MSRB
Municipal Securities Rulemaking Board

Regulatory Notice

2016-02

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Stakeholders
Municipal Securities Dealers

Notice Type
Request for Comment

Comment Deadline
March 6, 2016

Category
Uniform Practice

Affected Rules
Rule G-12

Request for Comment on Amendments to MSRB Rule G-12 on Close-Out Procedures

Overview

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on proposed draft amendments to MSRB Rule G-12, on uniform practice, to update the close-out procedures provided for under Rule G-12(h) and specifically require that municipal securities transactions be closed-out no later than 30 calendar days after settlement date. The proposed draft amendments are designed to lower the number of open inter-dealer fail transactions.

Comments should be submitted no later than March 6, 2016 and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking here. Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1300 I Street NW, Suite 1000, Washington, DC 20005. All comments will be available for public inspection on the MSRB's website.[1]

Questions about this notice may be directed to Michael Cowart, Assistant General Counsel, David Saltiel, Chief Economist or Barbara Vouté, Municipal Operations Advisor at 202-838-1500.

Background and Regulatory Justification

Rule G-12(h)[2] and the MSRB's *Manual on Close-Out Procedures*[3] provide optional procedures that can be used by brokers, dealers, or municipal

[1] Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should submit only information that they wish to make available publicly.

[2] *See* MSRB Rule G-12.

[3] *See* Manual on Close-Out Procedures.

securities dealers (dealers) to close out open inter-dealer fail transactions. The rule currently allows the purchasing dealer to issue a notice of close-out to the selling dealer on any business day from five to 90 business days after the scheduled settlement date.[4] If the selling dealer does not deliver the securities owed on the transaction within 10 business days after receipt of the close-out notice (15 business days for retransmitted notices), then the purchasing dealer may execute a close-out procedure using one of three options: (1) purchase ("buy-in") at the current market all or any part of the securities necessary to complete the transaction for the account and liability of the seller; (2) accept from the seller in satisfaction of the seller's obligation under the original contract (which shall be concurrently cancelled) the delivery of municipal securities that are comparable to those originally bought in quantity, quality, yield or price, and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller; or (3) require the seller to repurchase the securities on terms that provide for the seller to pay an amount which includes accrued interest and bear the burden of any change in market price or yield.[5]

Rule G-12(h) includes a 90-business day time limit for close-outs to encourage dealers to resolve open transactions in a timely manner, but there is no requirement that open transactions be closed out within 90 business days. Currently, a purchasing dealer is not required to initiate a close-out or to execute a close-out notice if one is initiated, nor does the selling dealer have a right to force a close-out of the transaction. If the purchasing dealer chooses not to initiate a close-out within 90 business days of the original contract settlement date (and ultimately execute the close-out), then that dealer loses its right to use the Rule G-12(h) procedure and the transaction remains open until it is resolved by agreement of the parties or through arbitration. During this period, the selling dealer is subject to market risk for any increase in the price of the securities.

Since Rule G-12(h) was last revised in 1983, evolutions in the municipal securities market have changed how securities are offered and modernized the manner in which inter-dealer transactions are cleared and settled. There

[4] The purchasing dealer may initiate a close-out within 15 business days after a reclamation made under Rule G-12(g)(iii)(C) or G-12(g)(iii)(D), even though more than 90 business days have elapsed since the original settlement date.

[5] For example, if the purchasing dealer executes a buy-in or a mandatory repurchase in a rising market, the selling dealer is liable for the increase in the market value of the securities. The selling dealer must pay any monies owed on a close-out within 10 business days of execution of the close-out.

are electronic alternative trading systems (ATS) and broker-dealers that serve in the role of a "broker's broker" in the municipal market, facilitating the ability of dealers to find securities for purchase. MSRB rules requiring use of the Depository Trust & Clearing Corporation (DTCC) automated comparison system and book entry settlement, as well as the shortening of the settlement cycle from T+5 to T+3, likewise have contributed to lowering the occurrence of inter-dealer fails since the rule's adoption. The initiative to move to T+2 settlement has received broad support from both the industry and the Securities and Exchange Commission (SEC),[6] and is likely to further reduce the instances of inter-dealer fails. The MSRB believes that a more timely resolution of inter-dealer fails would ultimately benefit customers by providing greater certainty that their fully paid for securities are long in their account, not allocated to a firm short, and would benefit dealers by reducing the risk and costs associated with inter-dealer fails.[7]

MSRB Rule G-14[8] requires the use of National Securities Clearing Corporation's (NSCC) Real-Time Trade Matching (RTTM) for submitting or modifying data with respect to Inter-Dealer Transactions Eligible for Comparison. Additionally, dealers almost universal use of continuous net settlement (CNS) on a voluntary basis[9] has resulted in inter-dealer transactions that are netted (or paired-off) with counterparties that may not have originally transacted together and new settlement dates are continually established. This scenario was not contemplated when Rule G-12(h) was originally adopted, thus making it unclear that firms should use the original contract settlement date pursuant to the rule today.[10]

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[6] *See* SEC Statement Regarding Proposals to Shorten the Trade Settlement Cycle.

[7] The SEC highlighted the importance of close-out procedures when amending Regulation SHO, stating, "delivery requirements would protect and enhance the operation, integrity and stability of the market and the clearance and settlement system." 17 CFR 240 and 242, Release No. 34-48709; File No. S7-23-03.

[8] *See* MSRB Rule G-14.

[9] As a key part of the CNS system, NSCC acts as the central counterparty for clearance and settlement for virtually all broker-to-broker equity, corporate and municipal bond and unit investment trust trading in the United States. CNS processes include an automated book-entry accounting system that centralizes settlement and maintains an orderly flow of security and money balances.

