.

(B) *Previously Delivered Bearer Securities*. An interest payment claim made with respect to a bearer security previously delivered to the claimant shall be directed to the broker, dealer or municipal securities dealer that previously delivered the security.

(C) *Securities Delivered by Claimant*. An interest payment claim made with respect to a security previously delivered by the claimant shall be directed to the broker, dealer or municipal securities dealer that received the securities.

(D) *Deliveries by Book-Entry*. An interest payment claim arising out of a transaction with a contractual settlement date before, and settled by book-entry on or after, the interest payment date of the security shall be directed to the broker, dealer or municipal securities dealer that made the delivery.

(ii) *Content of Claim Notice*. A claimant seeking to claim an interest payment under this section shall send to the broker, dealer or municipal securities dealer against which the claim is made a written notice of claim including, at minimum:

(A) the name and address of the broker, dealer or municipal securities dealer making the claim;

(B) the name of the broker, dealer or municipal securities dealer against which the claim is made;

(C) the amount of the interest payment which is the subject of the claim;

(D) the date on which such interest payment was scheduled to be made (and, in the case of an interest payment on securities which are in default, the original interest payment date);

(E) a description of the security (including any CUSIP number assigned) on which such interest payment was made;

(F) a statement of the basis of the claim for the interest payment;

(G) if the claim is based on the delivery of a registered security, the certificate numbers of each security on which the claim is based and a photocopy of the certificate(s) on which the claim is based or (in lieu of such a photocopy) a written statement from the paying agent identifying the party that received the interest payment which is the subject of the claim; and,

(H) if the claim is made against the broker, dealer or municipal securities dealer that previously delivered the security on which the claim is based, or the broker, dealer or municipal securities dealer that received such security, the delivery date or settlement date of the transaction.

Rule G-12 Interpretations

Notice Concerning "Immediate" Close-Outs

August 19, 1981

The Municipal Securities Rulemaking Board has recently received inquiries concerning the provisions of rule G-12(h)(iii) regarding close-out procedures in the event of a firm's liquidation. The Board has been advised that a SIPC trustee has been appointed in connection with the liquidation of a general securities firm with which certain municipal securities brokers and dealers have uncompleted transactions in municipal securities, and that the New York Stock Exchange and the National Association of Securities Dealers, Inc., have notified their respective members that they may institute "immediate" close-out procedures on open transactions with the firm in liquidation. In accordance with a previous understanding between the Board and the NASD, the NASD has also advised municipal securities brokers and dealers that, pursuant to rule G-12(h)(iii), they may execute "immediate" close-outs on open transactions in municipal securities.

Rule G-12(h)(iii) provides:

> Nothing herein contained shall be construed to prevent brokers, dealers or municipal securities dealers from closing out transactions as directed by a ruling of a national securities exchange, a registered securities by a ruling of a national securities exchange, a registered securities association or an appropriate regulatory agency issued in connection with the liquidation of a broker, dealer or municipal securities dealer.

Therefore, in the event that a national securities exchange or registered securities association makes a ruling that close-outs may be effected "immediately" on transactions with a firm in liquidation, municipal securities brokers and dealers may take such action. In these circumstances, a purchasing dealer seeking to execute such a close-out need not follow the procedures for initiation of a closeout procedure, nor is the dealer required to wait the prescribed time periods prior to executing the close-out notice. Similarly, a selling dealer need not attempt delivery prior to using the procedure for close-outs by sellers. In both cases dealers may proceed to execute the close-out immediately — that is, the purchasing dealer may immediately "buy in" the securities in question for the account and liability of the firm in liquidation (or utilize one of the other options available for execution of the close-out), and a selling dealer may immediately "sell out" the subject securities. Notification of the execution of the close-out should be provided in accordance with the normal procedure.

Dealers executing close-outs in these circumstances should advise the trustee of the firm in liquidation of their actions in closing out these transactions. If proceeds from the close-out execution are due to the firm in liquidation, they should be remitted to the trustee. Requests for payment of amounts due on close-out executions should also be sent to the trustee; the trustee will resolve these claims in the course of the liquidation.

The Board also notes that dealers having open transactions with a firm in liquidation may, but are not required to, execute "immediate" close-outs in these circumstances. If individual dealers wish to attempt some other means of completing these transactions, such as seeking to complete a transaction with the liquidated firm's other contra-side, they may do so.

