

Public Availability of Data

A number of commenters clearly interpreted the proposed rule as permitting public disclosure of the information to be reported. However, the NASD collected data will not be made available to the public. The data will be used solely for regulatory purposes, an approach fully consistent with NYSE practices under Rule 351. This would not be the case if, as one commenter suggested, CRD was used to collect and store the customer complaint and other information. CRD data is generally available to the public by state regulators pursuant to disclosure statutes. For this reason, it is imperative that a separate and private regulatory database be developed to collect and store the information.

Customer Complaint Reporting

The proposed rule is designed to act as an early warning system for potential sales practice problems engaged in by identified registered representatives. To achieve this result, the information collected will be analyzed for, among other things, patterns of customer complaints involving member firms and registered persons, whether or not all of the complaints are ultimately substantiated. This data represents a core feature of the new rule. As highlighted in the SEC's Large Firm Project Report, identical data obtained through NYSE Rule 351 was a key component in developing the Large Firm Project's special examination list. Similar customer complaint data was also used extensively to focus the new, ongoing joint regulatory problem representative sweep. In this regard, the regulatory priorities relating to the collection of written customer complaint data outweighs concerns about reporting customer allegations of misconduct. Again, commenters are likely to be comforted on this issue once they fully recognize that unsubstantiated customer complaints will be solely used for regulatory purposes and not be made available to the public.

Reporting Protocol

Concerns regarding the mechanics of the proposed rule will be addressed in subsequent Notices to Members. The staff has developed the specifications for electronic reporting that will facilitate the ease of data transmission by members and data collection by the NASD. The system specifications and the reporting protocol will be fully reported to the members via the Notice to Members and appropriate software will be provided.

Member Responsibility to Ensure Associated Person Disclosure

Commenters expressed concern about a member's obligation to ensure compliance with the proposed rule where an associated person fails to disclose to the member the occurrence of an event specified in subsection (a)(9). A resolution surfaced in the comments by the suggestion that the rule proposal be modified to require member reporting under subsection (a)(9) only if the member obtains knowledge of the reportable event. Extending this concept to ensure that members do not intentionally avoid becoming aware of a reportable event, it was suggested that proposed subsection (a)(9) be modified to obligate member reporting under this item only if the member "knows or should have known" of the existence of the reportable event.

Violation Reporting

Several commenters indicated that subsection (a)(1) information was too broad and should require reporting only after a finding of violation is made. Adopting this standard would add certainty to the proposed reporting obligation and clarify that members are not expected to launch independent inquiries to determine, for example, whether an associated person violated a provision of a business or professional organization. As a result, it was suggested that the rule proposal be modified to include language that a "finding of violation" is necessary before an occurrence needs to be reported under subsection (a)(1).

Arrest Reporting

Comments arose under proposed subsection (a)(5) that included the reporting of arrests. Analysis of this issue indicates that the NASD may not have the authority to gain access to arrest records of an individual. Similarly, "arraignment" carries a different meaning among states and is not consistently an indication that a person has been charged with a crime. For these reasons, it was suggested that the proposal be modified to delete the term "arrest" and "arraignment" from the text.

With regard to some of the specific comments raised, the NASD Board has amended the proposed rule in the following areas: (1) filings required pursuant to subsection (a)(1) are to be made only when there is a finding of violations; (2) "arrest" and "arraignment" are deleted from subsection (a)(5); and (3) filings required under subsection (a)(9) are to be made only where the member knows or

should have known of the information to be reported.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this Notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file number SR-NASD-95-16 and should be submitted by August 8, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²

Margaret H. McFarland,

Deputy Secretary.

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² 17 CFR 200.30-3(a)(12).

[Release No. 34-35953; File No. SR-MSRB-95-4]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Customer Confirmations

July 11, 1995.

On April 3, 1995,¹ the Municipal Securities Rulemaking Board ("Board" or "MSRB") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change (File No. SR-MSRB-95-4) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1). The proposed rule change amends rule G-15(a), on customer confirmations. Notice of the proposed rule change, together with the substance of the proposal, was issued by Commission release (Securities Exchange Act Release No. 35700, May 10, 1995) and by publication in the **Federal Register** 60 FR 26747, May 18, 1995). Two comment letters were received. The Commission is approving the proposed rule change.