[10] In NSCC's CNS & RECAPS program, transactions are marked to market, and receive new settlement dates that may also serve for purposes of the SEC's net capital rules. This may reduce the dealer's net capital deductions for "aged" failed transactions, but does not

Current processing and issues associated with an inter-dealer fail

While the Financial Industry Regulatory Authority (FINRA) Rule 11810[11] allows for the buy-in requirements of a national securities exchange or a registered clearing agency for transactions in corporate bonds, it is sometimes the case that a specific Committee on Uniform Securities Identification Procedures (CUSIP) for a municipal security is not available in the market and therefore, following the buy-in procedures of a registered clearing agency may not be possible.[12]

Additional burdens may exist for dealers when the security has been subsequently sold to a customer and any resulting interest payments to the customer may not be tax-exempt.[13] It is often the case that the purchasing dealer may have an offsetting transaction with a customer, and while a mandatory repurchase or acceptance of a substitute security may eliminate the inter-dealer fail from the purchasing dealer's books, it would not resolve the dealer's obligations to the customer.[14] Likewise, a dealer's duty to deliver securities promptly to customers is inherent in MSRB Rule G-17,[15] as well as the firm's obligation to obtain and maintain possession and control of customer fully paid and excess margin securities as noted in the Securities

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always resolve the open transaction. If the dealer keeps the transaction open, it must use the original contract settlement date for purposes of the 90-day limit on close-outs.

[11] *See* FINRA Rule 11810.

[12] On average, 99 percent of the securities outstanding do not trade on a given day (e.g., on average in 2014, about 13,000 unique securities traded every day).

[13] For example, the Internal Revenue Service previously addressed the tax implications of a short sale transaction where title passes from the lender of a municipal security to the purchaser, and the lender receives a substitute payment instead of receiving interest on the municipal security. In this instance, the IRS has found that, because title passed to the purchaser as a result of the short sale, the lender is no longer the owner of the bond, and so any subsequent payment received by the lender is not interest on an obligation of a state or political subdivision for purposes of determining the lender's gross income under the Internal Revenue Code. *See* IRS Rev. Rul. 80-135 (1980-1 C.B. 18). *See also* Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities FINRA Regulatory Notice 15-27 (July 2015).

[14] *Supra* n.2.

[15] *See* Notice of Interpretation of Rule G-17 Concerning Prompt Delivery of Securities MSRB Notice of Interpretation (October 13, 1983).

Exchange Act of 1934 (SEA) Rule 15c3-3.[16] Investors should be able to have a reasonable expectation that the municipal security that they paid for is, unless otherwise noted, owned by them and they maintain the right to sell, transfer, gift, etc. that security without concern.

Accelerating the close-out process and requiring completion of a close-out
As previously noted, currently a close-out notice may be issued on any business day from five to 90 business days after the original settlement date. Informal feedback from dealers has indicated that both the length of time one must wait to initiate the close-out and the time frame(s) associated with completing the close-out are too long. The draft amendments would significantly compress the timing to initiate and complete a close-out by allowing a close-out notice to be issued the day after the purchaser's original settlement date, with the last day by which the purchasing dealer must complete a close-out on an open transaction being reduced to 30 calendar days.

With the vast majority of municipal securities in book entry form and DTCC's continued efforts to promote dematerialization, the MSRB is proposing that firms should no longer have to provide a 10-day delivery window before implementing an execution period. A three-day delivery window should be sufficient as the majority of inter-dealer fails are resolved within days of the original settlement and/or a fail situation is known prior to the original settlement date.

Additionally, the current rule requires that the earliest day that can be specified as the execution date is 11 days after telephonic notice. The draft amendments would amend the current allowable execution time frame from 11 days to four days after electronic notification. Accelerating the execution date could improve a firm's likelihood of finding a security for a buy-in,[17] lower overall counter-party risk and may further reduce accrual, capital and other expenses.

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[16] *See* SEA Rule 15c3-3(d)(4) The rule states in part, that "[s]ecurities included on the broker's or dealer's books or records that allocate to a short position of the broker or dealer or a short position for another person, excluding positions covered by paragraph (m) of this section, for more than 30 calendar days, then the broker or dealer must, not later than the business day following the day on which the determination is made, take prompt steps to obtain physical possession or control of such securities."

[17] Informal feedback from firms has indicated that there is a higher likelihood of locating a security when the timing is closer to trade date.

Lastly, as part of implementation of the draft amendments, staff would propose a 90-calendar day grace period for resolving all outstanding inter-dealer fails. The MSRB understands that many of the outstanding fails have been open for years and is concerned that such fails could continue to exist until maturity unless dealers are mandated to close-out all outstanding inter-dealer fails. While firms may be reluctant to seek a solution other than a buy-in, the draft amendments provide alternative solutions that should be considered as part of an inter-dealer fail resolution.

The close-out process

The MSRB proposes that the close-out process continue to provide three options to the purchasing dealer. The three options include: (1) purchase (buy-in) at the current market all or any part of the securities necessary to complete the transaction for the account and liability of the seller; (2) accept from the seller in satisfaction of the seller's obligation under the original contract (which shall be concurrently cancelled) the delivery of municipal securities that are comparable to those originally bought in quantity, quality, yield or price, and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller; or (3) require the seller to repurchase the securities on terms which provide that the seller pay an amount which includes accrued interest and bear the burden of any change in market price or yield.

A purchasing dealer notifying the selling dealer of an intent to close out an inter-dealer fail would continue to prompt DTCC to "exit" the position from CNS and the two parties are responsible for effecting the close-out. Because a municipal security may not be available for purchase, incorporating the buy-in procedures of a registered clearing agency will often not solve the inter-dealer fail. The MSRB expects firms to not solely rely upon the CNS system or the services of a registered clearing agency to resolve inter-dealer fails and take prompt action to close out inter-dealer fails in a timely manner. Regardless of the date the positions are exited from CNS, the inter-dealer fail must be resolved within 30 calendar days of the purchasing dealer's original settlement date.

Firms must coordinate internally to determine which of the three close-out options are appropriate for any given fail-to-deliver situation. While a buy-in may be the most preferred method, Rule G-12(h) provides two other options to a purchaser in the event a buy-in is not feasible. Firms are reminded that, regardless of the option agreed upon by the counterparties, including a cancelation of the original transaction, the close-out transaction is reportable to Real-time Transaction Reporting System (RTRS) as currently required pursuant to Rule G-14.

Use of a registered clearing agency

Currently Rule G-12(h) references use of the telephone and mail as part of the notification process. Updating Rule G-12(h) to reflect modern communication methods and widely-used industry practices, could facilitate more timely and efficient close-outs. For example, DTCC's SMART/Track is available for use by any existing NSCC clearing firm or DTCC settling member, allowing users to create, retransmit, respond, update, cancel and view a notice.[18]

Economic Analysis

1. **The need for the draft amendments to Rule G-12(h) and how the draft amendments to Rule G-12(h) will meet that need.**

The need for the draft amendments arises primarily from three concerns: 1) Ensuring that the rule aligns with current market practices; 2) Ensuring that dealers seeking to resolve inter-dealer fails can do so reliably, efficiently and promptly; and 3) Reducing the number of customer long positions allocated to firm short positions and the associated risks as a result of inter-dealer fails.