Application of the Board's Rules to Trades in Misdescribed or Non-Existent Securities

January 12, 1984

From time to time, industry members have asked the Board for guidance in situations in which municipal securities dealers have traded securities which either are different from those described ("misdescribed") or do not exist as described ("nonexistent") and the parties involved were unaware of this fact at the time of trade. A sale of a misdescribed security may occur, for example, when a minor characteristic of the issue is misstated. A sale of a non-existent security may result, for example, from the sale of a "when, as and if issued" security which is never authorized or issued.

The Board has responded to these inquiries by advising that its rules do not address the resolution of any underlying contractual dispute arising from trades in such misdescribed or nonexistent securities, and that the parties involved in the trade should work out an appropriate resolution. Board rule G-12(g) does permit reclamation of an inter-dealer delivery in certain instances in which information required to be included on a confirmation by rule G-12(c)(v)(E)[1] is omitted or erroneously noted on the confirmation or where other material information is erroneously noted on the confirmation. Rule G-12(g)(v) and (vi), however, make clear that a reclamation only reverses the act of delivery and reinstates the open contract on the terms and conditions of the original contract, requiring the parties to work out an appropriate resolution of the transaction.

The Board wishes to emphasize that general principles of fair dealing would seem to require that a seller of non-existent or misdescribed securities make particular effort to reach an agreement on some disposition of the open trade with the purchaser. The Board believes that this obligation arises since it is usually the seller's responsibility to determine the status of the municipal securities it is offering for sale. The extent to which the seller bears this responsibility, of course, may vary, depending on the facts of a trade.

The Board notes that the status of the underlying contract claim for trades in non-existent or misdescribed securities ultimately is a matter of state law, and each fact situation must be dealt with under applicable state law, and each fact situation must be dealt with under applicable contract principles. The Board believes that the position set forth above is consistent with general contract principles, which commonly hold that a seller is responsible to the purchaser in most instances for failing to deliver goods as identified in the contract, or for negligently contracting for goods which do not exist if the purchaser relied in good faith on the seller's representation that the goods existed.

Parties to trades in misdescribed or non-existent securities should attempt to work out an appropriate resolution of the contractual agreement. If no agreement is reached, the Board's closeout and arbitration procedures may be available.

[1] Rule G-12(c)(v)(E) requires that confirmations contain a description of the securi-ties, including at a minimum 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 bonds, an indication to such effect, including in the case of revenue bonds the type of revenue, if necessary for a materially complete description of the securities and in the case of any securities, 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 or, if there is more than one such obligor, the statement "multiple obligors" may be shown.

Notice Concerning Documentation on Rejection and Reclamation of Deliveries

March 5, 1982

The Municipal Securities Rulemaking Board has recently received complaints from certain municipal securities brokers and municipal securities dealers concerning problems with the documentation provided on rejections or reclamations of deliveries on municipal securities transactions. These brokers and dealers have alleged that other organizations, when rejecting or reclaiming deliveries, have failed to provide the requisite information regarding the return of the securities, thereby making it very difficult to accomplish prompt resolution of any delivery problems. In particular, these dealers indicate, notices of rejection or reclamation have often failed to state a reason for the rejection or reclamation, or to name a person who can be contacted regarding the delivery problem.

Rule G-12(g)(iv) requires that a dealer rejecting or reclaiming a delivery of securities must provide a notice or other document with the rejected or reclaimed securities, which notice shall include the following information:

(A) the name of the party rejecting or reclaiming the securities;

(B) the name of the party to whom the securities are being rejected or reclaimed;

(C) a description of the securities;

(D) the date the securities were delivered;

(E) the date of rejection or reclamation;

(F) the par value of the securities which are being rejected or reclaimed;

(G) in the case of a reclamation, the amount of money the securities are reclaimed for;

(H) the reason for rejection or reclamation; and

(I) the name and telephone number of the person to contact concerning the rejection or reclamation.

The Uniform Reclamation Form may be used for this purpose. The Board believes that the required information is the minimum necessary to permit prompt resolution of the problem, and does not view the requirement to provide this information as burdensome. The Board is concerned that failure to provide this information may contribute to inefficiencies in the clearance process, and strongly urges municipal securities brokers and dealers to take steps to ensure that the requirements of the rule are complied with. The Board notes that, in the case of reclaimed securities, failure to provide this information may result in, at minimum, a refusal on the part of the receiving party to honor the reclamation.