I. Background

In response to market developments and regulatory concerns, the present rule G-15(a) has been subject to numerous amendments and Board interpretive notices since it was adopted in 1977. In November 1994, the SEC approved amendments to Rule 10b-10 under the Act, governing confirmation disclosure in securities other than municipal securities.² At the same time, the SEC deferred consideration of proposed Rule 15c2-13 that would have established confirmation disclosure requirements applicable to transactions in municipal securities.³ In response to revisions by the SEC to Rule 10b-10, to the SEC's proposed Rule 15c2-13 and to promote better compliance with the MSRB's rule, the MSRB is amending rule G-15(a).

¹ The Municipal Securities Rulemaking Board initially submitted the proposed rule change on March 30, 1995. Amendment No. 1, submitted on April 3, 1995, extended the delay for effectiveness of the rule to 120 days following Commission approval. See letter from Marianne I. Dunaitis, Assistant General Counsel, MSRB, to Karl Varner, Staff Attorney, Division of Market Regulation, Securities and Exchange Commission, dated April 3, 1995.

² Securities Exchange Act Release No. 34962 (Nov. 10, 1994), 59 FR 59612, *corrected*, Securities Exchange Act Release No. 34962A (Nov. 25, 1994), 59 FR 60555.

³ Securities Exchange Act Release No. 34962 (Nov. 10, 1994), 59 FR 59612, *corrected*, Securities Exchange Act Release No. 34962A (Nov. 25, 1994), 59 FR 60555.

II. Description

The change to rule G-15(a) will: (1) Clarify the current customer confirmation requirements by reorganizing the rule and incorporating previous Board interpretations into the language of the rule to promote better compliance; (2) revise certain requirements in areas to provide more disclosure; and (3) include modifications to the current confirmation disclosure requirements.

The rule change reorganizes the rule and incorporates previous Board interpretations into the rule. Most requirements are subdivided by subject matter into three board categories that comprised the content of municipal securities confirmations—terms of the transactions, securities identification, and securities confirmations—terms of the transactions, securities identification, and securities description (listing the features of the security). Under each category, Board rules and interpretations are organized by the specific confirmation requirement.

The rule change clarifies the confirmation format with the requirement that all disclosures, with certain exceptions, clearly and specifically be indicated on the front of the confirmation. To address concerns about the "crowding" of information on the front of the confirmation, certain requirements can be met by statements on the back of the confirmation, namely: (1) the required legend for zero coupon bonds; (2) the requirement that permits a dealer in agency transactions to include a statement that the name of the person from whom the securities were purchased or sold will be furnished upon the written request of the customer; (3) the requirement that permits a dealer, rather than indicating the time of execution, to include a statement that the time of execution will be furnished upon the written request of the customer; and (4) the requirements for the disclosure statement of actual yield and factors affecting yield of municipal collateralized mortgage obligations ("CMOs") in rule G-15(a)(i)(D)(2).

The rule change revises customer confirmation requirements to provide that dealers disclose on the confirmation: (1) If a security has not been rated by a nationally recognized statistical rating organization; (2) if a letter of credit is used, the identify of the bank issuing the letter of credit; (3) if call features exist in addition to the next pricing call, that the additional call features will be provided on request; (4) if necessary for the calculation of final money, the first interest payment date;

(5) if there is one additional obligor, the identity of the additional obligor; and (6) if there is more than one additional obligor, indication that there are "multiple obligors."

Furthermore, the rule change revises customer confirmation requirements to provide that dealers disclose on the confirmation: (1) A specific date and price for the next pricing call; (2) the primary revenue source for revenue bonds; (3) the amount of the dealer's "discount" or concession in an agency transaction; (4) the amount of any premium paid over accreted value for callable zero coupon bonds; (5) the initial public offering price for an original issue discount ("OID") security; (6) that the actual yield of municipal CMOs may vary according to the rate at which the underlying receivables or other financial assets are prepaid; and (7) that information concerning factors that affect yield of the municipal CMOs (including, at a minimum, estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon the customer's written request.