As discussed above, existing Rule G-12(h) refers to practices that are no longer frequently used by market participants and assumes the use of practices that are less effective and/or efficient than practices currently available to market participants. As such, the existing rule may result in uncertainties, inefficiencies or unnecessary costs associated with close-outs. The MSRB does not believe that continuing to refer to these infrequently used or out-of-date practices confers benefits on investors, issuers or other market participants and may, in fact, adversely affect them. The MSRB believes that updating the rule may reduce inefficiencies associated with efforts to comply with the existing rule, reduce the risk of inadvertent violations, result in more timely resolution of inter-dealer fails and reduce costs.

Second, the MSRB is aware that there are dealers who would like to resolve inter-dealer fails but, in the absence of a willing or cooperative counterparty, are unable to do so because the existing rule does not mandate resolution. Selling dealers that are unable to deliver securities may wish to resolve the fail to relieve them of the market risk associated with any increases in the

[18] SMART/Track provides a centralized Web-based communications hub for the transmission of various message types between DTCC participants.

price of the securities, purchasing dealers may wish to resolve the fail to ensure that they may confidently sell the securities to their customers without risk of leaving their customers with a long position allocated to a firm short position, ensure they are receiving tax-exempt interest or taking other actions that may be costly or detrimental to their customer. By shortening the timelines in the rule and making completion of the transaction mandatory, the MSRB believes that the total number of inter-dealer fails will decline, the resolution of inter-dealer fails will occur more quickly and dealer risk will be reduced.

Finally, a recent regulatory publication noted there can be instances in which a purchasing dealer did not receive securities and subsequently sold the not-yet-delivered securities to a customer.[19] In those cases, because the inter-dealer fail was not resolved, delivery to the customer did not occur in a timely fashion. Even when customers are aware that the securities they purchased have not been delivered, they may face limitations on what they may do with the securities they purchased (*e.g.*, transferring securities to another dealer or liquidating estates) and may receive taxable, substitute interest rather than the tax-exempt interest they were seeking. Such outcomes may adversely affect investors and may reduce investor confidence generally. The MSRB believes that reducing the number and duration of inter-dealer fails may reduce the number and duration of a customer long position allocated to a firm short position. This may, in turn, provide investors with greater confidence in the market, encourage activity that may result in increased liquidity, reduce tax exposure consequences and reduce costs borne by dealers.

2. Relevant baselines against which the likely economic impact of elements of the draft amendments to Rule G-12(h) can be considered.

To evaluate the potential impact of the draft amendments, a baseline or baselines must be established as a point of reference in comparison to the expected state with the draft amendments in effect. The economic impact of the draft amendments is generally viewed to be the difference between the baseline and the expected states.

Two existing MSRB rules serve as relevant baselines. The MSRB has interpreted Rule G-17 to impose a duty on dealers to deliver securities sold

[19] *See* Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities FINRA Regulatory Notice 15-27, (July 2015).

to customers in a prompt fashion. As described in more detail above, existing Rule G-12(h) and the MSRB's *Manual on Close-Out Procedures* provide timelines and optional procedures that can be used by dealers to close-out open inter-dealer transactions.

In addition to MSRB rules, SEA Rule 15c3-3 requires that firms obtain and maintain possession and control of customer fully paid and excess margin securities[20] and IRS rules govern the treatment and reporting of interest payments associated with short positions.[21]

At this time, the MSRB does not have and has not been able to identify data or evidence to support quantitative estimates of the cost of complying with existing Rule G-12(h).

According to DTCC, during the period December 16, 2015 through December 22, 2015, NSCC had an average of 500 end-of-day municipal security inter-dealer fails in CNS with an average total daily value of $54.0 million. Of that total, there were an average of 170 end-of-day inter-dealer fails with an average total daily market value of $6.3 million that had been outstanding for more than 20 days. The MSRB does not have access to public data on the number of dealers affected or the tax implications associated with short positions. The MSRB is seeking, as part of this request for comment, additional historical data that would support a more complete evaluation of the baseline.

The MSRB understands that all dealers should be able to readily and easily access information on their own short positions and the allocation of those short positions held by their customers on a real-time basis. The MSRB believes this information is held by each firm and that the inter-dealer information is also provided to firms by DTCC.

3. Identifying and evaluating reasonable alternative regulatory approaches.

The MSRB recognizes that there are alternatives to the approach proposed under the draft amendments that range from modifying specific parameters (*e.g.*, timelines) of the draft amendments to employing significantly different mechanisms to address the identified needs.

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[20] *Supra* n.16.

[21] *Supra* n.13.

The MSRB could make updates to Rule G-12(h) to account for current market practices and shorten the timelines during which the three close-out options are available to dealers, but not impose a requirement that inter-dealer short positions be resolved. Shortened timelines may increase the likelihood of resolving inter-dealer fails by increasing the likelihood that a specific security can be located and, thereby, reduce the number, quantity and duration of both inter-dealer short positions and those allocated to customer long positions. Such an approach may not, however, provide dealers seeking to resolve inter-dealer fails with any greater leverage or ensure that customers are not adversely impacted by firm short positions.

Rather than focusing on inter-dealer behavior, the MSRB could explicitly require that any securities purchased by a customer be delivered to that customer within a specific period of time or that the selling dealer repurchase the securities from that customer on terms which provide that the seller pay an amount which includes accrued interest and bear the burden of any change in market price or yield. This approach may provide dealers with the flexibility to address inter-dealer fails in whatever manner and timeline they choose while ensuring that customers are protected. By requiring dealers to resolve customer long positions, allocated to a firm short, this approach may create an incentive for dealers to address inter-dealer fails. Absent specific timelines and mechanisms, however, purchasing dealers may lack sufficient enforcement mechanisms to resolve inter-dealer fails and may have to frequently resort to more costly methods such as arbitration.