Notice of Interpretation of Rules G-12(e) and G-15(c) on Deliveries of Called Securities — Definition of "Publication Date"

October 20, 1986

Rules G-12(e)(x) and G-15(c)(viii) on deliveries of called securities provide that a certificate for which a notice of partial call has been published does not constitute good delivery unless it was identified as called at the time of trade. The rules also provide that, if a notice of call affecting an entire issue has been published on or prior to the trade date, called securities do not constitute good delivery unless identified as such at the time of trade.[1] Thus, a dealer, in some instances, must determine the date that a notice of call is published (the "publication date") to determine whether delivery of a called certificate constitutes good delivery for a particular transaction. The Board has adopted the following interpretation of rules G-12(e)(x) and G-15(e)(viii) to assist the industry in determining the publication date of a notice of a call. The Board understands this interpretation to be consistent with the procedure currently being used by certain depositories in allocating the results of partial calls.

In general, the publication date of a notice of call is the date of the edition of the publication in which the issuer, the issuer's agent or the trustee publishes the notice. To qualify as a notice of call under the rules, a notice must contain the date of the early redemption, and, for partial calls, must contain information that specifically identifies the certificates being called. If a notice of call is published on more than one date, the earliest date of publication constitutes the publication date for purposes of the rules.

If a notice of call for a registered security is not published, but is sent to registered owners, the publication date is the date shown on the notice. If no date is shown on the notice, the issuer, the trustee or the appropriate agent of the issuer should be contacted to determine the date of the notice of call.

If a notice of call of a registered security is published and also is sent directly to registered owners, the publication date is the earlier of the actual publication date or the date shown on the notice sent to registered owners. For bearer securities, the first date of publication always constitutes the publication date, even if another date is shown on the notice.

[1] An inter-dealer delivery that does not meet these requirements may be rejected or reclaimed under rule G-12(g).

Notice on Determining Whether Transactions Are Inter-Dealer or Customer Transactions: Rules G-12 and G-15

May 1, 1988

In December 1984, the Board published a notice providing guidance to dealers in determining whether certain transactions are inter-dealer or customer transactions for purposes of Board rules. Since the publication of this notice, the Board has continued to receive reports that inter-dealer transactions sometimes are erroneously submitted to automated confirmation/affirmation systems for customer transactions. This practice reduces the efficiencies of automated clearance since these transactions fail to compare in the initial comparison cycle. The Board is republishing the notice to remind dealers of the need to submit interdealer and customer transactions to the correct automated clearance systems.

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

Background

Rule G-12(f)(i) requires dealers to submit an inter-dealer transaction for automated comparison if the transaction is eligible for automated comparison .... Rule G-15(d)(ii) requires dealers to use an automated confirmation/affirmation service for delivery versus payment or receipt versus payment (DVP/RVP) customer transactions if the [transactions are eligible for automated confirmation and acknowledgement].

The systems available for the automated comparison of inter-dealer transactions and automated confirmation/affirmation of customer transactions are separate and distinct. As a result, misclassification of a contra-party may frustrate efficient use of the systems. For example, a selling dealer in an inter-dealer transaction may misclassify the contra-party as a customer, and submit the trade for confirmation/affirmation through the automated system for customer transactions while the purchaser (correctly considering itself to be a dealer) seeks to compare the transaction through the inter-dealer comparison system. Since, the automated systems for inter-dealer and customer transactions are entirely separate, the transaction will not be successfully compared or acknowledged through either automated system.

Transactions Effected by Banks

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

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

Transactions by Dealer Purchasing Municipal Securities for UIT Accumulation Accounts

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

The Board is of the view that, for purposes of its automated comparison requirements, transactions involving dealers purchasing for UIT accumulation accounts should be considered interdealer transactions. The Board also notes the distinction

between this situation, in which a dealer purchases for ultimate transfer to a trust or fund, and situations where purchases or sales of municipal securities are made directly by the fund, as is the case with purchases or sales by some open-end mutual funds. These latter transactions should be considered as customer transactions and confirmed accordingly.

Other Inter-Dealer Transactions

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

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

NOTE: Revised to reflect subsequent amendments.