However, the revisions to the customer confirmation requirements will: (1) Retain the specific confirmation requirements for zero coupon bonds; (2) delete the requirement for the "limited tax" and "ex-legal" designations of certificates; and (3) provide specific exemptions for statement of yield on transactions in defaulted bonds, bonds that prepay principal and variable rate securities that are not sold on basis of yield to put.

Finally, the rule change modifies the confirmation requirement to require that a separate confirmation be provided for each municipal securities transaction whenever several transactions are done at one time.

III. Summary of Comments

As noted above, the Commission received two comment letters on the proposal.⁴ Latham's clients generally support the proposed reorganization of rule G-15(a). However, Latham's clients believed the proposal should be modified to allow the issuance of a master confirmation that would not aggregate information nor omit any information that proposed rule G-15(a) requires to be included in a confirmation. Latham stated that the

⁴ Letter from Roger M. Zaitzeff and Carlos Alvarez, Esq., Latham and Watkins ("Latham"), on behalf of unnamed clients to Jonathan G. Katz, Secretary, Commission (June 8, 1995); Letter from Robert B. Mayers, Senior Vice President/Group Executive, Wachovia Bank of North Carolina, N.A. ("Wachovia Bank") to Jonathan G. Katz, Secretary, Commission (June 6, 1995).

proposed addition of G-15(a)(ii) which requires delivery of a separate confirmation for each transaction creates an administrative burden on institutional investors that have multiple odd lot trades with the same dealer at one time. Latham stated that late in the trading day institutional investors are not receptive to the purchase of multiple remarketed odd lot securities because of the administrative burdens required to separately confirm the purchase of multiple securities issued by many different municipal issuers, with each security having a different CUSIP number. As a result of requiring a separate confirmation for each transaction, Latham stated that multiple remarketed odd lot securities often are not placed, which results in a loss to the seller and the institutional investors who would have purchased the securities late in the trading day.

The other commenter, Wachovia Bank, was generally in agreement with the proposed changes to the customer confirmation requirements for municipal securities transactions, however, Wachovia Bank believed: (1) That disclosing the remuneration received in an agency transaction may mislead the customer, and (2) that disclosing the initial offering price for an OID security could present difficulties for the secondary municipal market because the information for older issues is not readily available, or may not be available at all.

Wachovia Bank stated that disclosing any dealer concession or discount received as a result of an agency transaction may mislead the customer to conclude that the dealer through which the transaction was executed received some additional compensation, paid by the customer, that the customer would not have paid had the transaction been executed through another dealer. Furthermore, Wachovia Bank stated that the customer may mistakenly believe that the broker-dealer received other compensation or profit beyond the amount shown as remuneration from the customer and may not realize that the amount disclosed is the dealer's total compensation for the transaction. Wachovia Bank believed that it is the dealer's standing as a member of the broker-dealer community and the selling dealer's willingness to sell at less than the net price to another dealer, not to the customer, which allows the purchase at a discount or concession from another dealer.

Finally, Wachovia Bank stated that disclosing the initial offering price for an OID security could present difficulties for the secondary municipal market because the information for

older issues is not readily available, or may not be available at all. Wachovia Bank stated that older OID issues may become illiquid because a bidder may be precluded from bidding for an OID security if the initial public offering price is not known as the purchaser could not reoffer the bonds without the OID price.

IV. Discussion

The Commission has considered the above comment letters. The Commission believes that a separate confirmation should be provided for each municipal securities transaction whenever several transactions are effected at one time. The Commission believes that separate confirmations are not too burdensome and that aggregating confirmation data has the potential to confuse the customers. If a customer purchases several different securities of one issuer from a dealer, it would be inappropriate for the dealer to aggregate on the confirmation the accrued interest for all the bonds acquired or to aggregate yield data and disclose the "yield to the average life" rather than providing yield to maturity information for each bond acquired. Moreover, the MSRB's rules require members to use an automated clearance and settlement system for transactions which makes it necessary to have separate confirmations to enter transactions into the automated system.