Finally, rather than the MSRB imposing a requirement that inter-dealer fails be resolved, DTCC could increase collateral requirements and/or impose higher fees which may create a stronger incentive for dealers to resolve inter-dealer fails.

4. Assessing the benefits and costs of the draft amendments to Rule G-12(h) and the main alternative regulatory approaches.

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely costs and benefits of the draft amendments with the draft amendments fully implemented against the context of the economic baseline discussed above.

The MSRB has been unable to identify or obtain sufficient data to quantify the economic impact of the draft amendments and, therefore, can only assess the impact of the draft amendments qualitatively. The MSRB is seeking, as part of this request for comment, additional data or studies relevant to the practices and procedures referenced in existing Rule G-12(h),

the magnitude and extent over time of inter-dealer fails and subsequently allocate to a customer long positions, the implications of short positions for investors and the market generally and the likely costs of complying with the proposed draft amendments.

Benefits

The MSRB believes that the draft amendments would benefit investors, dealers and issuers. Specifically, the MSRB believes that dealers may benefit from clarifications and revisions that more closely reflect actual market practices. In addition, dealers may be able to more quickly and efficiently resolve inter-dealer fails which may reduce dealer risk, reduce the likelihood and duration that dealers are required to pay "substitute interest" to customers, and reduce systemic risk. The MSRB believes that the draft amendments may also reduce the likelihood and duration of firm short positions that allocate to customer long positions, reduce investor tax exposure and increase investor confidence in the market. Issuers and the market as a whole may benefit from increased investor confidence. At present the magnitude of these benefits cannot be quantified.

Costs

The analysis of the potential costs does not consider all of the costs associated with the draft amendments, but instead focuses on the incremental costs attributable to it that exceed the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft amendments to isolate the costs attributable to the incremental requirements of the draft amendments.

The draft amendments would create a new burden on both selling and purchasing dealers by requiring that inter-dealer fails be resolved within 30 calendar days. Purchasing dealers may have to adopt new policies and procedures to more quickly identify inter-dealer fails and take the necessary action to resolve inter-dealer fails. The MSRB assumes that dealers will be able to readily identify firm short positions and that DTCC can assist in the identification of counterparties. Nonetheless, the process of resolving inter-dealer fails may impose costs on purchasing dealers. Selling dealers will need to meet the established deadlines and bear any costs associated with resolving a fail within 30 calendar days. Both the action to resolve these inter-dealer fails and the cost of the buy-in or purchasing alternative securities may, depending on market conditions, be significant. While, at present, the MSRB is unable to quantitatively evaluate the magnitude of the costs that the draft amendments will impose on dealers, the relatively small number of inter-dealer fails in CNS suggests that the costs would also be relatively low.

The MSRB is not aware of any costs that the draft amendments will impose on investors.

Effect on Competition, Efficiency, and Capital Formation

The MSRB believes that the draft amendments may improve the efficiency of the market by addressing potential confusion associated with the existing rules reference to market practices and procedures that are not frequently used. The MSRB also believes that by requiring dealers to resolve inter-dealer fails within 30 calendar days, the resolution process may be more efficient. These potential outcomes, along with a likely increase in investor confidence and decreased transaction costs as a result of reduced risk may encourage wider participation in the market and have a positive benefit on capital formation.

At present, the MSRB is unable to quantitatively evaluate the magnitude of efficiency gains or losses of the impact on capital formation, but believes that the benefits outweigh the costs.

Selling dealers who frequently fail to deliver securities or who owe a large number of securities may be disproportionately impacted by the draft amendments. Clearing firms who do not regularly communicate fails to correspondents and purchasing dealers who frequently fail to resolve inter-dealer fails or do not have policies and procedures in place to monitor inter-dealer fails may also be disproportionately impacted. At present, the MSRB is unable to quantitatively evaluate the magnitude of any burden on competition, but believes that the burden will be minimal and will be outweighed by benefits to all market participants.

Conclusion

The MSRB believes that these changes will provide a range of benefits including reducing the number of inter-dealer fails and/or shortening the period before they are resolved, reducing regulatory risk and reinforcing investor confidence in the market. Firms switching from certified mail to electronic communication should realize cost savings and more timely close-outs should reduce some of the ancillary costs associated with fails including NSCC fees[22] and the payment of substitute interest.[23] The amendments will also provide firms seeking to resolve inter-dealer fails with the ability to do so in a timely fashion. Mandating close-outs and the use of industry utilities,

[22] *See* Guide to The 2015 NSCC Fee Schedule.

[23] *See* FINRA Regulatory Notice 15-27 Guidance Relating to Firm Short Positions and Fails-to-Receive in Municipal Securities, July 2015.

however, may impose some costs on firms or require them to revise certain business practices. The MSRB is soliciting estimates of these costs in this request for comment, but assumes that they will be significantly less than the benefits that will accrue to dealers and the market as a whole.

Questions

The MSRB requests comment on all aspects of the draft amendments and specifically requests comment concerning the following issues, in addition to the economic impacts, costs and benefits of the proposed changes.

- To what extent have MSRB registrants found it difficult or costly to comply with the existing rule due to its references to infrequently used practices and procedures? If possible, please quantify the impact of these challenges. What is the, per firm, annual cost of compliance with existing Rule G-12(h)?
- Under what circumstances do dealers fail to resolve inter-dealer fails within 90 days of settlement date?
- Are there circumstances under which a customer long allocated to a firm short realizes benefits from not resolving the inter-dealer fail? If so, please provide estimates of those benefits, net of any costs associated with complying with applicable other SRO regulations.
- Under what circumstances can a firm(s) cancel a transaction or delivery of securities when effecting a close-out?
- Under what circumstances do dealers seek to resolve inter-dealer fails outside of the mechanisms identified in Rule G-12(h)?
- Are there any tools available to assist firms in locating a security to execute a buy-in? What are the costs associated with use of the tools used to locate a security, and should they be absorbed by the selling dealer?
- Do the alternatives identified above represent a comprehensive set of reasonable regulatory alternatives or are there alternative methods the MSRB should consider regarding close-outs that would be more effective and/or less burdensome?
- What, if any, modifications should the MSRB consider to proposed timelines taking into account current market practices?
- Will requiring that inter-dealer fails be resolved within 30 calendar days result in the resolution of any customer long positions allocated to a firm short position?
- Is within five days of the date of execution of the close-out notice sufficient timing for either party to forward any moneys due on the transaction?
- Should the purchaser be required to accept a partial delivery on an inter-dealer fail?