Locked-In Transactions

March 1, 2001

The Securities and Exchange Commission has approved the National Securities Clearing Corporation's ("NSCC") proposed rule change (SR-NSCC-00-13) regarding the submission of trade data for comparison of fixed income inter-dealer transactions.[1] NSCC proposes to offer its members the ability to submit their fixed income transaction information "locked-in" through Qualified Special Representatives ("QSR") for trades executed via an Alternative Trading System ("ATS"). Locked-in QSR trade data submission currently is only available for transactions in equity securities. The Municipal Securities Rulemaking Board ("MSRB") is publishing this notice to clarify the requirements of MSRB rules G-12(f) and G-14 as they pertain to the submission of locked-in transactions.

To accomplish a locked-in QSR submission, NSCC members on each side of a trade must have executed, or clear for a firm that executed, their trade through an ATS and previously authorized a specific NSCC-authorized QSR to submit locked-in trades to NSCC on their behalf. The locked-in transaction records are not compared in the traditional manner through the two-sided NSCC comparison process. Instead, the QSR itself takes responsibility to ensure that the trade data is correct and the parties have agreed to the trade according to the stated terms. Once NSCC receives a locked-in trade, it treats it as compared so that the transaction can proceed to netting or other automated settlement procedures.

MSRB rule G-12(f) on inter-dealer comparison and rule G-14 on Transaction Reporting Procedures each refer to the NSCC comparison process for inter-dealer transactions in municipal securities. These rules require dealers to submit their inter-dealer trade data to NSCC for purposes of comparison and for forwarding to the MSRB for trade-reporting purposes. Questions may arise as to whether the submission of trade data already locked-in by a QSR complies with these rules.

NSCC's proposal requires that a QSR must obtain authorization to submit locked-in transactions both from NSCC as well as from the NSCC members who wish to use the QSR for locked-in trade submission. Given this fact, and the fact that both rules G-12(f) and G-14 specifically contemplate the use of intermediaries in submitting data to NSCC and to the MSRB, locked-in trades submitted under NSCC's program will comply both with rule G-12(f) and rule G-14.

[1] *See* Securities Exchange Act Release No. 43949 (Feb. 9, 2001), 66 FR 10765 (Feb. 16, 2001)

Interpretation on the Application of Rules G-8, G-12 and G-14 to Specific Electronic Trading Systems

March 26, 2001

The Municipal Securities Rulemaking Board (the "MSRB") understands that, over time, the advent of new trading systems will present novel situations in applying MSRB uniform practice rules. The MSRB is prepared to provide interpretative guidance in these situations as they arise, and, if necessary, implement formal rule interpretations or rule changes to provide clarity or prevent unintended results in novel situations. The MSRB has been asked to provide guidance on the application of certain of its rules to transactions effected on a proposed electronic trading system with features similar to those described below.

Description of System

The system is an electronic trading system offering a variety of trading services and operated by an entity registered as a dealer under the Securities Exchange Act of 1934. The system is qualified as an alternative trading system under Regulation ATS. Trading in the system is limited to brokers, dealers and municipal securities dealers ("dealers"). Purchase and sale contracts are created in the system through various types of electronic communications via the system, including acceptance of priced offers, a bid-wanted process, and through negotiation by system participants with each other. System

rules govern how the bid/offer process is conducted and otherwise govern how contracts are formed between buyers and sellers.

Participants are, or may be, anonymous during the bid/offer/negotiation process. After a sales contract is formed, the system immediately sends an electronic communication to the buyer and seller, noting the transaction details as well as the identity of the contra-party. The transaction is then sent by the buyer and seller to a registered securities clearing agency for comparison and is settled without involvement of the system operator.

The system operator does not take a position in the securities traded on the system, even for clearance purposes. Dealers trading on the system are required by system rules to clear and settle transactions directly with each other even though the parties do not know each other at the time the sale contract is formed. If a dealer using the system does not wish to do business with another specific contra-party using the system, it may direct the system operator to adjust the system so that contracts with that contra-party cannot be formed through the system.

Application of Certain Uniform Practice Rules to System

It appears to the MSRB that the dealer operating the system is effecting agency transactions for dealer clients.[1] The system operator does not have a role in clearing the transactions and is not taking principal positions in the securities being traded. However, the system operator is participating in the transactions at key points by providing anonymity to buyers and sellers during the formation of contracts and by setting system rules for the formation of contracts. Consequently, all MSRB rules generally applicable to inter-dealer transactions would apply except to the extent that such rules explicitly, or by context, are limited to principal transactions.