The Commission believes that a dealer, when acting as an agent for the customer, has a fiduciary duty to disclose on the confirmation the amount of the dealer's "discount" or concession received in the transaction. In an agency transaction, if a dealer acquires a bond from another dealer at a discount (e.g., "net" price less concession) and the customer pays the "net" price, the inter-dealer discount or concession received by the dealer should be considered remuneration received from the customer and should be disclosed.

The Commission believes that requiring the dealer to disclose the initial public offering price for the original issue discount security information is particularly important to customers since it may be needed for tax reasons and also may be important in determining the investor's gain if the security is subject to an early call. Moreover, most commercial information vendors will have the OID price available.

The Commission believes that the rule change is consistent with and promotes better compliance with the provisions of Section 15B(b)(2)(C) of the Act.⁵ The

⁵ 15 U.S.C. 78o-3. Section 15B(b)(2)(C) provides that the Board's rules shall be designed to prevent

reorganization of the rule should assist operations personnel in programming automated systems for generating municipal securities confirmations since it will no longer be necessary to review all previous interpretive notices on confirmations to find those that may address the statement of interest rate for a particular type of municipal security.

The Commission believes the rule change will strengthen the disclosure requirements for municipal securities and customer protection objectives of the rule. The change to rule G-15(a)(i)(E) will require that all disclosures, with certain exceptions, be clearly and specifically indicated on the front of the confirmation. The rule change will allow certain requirements to be met by statements on the back of the confirmation to avoid crowding of information on the front side of the confirmation.

The Commission believes that the current disclosure of call features in the pre-printed legend on the back of the confirmation has not always been effective in alerting customers to the existence of all features. The rule change will put customers clearly on notice as to the presence of call features on the front of the confirmation, including the requirement that a specific date and price for the next pricing call (one of the most important elements of call information) always be disclosed.⁶ If any call features exist in addition to the next pricing call, the proposed rule change will require the following notation on the front of the confirmation—"Additional call features exist that may affect yield; complete

fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market in municipal securities, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, municipal securities brokers, or municipal securities dealers, to fix minimum profits, to impose any schedule or fix rates of commissions, allowances, discounts, or other fees to be charged by municipal securities brokers or municipal securities dealers, to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the Board, or to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

⁶ Rule G-15(a)(vi)(F) as amended defines "pricing call" as a call feature that represents "an in-whole call" of the type that may be used by the issuer without restriction in a refunding. Consistent with the current rule, pricing calls do not include catastrophe calls, that is, calls which occur as a result of events specified in the bond indenture which are beyond the control of the issuer or calls that may operate to call part of an outstanding issue. See Interpretation of Nov. 7, 1977, published in *MSRB Manual* (CCH) at ¶ 3571.10.

information will be provided upon request."

The change to rule G-15(a)(i)(C)(3)(f) will require that if a security is unrated by a nationally recognized statistical rating organization, a disclosure to that effect be made. The Commission believes that this disclosure will alert customers that they may wish to obtain further information or clarification from their dealer.

The change to rule G-15(a)(i)(C)(1)(a) will require dealers to put the primary revenue source for revenue bonds on the confirmation (e.g., project name) and delete the language requiring disclosure of the primary revenue source "if necessary for a materially complete description of the securities." The Commission believes that requiring disclosure of the primary revenue source of revenue bonds on the confirmation will help ensure that customers receive important information about the purpose and source of payment of revenue bonds.

The change to rule G-15(a)(i)(C)(1)(b) will require dealers always to identify the additional obligor on the confirmation or indicate "multiple obligors" if there is more than one additional obligor. The Commission believes this will simplify and clarify the intent of the rule. Also, the rule change will clarify that, if a letter of credit is used, the identity of the bank issuing the letter of credit must be noted.

The rule change will delete both the "limited tax" and the "ex-legal" designations of certificates. The "limited tax" designation is no longer necessary because the meaning of this "limited tax" designation has become ambiguous as various states have implemented a variety of tax limitation measures. The "ex-legal" delivery designation is no longer necessary because of the high percentage of book-entry-only securities in the market and the movement away from physical delivery of certificates which included a copy of the legal opinion.

