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MSRB Proposes Rule Changes on Interdealer Transaction Failures.

WASHINGTON - The Municipal Securities Rulemaking Board is seeking comment on a proposal it says would lessen the effect of interdealer transaction failures on the municipal market while providing needed changes to an outdated rule.

The proposed changes are to a portion of MSRB Rule G-12 on uniform practice that governs close-out procedures after a dealer fails to deliver securities to another dealer by the agreed upon settlement date. Under the new proposal, interdealer failures would have to be closed out within 30 calendar days of the settlement date, instead of the currently recommended 90 days.

Comments on the proposal are to be submitted by March 6.

This section of G-12 has not been updated since 1983 and the proposal is part of a larger MSRB effort to revise, reorganize and retire rules that may have become outdated or less effective as market practices and participants have evolved.

The proposal would eliminate the dated references to phone notification and take into account the current trading environment, which now includes things like alternative trading systems and the Depository Trust & Clearing Corp.'s automated comparison system and book entry settlement.

"Evolutions in the municipal securities market have modernized the manner in which interdealer transactions are cleared and settled," said MSRB executive director Lynnette Kelly. "More timely resolution of open transactions would give investors greater certainty in their purchases and would benefit dealers by reducing the risk and costs associated with failed interdealer trades."

Rule G-12 currently offers optional procedures to close out interdealer failures and allows the purchasing dealer to give the selling dealer notice of close-out on any business day from five to 90 business days after the settlement date. However, the rule's 90-day close-out deadline is not a requirement and dealers that want to resolve interdealer failures sometimes cannot do so because they do not have a willing or cooperative counterparty, the MSRB said.

The proposed rule changes would allow the purchasing dealer to issue a close-out notice the day after the settlement date and would then mandate the 30 calendar day timeframe. The changes would also allow the purchasing dealer to start close-out procedures within three business days of the settlement date, a change from the current 10-business day window. Additionally, the proposal would change the earliest day for execution to four days after electronic notification instead of the rule's current 11 days after telephonic notice.

If the proposal is implemented, the MSRB will give dealers a 90-calendar day grace period to resolve all outstanding interdealer failures.

While the time period for close-outs would be significantly shortened, the three interdealer options for remedying a failed transaction would remain the same through the transition. The purchasing

dealer could choose a “buy-in” and go to the open market to purchase the securities. It could also choose to accept securities from the selling dealer that are similar to the originally purchased securities in a number of areas. Lastly, the purchasing dealer could require the seller to repurchase the securities along with payment of accrued interest and the burden of any change in market price or yield.

One area of concern the MSRB specifically mentioned is when the purchasing dealer agrees to sell securities to a customer but never receives them from the selling dealer. While the proposal would not specifically govern the relationship between the purchasing dealer and its customers, the MSRB said it would benefit customers by providing greater certainty that the securities they paid for are in their account. Additionally, the rule changes may give customers greater confidence in the market.

Customers and their dealers will still have to consider which of the three interdealer close-out options works best for the situation, as a customer may not want different securities that have the same properties or would likely have to pay taxes on the interest they receive if the dealer chooses the third option of recouping its payment and any accrued interest.

Jessica Giroux, general counsel and managing director of federal regulatory policy for Bond Dealers of America, said BDA is pleased that the MSRB is trying to provide clearer information for investors. She added however that there could be unknown costs to BDA members and that the organization plans to provide more feedback closer to the comment deadline.

Leslie Norwood, associate general counsel and co-head of the municipal securities division for the Securities Industry and Financial Markets Association, said SIFMA “wholeheartedly” supports rulemaking like this that reduces risk and costs to dealers while giving investors greater certainty. SIFMA will continue to look for any unanticipated or negative consequences that could come from the proposal and file a comment letter, she added.

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