- In the event the purchasing dealer has multiple transactions in an inter-dealer fail status with one or more counterparties, should the purchasing dealer utilize the FIFO (first-in-first-out) method for determining which contract date to use for the failing quantity?
- Is Rule G-12(h)(i)(G) regarding "cash" transactions still relevant and necessary?
- What are the challenges associated with resolving existing inter-dealer fails within 90 calendar days? What is the estimated cost of resolving all existing inter-dealer fails within 90 days?
- Are there other relevant baselines the MSRB should consider when evaluating the economic impact of the draft amendments? Are commenters aware of any studies assessing the impact of inter-dealer fails in the municipal securities market?
- How much time would be required to alter systems and business procedures to comply with the proposed close-out procedures?
- Should MSRB Rule G-26(e) regarding fail contracts on customer account transfers continue to require dealers to close-out pursuant to Rule G-12(h)?
- Should the MSRB consider additional requirements or guidance specific to the resolution of short positions?

January 6, 2016

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Text of Draft Amendments[24]

Rule G-12: Uniform Practice

(a)-(g) No changes

(h) *Close-Out.* Transactions which have been ~~confirmed~~ compared or otherwise agreed upon by both parties but which have not been completed ~~may~~ shall be closed out in accordance with this section, or ~~as otherwise agreed~~ cancelled by the parties, no later than 30 calendar days after settlement date.

(i) *Close-Out by Purchaser*. With respect to a transaction which has not been completed by the seller according to its terms and the requirements of this rule, the purchaser may close-out the transaction in accordance with the following procedures:

(A) *Notice of Close-Out*. If the purchaser elects to close-out a transaction ~~in accordance with this paragraph (i)~~, the purchaser shall, not earlier than the ~~fifth~~ first business day following

[24] Underlining indicates new language; strikethrough denotes deletions.

the purchaser's original transaction settlement date, notify the seller ~~by telephone of the purchaser's intention to close out the transaction~~ via an inter-dealer communication system of the registered clearing agency through which the transaction was compared of the purchaser's intention to close-out the transaction ("notice").

(1) The purchaser's notice shall state:

(a) ~~that unless the transaction is completed by a specified~~ the date and time~~,~~ by which the transaction must be completed, which shall not be earlier than 5:15 p.m. EST ~~the close~~ of the ~~tenth~~ third business day following the date ~~the telephonic~~ notice is given (the ~~fifth~~ first business day, in the case of a second or subsequent notice);~~,~~

(b) ~~the transaction may be closed out in accordance with this section at any time during~~ the period of time during which the purchaser intends to execute the close-out transaction, provided that the close-out transaction initiated by the notice (or subsequent notices) must be completed and settled no later than the thirtieth business day following the purchaser's original transaction settlement date; and ~~,which shall not be more than five business days, specified by the purchaser for such purpose. The purchaser shall immediately thereafter send, return receipt requested, a written notice of close-out to the seller. Such notice shall~~

(c) contain the information specified in item (1) of subparagraph (C) below.

(B) *Retransmittal*. Any party receiving a notice of close-out may retransmit the notice to another ~~party~~ broker, dealer or municipal securities dealer from whom the securities are due ("obliged party"). The retransmitting party shall, not later than 5:15 p.m. EST of the first business day following its receipt of the ~~telephone~~ notice from the originating party:

(1) provide the obliged party ~~of close-out, notify the party to whom it is retransmitting by telephone of its intention to retransmit such notice, specifying~~ the name of the originating party and note the dates applicable to the notice are extended by one business day;

(2) retransmit the notice to the obliged party, which shall contain the requirements specified in subparagraph (C)(2) below; and ~~originator and the applicable dates for delivery and effectiveness of the notice. The retransmitting party shall immediately thereafter send, return receipt requested, a written notice of retransmittal which shall contain the information specified in item (2) of subparagraph (C) below. The first such retransmittal shall extend the dates for close-out by five business days, and the first retransmitting party shall specify the extended dates on its notice of retransmittal.~~

(3) notify the originating party, of the retransmittal notice of extension dates, which shall include the information specified in subparagraph (C)(3) below. ~~The first retransmitting party shall, on the date telephone notice of the retransmittal is given, notify the purchaser originating the notice by telephone of the extended dates and immediately thereafter send, return receipt requested, a notice of extension of dates which shall contain the information specified in item (3) of subparagraph (C) below. Any party subsequently retransmitting such notice shall, on the date telephonic notice of the retransmittal is given, notify the purchaser originating the notice by telephone of such retransmittal, and immediately thereafter send a copy of the retransmittal notice to such originating purchaser~~.

(C) *Contents of Notices*. ~~Written~~ N~~n~~otices sent in accordance with the requirements of subparagraphs (A) or (B) above shall contain the following information:

(1) The notice of close-out required under subparagraph (A) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being sent;

(c) the date on which the notice was sent ~~the name of the person to whom the originator provided the required telephonic notice~~;

~~(d) the date of such telephonic notice;~~

(~~e~~d) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;

(~~f~~e) the trade date and settlement date of the transaction;

(~~g~~f) the price and total dollar amount of the transaction;

(~~h~~g) the date by which the securities must be received by the originating dealer, which shall be completed within 30 calendar days of the purchaser's original transaction settlement date;

(~~i~~h) the date or dates during which the notice of close-out may be executed; and

(~~j~~i) the name and telephone number of the person at the broker dealer, or municipal securities dealer originating the notice to contact concerning the close-out.

(2) The notice of retransmittal required under subparagraph (B) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer retransmitting the notice;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(c) the ~~name~~ identity of the broker, dealer or municipal securities dealer originating the notice;

(d) the date on which the original notice was sent; ~~the name of the person to whom the retransmitting party provided the required telephonic notice;~~

~~(c) the date of such telephonic notice;~~

(~~f~~e) the par value and description of the securities involved in the transaction with respect to which the retransmittal notice is given;

(~~g~~f) the trade date and settlement date of the transaction;

(~~h~~g) the price and total dollar amount of the transaction;

(~~i~~h) the date by which the securities must be received by the dealer originating the notice (as extended due to the retransmittal);

(~~j~~i) the date or dates during which the notice of close-out may be executed (as extended due to the retransmittal); and

(~~k~~j) the name and telephone number of the person at the broker dealer, or municipal securities dealer retransmitting the notice to contact concerning the retransmittal.