Automated Comparison

One issue raised by the description of the system above is the planned method of clearance and settlement. Rule G-12(f)(i) requires that inter-dealer transactions be compared in an automated comparison system operated by a clearing corporation registered with the Securities and Exchange Commission. The purpose of rule G-12(f)(i) is to facilitate clearance and settlement of inter-dealer transactions. In this case, the system operator: (i) electronically communicates the transaction details to the buyer and seller; (ii) requires the buyer and seller to compare the transaction directly with each other in a registered securities clearing corporation; and (iii) is not otherwise involved in clearing or settling the transaction. The MSRB believes that under these circumstances, it is unnecessary for the system operator to obtain a separate comparison of its agency transactions with the buyer and seller.

Although automated comparison is not required between the system operator and the buyer and seller, the transaction details sent to each party by the system must conform to the information requirements for inter-dealer confirmations contained in rule G-12(c). Since system participants implicitly agree to receive this information in electronic form by participating in the system, a paper confirmation is not necessary. Also, the system operator may have an agreement with its participants that participants are not required to confirm the transactions back to the system operator, which normally would be required by rule G-12(c).

The system operator, which is subject to Regulation ATS, will be governed by the recordkeeping requirements of Regulation ATS for purposes of transaction records, including municipal securities transactions. However, the system operator also must comply with any applicable recordkeeping requirements in rule G-8(f), which relate to records specific to effecting municipal securities transactions. With respect to recordkeeping by dealers using the system, the specific procedures associated with this system require that transactions be recorded as principal transactions directly between buyer and seller, with notations of the fact that the transactions were effected through the system.

Transaction Reporting

Rule G-14 requires inter-dealer transactions to be reported to the MSRB for the purposes of price transparency, market surveillance and fee assessment. The mechanism for reporting inter-dealer transactions is through National Securities Clearing Corporation ("NSCC"). In the system described above, the buyer and seller clear and settle transactions directly as principals with each other, and without the involvement of the dealer operating the system. The buyer and seller therefore will report transactions directly to NSCC. No transaction or pricing information will be lost if the system operator does not report the transaction. Consequently, it is not necessary for the system operator separately to report the transactions to the MSRB.

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[1] This situation can be contrasted with the typical broker's broker operation in which the broker's broker effects riskless principal transactions for dealer clients. The nature of the transactions as either agency or principal is governed for purposes of MSRB rules by whether a principal position is taken with respect to the security. "Riskless principal" transactions in this context are considered to be principal transactions in which a dealer has a firm order on one side at the time it executes a matching transaction on the contraside. For purposes of the uniform practice rules, the MSRB considers broker's broker transactions to be riskless principal transactions even though the broker's broker may be acting for one party and may have agency or fiduciary obligations toward that party.

Notice on Reporting and Comparison of Certain Transactions Effected by Investment Advisors: Rules G-12(f) and G-14

May 23, 2003

In recent months, the MSRB has received a number of questions relating to certain kinds of transactions in which independent investment advisors instruct selling dealers to make deliveries to other dealers. This notice addresses questions that have been raised relating to Rule G-12(f)(i), on automated comparison, and Rule G-14, on transaction reporting. It describes existing requirements that follow from the language of the rules and does not set forth any new policies or procedures.

An independent investment advisor purchasing securities from one dealer sometimes instructs that dealer to make delivery of the securities to other dealers where the investment advisor's clients have accounts. The identities of individual account holders typically are not given.[1] The dealers receiving the deliveries in these cases generally are providing "wrap fee" or similar types of accounts that allow investors to use independent investment advisors to manage their municipal securities portfolios. In these kinds of arrangements, the investment advisor chosen by the account holder may be picked from a list of advisors approved by the dealer; however, dealers offering these accounts have indicated that the investment advisor acts independently in effecting transactions for the client's municipal securities portfolio.