The rule change will retain the specific confirmation requirements for zero coupon bonds, including disclosure that the interest rate is 0% and, if the securities are callable and available in bearer form, a statement to that effect which can be satisfied by the following legend: "No periodic payments—callable below maturity value without prior notice by mail to holder unless registered."

In addition, the change to rule G-15(a)(i)(A)(6)(h) will require that the amount of any premium paid over accreted value for callable zero coupon

bonds be included on confirmations.⁷ The Commission believes it is important for customers to know that zero coupon securities may be affected by an early call and that a premium over the accreted value is being paid in the purchase price.

Rule G-15(a)(i)(A)(6)(g) will clarify that the first interest payment date is required on the confirmation only in those cases in which it is necessary for the calculation of final money, so as not to be ambiguous as to whether the first interest payment date must be included on the confirmation in all instances in which there is no regular semi-annual interest payment, or only if the first payment date is necessary for purposes of calculation of final monies. It would, for example, not be required for transactions in the issue occurring after the first interest payment date.⁸

The change to rule G-15(a)(i)(A)(5)(d) will include specific exemptions for statement of yield on transactions in defaulted bonds, bonds that prepay principal and variable rate securities that are not sold on basis of yield to put. The current rule includes no exemption for these transactions. The Commission believes that a statement of yield on these transactions may mislead investors.

Rule G-15(a)(i)(D)(2) will include a provision regarding municipal CMOs that the dealer must include a statement on the confirmation indicating that the actual yield of municipal CMOs may vary according to the rate at which the underlying receivables or other financial assets are prepaid, and a statement of the fact that information concerning the factors that affect yield (including, at a minimum, estimated yield, weighted average life, and the prepayment assumptions underlying yield) will be furnished upon the written request of a customer. The Commission believes that this provision should apply to municipal securities as it is similar to the Commission's requirements in Rule 10b-10, the rule for non-municipal securities.

Finally, the Commission believes the proposed rule change does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title because the rule will apply to all MSRB members.

⁷ The accreted value for a zero coupon bond reflects the increase in the security's value as it approaches the maturity date. For zero coupon bonds that are callable, the call price is generally at the accreted value.

⁸ The change to rule G-15(a)(i)(C)(2)(e), consistent with current rule G-15(a)(ii)(I), requires that if securities pay interest on other than semi-annual basis, a statement of the basis on which interest is paid shall be included.

Thus, individual brokers and dealers will not be disparately affected by the rule change.

At the MSRB's request, the Commission is delaying effectiveness of the proposed rule change until 120 days after the approval order by the Commission is published in the Federal Register to ensure that firms' confirmation practices are in compliance.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-MSRB-95-4 be, and hereby is, approved and effective November 15, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95-17518 Filed 7-17-95; 8:45 am]

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[Release No. 34-35954; File No. SR-NASD-95-21]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Freely Tradeable Direct Participation Program Securities

July 11, 1995.

On May 23, 1995,¹ the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),² and Rule 19b-4 thereunder.³ The proposed rule change excludes freely tradeable direct participation program securities from the prohibition on transactions in discretionary accounts without written approval. However, the exclusion is restricted to members that are not affiliated with the freely tradeable direct participation program.

Notice of the proposed rule change, together with the substance of the proposal, was issued by Commission

¹ The proposal was originally filed with the Commission on May 10, 1995. The NASD subsequently submitted Amendment No. 1 to the filing which amends Subsections (b)(3)(C)(i) and (ii) to Article III, Section 34 of the Rules of Fair Practice, by replacing the phrase "the NASDAQ System" in Subsections (i) and (ii) and the word "NASDAQ" in Subsection (ii) with the word "Nasdaq." Letter from Suzanne E. Rothwell, Associate General Counsel, NASD, to Mark P. Barracca, Branch Chief, Over-the-Counter Regulation, Division of Market Regulation, SEC, dated May 22, 1995.

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240.19b-4.