(3) The notice of extension of dates required under subparagraph (B) above shall set forth:

(a) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice of close-out;

(b) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer retransmitting the notice;

(c) the ~~name~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being retransmitted;

(d) the date on which the original notice was sent; ~~the name of the person to whom the retransmitting party provided the required telephonic notice of the extension of dates;~~

~~(e) the date of such telephonic notice;~~

(~~f~~e) the par value and description of the securities involved in the transaction with respect to which the notice is given;

(~~g~~f) the date specified by the originating dealer as the date by which delivery of such securities must be made;

(~~h~~g) the date by which such delivery must be made, as extended due to the retransmittal;

(~~i~~h) the effective date or dates for the notice of close-out, as extended due to the retransmittal; and

(~~j~~i) the name and telephone number of the person at the broker dealer, or municipal securities dealer retransmitting the notice to contact concerning the close-out.

(D) *Purchaser's Options*. If the securities described in the notice of close-out are not delivered to the originating purchaser by the date specified in the original notice, or the extended date resulting from a retransmittal, such purchaser may close-out the transaction in accordance with the terms of the notice. To close-out a transaction as provided herein the purchaser may, at its option, take one of the following actions:

(1) purchase ("buy-in") at the current market all or any part of the securities necessary to complete the transaction, for the account and liability of the seller;

(2) accept from the seller in satisfaction of the seller's obligation under the original contract (which shall be concurrently cancelled) a transaction for the delivery of municipal securities which are comparable to those originally bought in quantity, quality, yield or price, and maturity, with any additional expenses or any additional cost of acquiring such substituted securities being borne by the seller; or

(3) require the seller to repurchase the securities in a transaction on terms which provide that the seller pay an amount which includes accrued interest and bear the burden of any change in market price or yield.

A purchaser executing a close-out shall, upon execution, notify the selling dealer for whose account and liability the transaction was closed out ~~by telephone~~, stating the means of close-out utilized. The purchaser shall immediately thereafter confirm such notice ~~in writing, sent return receipt requested,~~ and forward a copy of the confirmation of the executed transaction. A retransmitting party shall give immediate notice of the execution of

the close-out, in accordance with the procedure set forth herein, to the party to whom it retransmitted the notice.

A close-out will operate to close-out all transactions covered under retransmitted notices. Any moneys due on the transaction, or on the close-out of the transaction, shall be forwarded to the appropriate party within ~~ten~~ five business days of the date of execution of the close-out notice. A buy-in may be executed from a long position in customers' accounts maintained with the party executing the buy-in or, with the agreement of the seller, from the purchaser's contra-party. In all cases, the purchaser must be prepared to defend the price at which the close-out is executed relative to market conditions at the time of the execution.

~~(E) *Close-Out Not Completed*. If a close-out pursuant to a notice of close-out is not completed in accordance with the terms of the notice and the provisions of this rule, the notice shall expire. Additional close-out notices may be issued, provided that a close-out procedure with respect to a transaction may not be initiated later than the ninetieth business day following the settlement date of such transaction, regardless of the number of close-out notices issued. Notwithstanding the foregoing, in the case of a transaction on which a delivery of securities has been reclaimed pursuant to the provisions of subparagraphs (g)(iii)(C) or (g)(iii)(D) of this rule and which remains uncompleted, the purchaser may initiate one or more close-out procedures with respect to such transaction at any time during a period of fifteen business days following the date of reclamation. The first such procedure shall be considered an initial procedure for purposes of subparagraph (A) above.~~

~~(F) *Completion of Transaction*. If, at any time prior to the execution of a close-out pursuant to this paragraph (i), the seller, or any subsequent selling party to whom a notice has been retransmitted, can complete the transaction within two business days, such party shall give immediate notice to the purchaser originating the notice of close-out that the securities will be delivered within such time period. If the originating purchaser receives such notice, it shall not execute the close-out for two business days following the date of such notice; the period specified for the execution of the close-out shall be extended by two business days or, in the event that the notice is given on the last day specified for execution of the close-out, by three business days. Delivery of the securities in accordance with such notice shall cancel the close-out notice outstanding with respect to the transaction.~~

(~~G~~E) *"Cash" Transactions*. The purchaser may close-out transactions made for "cash" or made for or amended to include guaranteed delivery at the close of business on the day delivery is due.

(ii) *Close-Out by Seller*. If a seller makes good delivery according to the terms of the transaction and the requirements of this rule and the purchaser rejects delivery, the seller may close-out the transaction in accordance with the following procedures:

(A) *Notice of Close-Out*. If the seller elects to close-out a transaction in accordance with this paragraph (ii), the seller shall at any time not later than the close of business on the ~~fifth~~ first business day following receipt by the seller of notice of the rejection, notify the purchaser ~~by telephone~~ via an inter-dealer communication system of the registered clearing agency through which the transaction was compared of the purchaser's intention to close out the transaction of the seller's intention to close-out the transaction.

(1) The seller's notice shall ~~state~~:

(a) state the ~~that unless the transaction is completed by a specified~~ date and time by which the transaction must be completed, which shall not be earlier than 5:15 p.m. EST of the close of the business day following the date the ~~telephonic~~ notice is given, the transaction may be closed out in accordance with this section.; ~~The seller shall immediately thereafter send, return receipt requested, a written notice of close-out to the purchaser.~~

(b) ~~Such notice shall~~ contain the information specified in subparagraph (B) below; and

(c) ~~shall~~ be accompanied by a copy of the purchaser's confirmation of the transaction to be closed out or other ~~written~~ evidence of the contract between the parties.

(B) *Content of Notice*. The written notice sent in accordance with the requirements of subparagraph (A) above shall set forth:

(1) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer originating the notice;

(2) the ~~name and address~~ identity of the broker, dealer or municipal securities dealer to whom the notice is being sent;

(3) the date on which the notice was sent; ~~the name of the person to whom the originator provided the required telephonic notice;~~

~~(4) the date of such telephonic notice;~~

(~~5~~4) the par value and description of the securities involved in the transaction with respect to which the close-out notice is given;

(~~6~~5) the trade date and settlement date of the transaction;

(~~7~~6) the price and total dollar amount of the transaction;

(~~8~~7) the date of improper rejection of the delivery;

(~~9~~8) the date by which the delivery of the securities must be accepted~~;~~ ,which shall be completed within 30 calendar days; and

(~~10~~9) the name and telephone number of the person at the broker dealer, or municipal securities dealer originating the notice to contact regarding the close-out.