The following example illustrates the situation. An Investment Advisor purchases a $1 million block of municipal bonds from the Selling Dealer and instructs the Selling Dealer to deliver $300,000 of the bonds to Dealer X and $700,000 to Dealer Y. The Investment Advisor does not give the Selling Dealer the individual client accounts at Dealer X and Dealer Y to which the bonds will be allocated and there is no contact between the Selling Dealer and Dealers X and Y at the time of trade. The Investment Advisor, however, later informs Dealer X and Dealer Y to expect the delivery from the Selling Dealer, and gives the identity and quantity of securities that will be delivered, the final monies, and the individual account allocations. For example, the Investment Advisor may instruct Dealer X to allocate its $300,000 delivery by placing $100,000 in John Doe's account and $200,000 in Mary Smith's account.

With respect to transaction reporting requirements in this situation, the Selling Dealer should report a $1 million sale to a customer. No other dealer should report a transaction. The comparison system should not be used for the inter-dealer transfers between the Selling Dealer and Dealers X and Y because this would cause them to be reported as inter-dealer trades.

Frequently Asked Questions

One frequently asked question in the context of the above example is whether the transfers of the $300,000 and $700,000 blocks by the Selling Dealer to Dealer X and Dealer Y should be reported as inter-dealer transactions. Another question is whether these transfers may be accomplished by submitting them to the automated comparison system for inter-dealer transactions. Based on the information that has been provided to the MSRB, these transfers do not appear to represent inter-dealer trades and thus should not be reported under Rule G-14 or compared under Rule G-12(f)(i) using the current central comparison system.

One reason for the conclusion that no inter-dealer trade exists is that municipal securities professionals for firms in the roles of Dealer X and Y have stated that the Investment Advisor is acting independently and is not acting as their agent when effecting the trade with the Selling Dealer. In support of this assertion, they note that they often are not informed of the transaction or the deliveries that they should expect until well after the trade has been effected by the Investment Advisor. They also note that the actions of the Investment Advisor are not subject to their control or supervision. Thus, the $300,000 and $700,000 inter-dealer transfers in the above example appear to be simply deliveries made in accordance with a contract made by, and the instructions given by, the Investment Advisor. The inter-dealer transfers thus do not constitute inter-dealer transactions.

Because Rule G-14 transaction reporting of inter-dealer trades is accomplished through the central comparison system, any dealer submitting the $300,000 and $700,000 inter-dealer transfers to the comparison system is in effect reporting interdealer transactions that did not occur. In addition, this practice tends to drive down comparison rates and the overall performance of dealers in the automated comparison system. As noted above, the trading desks of Dealer X and Dealer Y generally do not know about the Investment Advisor's transaction at the time of trade. They consequently cannot submit comparison information to the system unless the Investment Advisor provides them with the trade details in a timely, accurate and complete manner. Since the Investment Advisor is acting independently and is not supervised by municipal securities professionals at Dealer X and Dealer Y, there is no means for the municipal securities professionals at Dealer X and Dealer Y to ensure that this happens.

Questions also have been received on whether the individual allocations to investor accounts (*e.g.*, the $100,000 and $200,000 allocations to the accounts of John Doe and Mary Smith in the example above) should be reported under Rule G-14 as customer transactions. Even though the dealer housing these accounts obviously has important obligations to the investor with respect to receiving deliveries, paying the Selling Dealer for the securities, and processing the allocations under the instructions of the Investment Advisor, it does not appear that the dealer entered into a purchase or sale contract with the investor and thus nothing is reportable under Rule G-14. This conclusion again is based upon statements by dealers providing the "wrap fee" and similar accounts, who

indicate that the investment advisor acts independently and not as the dealer's agent when it effects the original block transaction and when it makes allocation decisions.

For purposes of price transparency, the only transaction to be reported in the above example is a single $1 million sale to a customer. This is appropriate because the only market price to be reported is the one set between the Selling Dealer and the Investment Advisor for the $1 million block of securities. It is appropriate that the $300,000 and $700,000 inter-dealer transfers, and the $100,000 or $200,000 investor allocations are not disseminated as transactions since they would have to be reported using the price for the $1 million block. This could be misleading in that market for $1 million round lots are often different than market prices for smaller transaction sizes.

[1] It should be noted that in this situation, the investment advisor itself is the customer and must be treated as such for recordkeeping and other regulatory purposes. For discussion of a similar situation, see "Interpretive Notice on Recordkeeping" dated July 29, 1977.

