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MSRB Adds Exception in Revised Proposal Requiring CUSIPs for Private Placements.

WASHINGTON – The Municipal Securities Rulemaking Board has recast a prior proposal clarifying that CUSIPs are required for private placements by providing a limited exception in response to market comments.

Comments on the MSRB's revised proposal are due by June 20.

The modified proposal is like the prior version that was released on March 1 in that it clarifies the requirement in MSRB Rule G-34 on CUSIP numbers for dealers to obtain CUSIP numbers for new issue securities sold in private placement transactions, including direct purchases, where the dealer is the placement agent. It also requires that non-dealer municipal advisors be subject to the CUSIP requirement for new issue securities that are sold in a competitive offering.

CUSIPs are groups of six- and nine- numbers and letters that identify an issuer and its securities. They are used for a number of purposes in the muni market, including trading, recordkeeping, clearance and settlement, customer account transfers and safekeeping.

Market groups representing dealers, MAs, and issuers responded to the initial proposal asking that the MSRB include an exemption for private placements that involve a limited number of participants and are not expected to be resold. A number of groups also said they were concerned that the proposed changes and clarifications could adversely impact the municipal market by discouraging banks from pursuing private placements and discouraging issuers from engaging placement agents and municipal advisors.

In response to these comments, the MSRB said that while it believes obtaining CUSIP numbers is a necessary aspect of activities like tracking trading and recordkeeping, it also "is of the view that the increase in the number of direct purchase transactions between municipal issuers and banks as an alternative to letters of credit and other similar types of financings may support an exception from the blanket requirement to obtain CUSIP numbers in all private placements."

The MSRB is proposing an exception in the modified proposed rule under which a dealer acting as an underwriter or a placement agent in a new private placement with a bank could "elect not to apply for assignment of a CUSIP number if the dealer has a reasonable belief that the purchasing bank is likely to hold the securities to maturity or limit the resale of the municipal securities to another bank."

There would also be an exception from applying for CUSIPs for MAs in competitive sales of munis where the securities are purchased directly by a bank and the MA believes the bank will hold the securities to maturity or limit any resale to another bank.

The MSRB said it expects both dealers and MAs to have policies and procedures in place that are reasonably designed to help them come to conclusions about whether to get a CUSIP number and to apply those policies and procedures during any CUSIP number-related evaluations. Dealers and MAs

would also be expected to document their findings that play into any ultimate determinations about whether to get CUSIPs.

The board also clarifies that an MA advising an issuer in a competitive sale of new issue securities must apply for the CUSIP number no later than one business day after dissemination of a notice of sale or other such request for bids.

Lynnette Kelly, the MSRB's executive director, noted in a release accompanying the new request for comment that the MSRB modified the draft amendments in light of market feedback and added the MSRB "appreciates the thoughtful participation of commenters in the rulemaking process and invites further dialogue on how to ensure CUSIP number requirements appropriately reduce investor risk and regulatory uncertainty."

The MSRB said it is not setting prescriptive steps to comply with the exception and will not further specify instances where the exception would apply. It also will not define the parameters for how a dealer should craft its policies and procedures. The proposal also does nothing to affect a dealer's obligation to determine whether a transaction should be considered a loan or security, the board said.

Dealers had also been concerned that the first proposal would have been problematic because G-34 requires dealers to apply for depository eligibility and disseminate new issue information, something placement agents may not be able to do because they never purchase the securities.

The MSRB is extending a similar exception to the portion of G-34 that deals with depository eligibility to cover that concern. It proposes the exception cover munis purchased directly by a bank where the underwriter reasonably believes the bank is likely to hold or limit resale of the munis to another bank in a way that makes immobilization in a depository unnecessary. The underwriter would have to make a "principles-based assessment as to whether depository eligibility, and thus, dissemination of new issue information, would be necessary for the particular new issue" and be subject to requirements for policies and procedures and documentation, according to the MSRB.

The MSRB is additionally proposing to make the draft rule amendments prospective after commenters said market participants see the changes as new requirements.

Jessica Giroux, general counsel and managing director of Bond Dealers of America, said BDA is "pleased that the MSRB revised the proposed rule to create an exception for direct purchase transactions," adding it will "provide a major point of needed clarity in the municipal securities market." BDA is still reviewing the proposed changes and plans to comment on other aspects of the proposal in the future, she said.

Leslie Norwood, managing director, associate general counsel and co head of the Securities Industry and Financial Markets Association's municipal securities division, said the group is pleased the MSRB considered industry comments and that SIFMA plans to file a comment letter on the revised proposal.

"Although we are still reviewing the proposal, we believe the addition of an exception to the rule for certain direct placements and the clarification that the rule change will only be applied prospectively are positive changes to the proposal," Norwood said.

Susan Gaffney, executive director of the National Association of Municipal Advisors, said that while the group appreciates the MSRB's work to re-propose the rulemaking, "we remain concerned with the proposal, including having MAs obtain CUSIPs for competitive sales."

“Also, at first glance, the new provision that calls on MAs to ‘reasonably believe’ that the bank will “likely” hold the security seems to place a burden on MAs to determine the intent of investors, which may conflict with the regulatory limitations that exist with having MAs interface with investors,” Gaffney added.

The Bond Buyer

By Jack Casey

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