(C) *Execution of Close-Out*. Not earlier than the close of the business day following the date ~~telephonic~~ notice of close-out is given to the purchaser, the seller may sell out the transaction at the current market for the account and liability of the purchaser. A seller executing a close-out shall, upon execution, notify the purchaser for whose account and liability the transaction was closed out by telephone. The seller shall immediately thereafter confirm such notice ~~in writing, sent return receipt requested,~~ and forward a copy of the confirmation of the executed transaction. Any moneys with any additional expenses or any additional cost due on the close-out of the transaction shall be forwarded to the appropriate party within ~~ten~~ five business days of the date of execution of the close-out notice.

(D) *Acceptance of Delivery*. In the event the transaction is completed by the date and time specified in the notice of close-out, the seller shall be entitled, upon ~~written~~ 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*. Records reflecting the close-out process, including but not limited to the close-out transaction, shall be maintained as part of the firm's books and records.

~~(iv) *Procedures Optional*. Nothing herein contained shall be construed to require the parties to follow the close-out procedures herein specified if they otherwise agree.~~

(i)-(j) No changes.

ALPHABETICAL LIST OF COMMENT LETTERS ON MSRB NOTICE 2016-02 (JANUARY 6, 2016)

1. Bond Dealers of America: Letter from Mike Nicholas, Chief Executive Officer, dated March 4, 2016

2. Breena LLC: E-mail from Geraldine Lettieri dated January 6, 2016

3. National Securities Clearing Corporation: Letter from Murray C. Pozmanter, Managing Director, dated January 12, 2016

4. Securities Industry and Financial Markets Association: Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated March 6, 2016

BDA Bond Dealers of America

1909 K Street NW • Suite 510
Washington, DC 20006
202.204.7900
www.bdamerica.org

March 4, 2016

VIA ELECTRONIC MAIL

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street, NW Suite 1000
Washington, DC 20005

RE: MSRB Notice 2016-02: Request for Comment on Amendments to MSRB Rule G-12 on Close-Out Procedures

Dear Mr. Smith:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to Municipal Securities Rulemaking Board ("MSRB") Notice 2016-02, on its proposed amendments ("Proposed Amendments") to Rule G-12, on uniform practice, to update the close-out procedures to specifically require a municipal securities transaction to be closed-out no later than 30 calendar days after the transaction's original settlement date. BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets and we welcome this opportunity to present our comments.

The BDA supports the MSRB's amendments to make the close-out process a requirement

BDA understands these regulatory changes are part of a broader, industry-wide initiative supported by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority ("FINRA") to improve overall market efficiencies. Additional changes, including the initiative to shorten the settlement cycle may also reduce the amount of inter-dealer fails. The BDA urges the MSRB to consider the following three requests related to the Proposed Amendments which we expand upon below: 1) Provide more detailed guidance for comparable securities or alternatives for municipal securities which do not trade frequently 2) Provide additional guidance with respect to the operational and implementation of the proposed amendments, and 3) Provide a 180-calendar day grace period for current outstanding inter-dealer fails to allow dealers ample time to resolve aged fails.

We appreciate the common sense approach the MSRB has taken in regard to the proposed amendments. Presently, there are three remedies available if the selling dealer fails to deliver to the purchasing dealer. While these remedial options provide a basic framework for the purchasing dealer to initiate a close-out, they could be improved to provide dealers with more latitude, which would further benefit municipal securities investors.

Concerns with the proposals three options for closing out a transaction

As you know, the municipal securities marketplace is unique and the reality is that some securities trade infrequently. For example, just a few investors may hold the preponderance of a small

serial maturity within a larger issuance. For the purposes of close-out procedures this creates issues that are unique to the municipal securities market that do not exist in the corporate taxable bond market or equity market.

A dealer may not be able to exercise purchaser's "Option One" if the securities are not available for purchase in the market within the proposed close-out timeframes. If that is the case, the dealer would be able to choose "Option Two", to "accept from the seller a 'comparable' security," which creates the customer-focused question of finding a 'comparable' security that is acceptable to the investor's particular interests or investment strategy. The proposed amendments to Rule G-12 are helpful to BDA members and other dealers in providing a shorter period closer to the original trade date for firms to find matching or comparable bonds. However, it is important to note that BDA members will incur costs to find such bonds, to purchase the matching or comparable bonds, or to use CNS/DTCC to find a particular security, any or all of which could potentially be cost prohibitive and especially to the small and middle market dealer.

Finally, "Option Three" is focused on the inter-dealer transaction and requires the selling dealer to repurchase the securities back from the purchasing dealer for a price that includes accrued interest and any changes in market price. The BDA believes the MSRB should add to "Option Three," a requirement for the selling dealer to deliver securities to its customer within 30 days. If the purchasing dealer cannot deliver the securities to its customer within the specified timeframe, the purchasing dealer must repurchase the bonds from its customer at a price that includes accrued interest and any change in market price. See Figure 1 below:

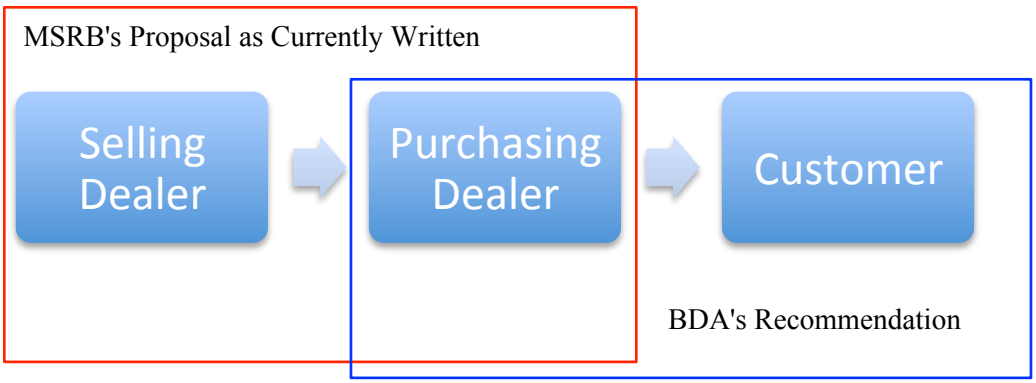

Figure 1 – It is the selling dealer failing to deliver to the purchasing dealer, who sold to the customer. It is the sale from the purchasing dealer to the customer that is being covered by the recommended language from the BDA to Option Three.