Transaction Reporting of Multiple Transactions Between Dealers in the Same Issue: Rules G-12(f) and G-14

November 24, 2003

The MSRB has become aware of problems in transaction reporting as a result of dealers "bunching" certain inter-dealer transactions in the comparison system. Recently, some dealers have reported the sum of two trades as one transaction in instances when two dealers effected two trades with each other in the same issue and at the same price. When two transactions are effected, two transactions should be reflected in each dealer's books and records and two transactions are required to be reported to the MSRB. The time of trade for each transaction also must accurately reflect the time at which a contractual commitment was formed for each quantity of securities. For example, if Dealer A purchases $50,000 of a municipal issue at a price of par from Dealer B at 11:00 am and then purchases an additional $50,000 at par from Dealer B at 2:00 pm, two transactions are required to be reflected on each dealers' books and records and two transactions are required to be reported to the MSRB.

Since the same inter-dealer trade record submitted for automated comparison under Rule G-12(f) also is used to satisfy the requirements of Rule G-14, on transaction reporting, each interdealer transaction should be submitted for automated comparison separately in order to comply with Rule G-14's requirement to report all transactions. Failure to do so causes erroneous information concerning transaction size and time of trade to appear in the transparency reports published by the MSRB as well as in the audit trail used by regulators and enforcement agencies. To the extent that dealers use the records generated by the comparison system for purposes of complying with MSRB Rule G-8, on recordkeeping, it may also create erroneous information as to the size of transactions effected or time of trade execution.

Notice on Certain Inter-Dealer Transfers of Municipal Securities: Rules G-12(f) and G-14

June 4, 2004

The MSRB has received questions about whether certain transfers of municipal securities between dealers to move securities between safekeeping locations are required to be reported to the MSRB Transaction Reporting System under Rule G-14, on transaction reporting. When a transfer of municipal securities does not represent a purchase-sale transaction and is not required to be recorded on a dealer's books and records under MSRB Rule G-8 or SEC Rule 17a-3, such transfers should not be reported under Rule G-14 and a transaction report must not be sent to the MSRB.

One scenario that has been brought to the MSRB's attention is when a dealer ("Dealer A") that self-clears inter-dealer transactions contracts with another dealer ("Dealer B") for the safekeeping and maintenance of customer accounts. As part of this process, Dealer A transfers securities sold to customers to Dealer B for safekeeping. The transfer of securities from Dealer A to Dealer B in this example is not an inter-dealer purchase-sale transaction and must not be reported to the MSRB as such. However, Dealer A and Dealer B may wish to utilize the comparison and netting facilities of a registered clearing agency to effect the delivery of securities.

In March 2004, the MSRB published a notice addressing the processing of certain inter-dealer transfers of securities that do not represent inter-dealer purchase-sale transactions through the automated comparison facilities of National Securities Clearing Corporation (NSCC).[1] Since data sent to NSCC for comparison of an inter-dealer purchase-sale transaction also is sent to the MSRB for transaction reporting purposes, the March 2004 notice described use of the "B" indicator for identifying such data submissions relating to transfers of securities so that they are not confused with transaction reports between dealers that represent trades made through the comparison system. Dealers should refer to the March 2004 notice if they chose to use the facilities of NSCC for such transfers to ensure that erroneous inter-dealer transaction reports are not sent to the MSRB Transaction Reporting System.[2]

[1] *See* MSRB Notice 2004-9, "Notice on Deliveries of Step Out Transactions Through the Automated Comparison System," March 3, 2004, on www.msrb.org.

[2] Note, however, that a different procedure will be used to effect inter-dealer transfers of securities, using the NSCC comparison system, and without reporting the transfer to the MSRB as a transaction when MSRB's Real-Time Transaction Reporting System goes into operation, currently planned for January 2005.

Notice on Automated Comparison and Transaction Reporting of Certain Inter-Dealer Transactions in When-Issued Municipal Securities: Rules G-12(f) and G-14

September 28, 2004

The MSRB has received reports of problems with automated comparison and transaction reporting of certain inter-dealer transactions involving syndicate managers. These reports indicate that some dealers may have incorrectly identified some of their when, as and if issued ("when-issued") transactions in new issue municipal securities as "syndicate transactions." The MSRB reminds dealers that erroneous coding of comparison reports is a violation of Rule G-14, on transaction reporting, and that transactions with dealers that are not members of the syndicate or selling group for a new issue, by definition, cannot be considered "syndicate transactions" for purposes of comparison procedures.

MSRB Rule G-12(f), on automated comparison of inter-dealer transactions, requires dealers to submit for automated comparison all transactions eligible for comparison under National Securities Clearing Corporation's (NSCC) rules and procedures. For transactions by a syndicate manager with syndicate or selling group members, NSCC procedures call for the use of a special "syndicate" submission, which does not require a submission by the contra-side for comparison to occur.[1] Transactions between syndicate managers and dealers that are not members of the syndicate or selling group are not "syndicate transactions" under NSCC's rules and procedures and both the selling and purchasing dealers are required to report its side to the transaction for automated comparison.

Various problems arise in the comparison process if the parties to a trade do not follow the correct procedures for comparison of the trade. Moreover, since the trade report submitted for comparison also serves as the transaction report to the MSRB, identifying a transaction as a "syndicate transaction" in trade reports, when such transaction is not a syndicate transaction under NSCC's rules and procedures, represents a violation of a dealer's obligation to accurately report transactions to the MSRB under Rule G-14.

[1] *See* "Municipal Bond Selling Group Trades," NSCC Important Notice # 2971 dated April 8, 1988.

See also:

Rule G-11 Interpretation — Syndicate Settlement Practice Violations Noted, July 1981.

Rule G-15 Interpretations — Interpretive Notice on Rule G-12 on Uniform Practice and Rule G-15 on Customer Confirmations, November 28, 1977.

- **Interpretive Notice on Confirmation Requirements,** March 25, 1980.
- **Interpretive Notice Concerning Confirmation Disclosure Requirements Applicable to Variable-Rate Municipal Securities,** December 10, 1980.
- **Notice Concerning "Zero Coupon" and "Stepped Coupon" Securities,** April 27, 1982.
- **Notice Concerning Pricing to Call,** December 10, 1980.
- **Notice Concerning Confirmation Disclosure Requirements for Callable Municipal Securities,** February 20, 1986.
- **Notice Concerning Confirmation, Delivery and Reclamation of Interchangeable Securities,** August 10, 1988.
- **Notice Concerning Stripped Coupon Municipal Securities,** March 13, 1989.

Rule G-17 Interpretations — Notice Concerning the Application of Board Rules to Put Option Bonds, September 30, 1985.

- **Notice of Interpretation on Escrowed-to-Maturity Securities: Rules G-17, G-12 and G-15,** September 21, 1987.

Rule G-32 Interpretation — Notice Regarding Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, *November 20, 1998*.

Interpretive Letters

Delivery requirements: partials. I am writing to confirm the substance of our telephone conversation concerning the provision of rule G-12(e)(iv) on partial deliveries. In our discussion, you posed a specific example of a single purchase of securities in which half are of one maturity and half of another maturity and inquired whether or not delivery of only one of the maturities would constitute a "partial" under the terms of the rule.

As I stated to you, if the transaction is effected on an "all or none" basis, and your confirmation is marked "all or none" or "AON," this would suffice to indicate that the purchase of both maturities constitutes a single transaction, and that both maturities must be delivered to effect good delivery. *MSRB interpretation of February 23, 1978.*

Delivery requirements: coupons and coupon checks. This letter is to confirm the substance of conversations you had with the Board's staff concerning the application of certain provisions of rule G-12, the uniform practice rule, to deliveries of securities bearing past-due coupons. You inquire whether, in the case where a transaction is effected for a settlement date prior to the coupon payment date, a delivery of securities with this past-due coupon attached constitutes "good delivery" for purposes of the rule.

Rule G-12(e)(vii)(C) provides that a seller may, but is not required to, deliver a check in lieu of coupons if delivery is made within thirty calendar days prior to an interest payment date. Thus, in the circumstances you set forth, the seller would have the option to detach the coupons and provide a check, but is under no obligation to do so. A delivery with these coupons still attached would constitute "good delivery," and a rejection of the delivery for this reason would be an improper rejection. *MSRB interpretation of March 9, 1978.*

Delivery requirements: mutilated coupons. I am writing in response to your recent letter concerning the provisions of Board rule G-12(e) with respect to interdealer deliveries of securities with mutilated coupons attached. You indicate that your firm recently became involved in a dispute with another firm's clearing agent concerning whether certain coupons