Implementation and Operational Concerns

Operationally speaking, BDA members generally support this initiative, which should decrease the costs and risks associated with interdealer fails. BDA-member firms do have concerns with how the proposal's close-out processes will interact with current systems in place and seek additional clarity for two systems in particular.

First, the Reconfirmation and Pricing Service ("RECAPS") is NSCC's automated fail clearance system for eligible securities. BDA member firms have concerns that applying a municipal security fail through the RECAPS process raises questions for firms about which settlement date should be used for calculating the time frames for close-outs. The RECAPS process is intended to reset the settlement date of a fail for the purposes of determining the age of the fail to calculate the net capital computation under 15c3-3. While footnote 10 in MSRB Notice 2016-02 states, "for close-out purposes, dealers should continue to use the original settlement date for calculating applicable time frames," we urge this information be featured more prominently within the rule itself or provided in future supplementary guidance.

Second, the Automated Customer Account Transfer Service ("ACATS") system facilitates the transfer of securities from one trading account to another at a different brokerage firm or bank. BDA member firms would like to see additional information in G-12, or supplementary rule guidance, on how ACATS fails should be resolved. The proposed timeframes in the proposed amendments to Rule G-12 work well for ACATS generally, but the terminology in the rule, as currently drafted, does not fit the reality for transfer scenarios, as there is no trade date for a transfer.

BDA recommends 180-calendar day grace period

BDA recommends the MSRB provide a 180-day grace period to allow the municipal markets industry ample time to resolve aged fails. In reality, every fail can be closed out with a buy back. However, negotiating the terms of the buy back is potentially difficult, especially for very aged fails. Dealers may experience the difficulty in determining a "fair" price for a buy back, or at least a price acceptable to the selling and purchasing dealer, which could further contribute to a large loss when executing a buy back transaction. Furthermore, dealers would have to negotiate to determine who would take the loss, or how it would be apportioned between each dealer. There is even additional complexity when you add a retail customer to this scenario.

Therefore, BDA recommends that MSRB provide a 180-day period for dealers to make reasonable efforts to close out existing inter-dealer fails, which we believe will give the industry time to work through the complex process we describe above.

Again, we appreciate the opportunity to comment on this proposal and we would be happy to answer any questions you have in relation to our recommendations.

Sincerely,

Mike Nicholas
Chief Executive Officer

Comment on Notice 2016-02

from Geraldine Lettieri, Breena LLc

on Wednesday, January 6, 2016

Comment:

At the very least, trades should be closed out within 30 days . Ideally, this should be done within 10 days, as a start.

55 WATER STREET
NEW YORK, NY 10041-0099
TEL: 212-855-7522
mpozmanter@dtcc.com

January 12, 2016

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW, Suite 1000
Washington, DC 20005

Re: Request for Comment on Amendments to MSRB Rule G-12 on Close-Out Procedures 2016-02, dated January 6, 2016

Dear Mr. Smith,

National Securities Clearing Corporation ("NSCC") is writing in support of the Municipal Securities Rulemaking Board ("MSRB")'s proposed amendments to MSRB Rule G-12 regarding its close-out procedures (File No. 2016-02), in which MSRB is proposing to require that municipal securities transactions be closed-out no later than 30 calendar days after settlement date. As MSRB described in greater detail in the filing, the proposal is intended to benefit customers by providing greater certainty that their fully paid for securities are long in their account, not allocated to a firm short, which is intended to reduce market risk by facilitating the timely resolution of inter-dealer fails.

Most net buyers of municipal bonds in NSCC's systems take delivery in DTC from NSCC's Continuous Net Settlement (CNS) system on Settlement Date or within a few days thereafter. However, in a small percent of municipal bond activity, the buyer does not receive the bonds for 30 calendar days or more. Failure to receive municipal bonds from CNS for 30 days or longer may indicate a problem at the firm failing to deliver the bonds to CNS. Therefore, NSCC agrees with the MSRB that it is prudent to require buyers to take action to close out their municipal bond fails within the 30 day period as recommended by MSRB. This requirement will help to identify and promptly resolve any potential delivery problems.

We believe market participants will be given ample opportunity to prepare for the impact of this proposal, and to take steps to mitigate its impact to their business.

Accordingly, we agree with MSRB's efforts to eliminate aged municipal fails over 30 days, and believe this proposed change will improve the safety and soundness of the U.S. markets.

Should you have any questions, please do not hesitate to contact me at (212) 855-7522.

Sincerely,

Murray C. Pozmanter
Managing Director

sifma
Invested in America

March 6, 2016

Ronald W. Smith
Corporate Secretary
Municipal Securities Rulemaking Board
1300 I Street NW
Suite 1000
Washington, DC 20005

Re: MSRB Notice 2016-02: Request for Comment on Amendments to MSRB Rule G-12 on Close-Out Procedures

Dear Mr. Smith:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates this opportunity to respond to Notice 2016-02[2] (the "Notice") issued by the Municipal Securities Rulemaking Board (the "MSRB") in which the MSRB is requesting comment on amendments to MSRB Rule G-12 on close-out procedures ("MSRB Close-Out Procedures"). SIFMA and its members are very pleased that the MSRB has requested comment on the close-out procedures, as they have not been updated in over 30 years. SIFMA wholeheartedly supports rulemaking and procedures that reduce risk and costs to broker dealers while giving investors greater certainty. The current MSRB Close-Out Procedures are essentially voluntary, and require broker dealers to wait before acting to resolve problem trades. The Notice mandates new timeframes for faster resolution of open transactions and requires their use. The proposed amendments are largely very helpful, but to support the goals of the amendments, SIFMA suggests that the new timeframes should be even shorter than those proposed by the MSRB. Our full comments on these amendments can be found herein.

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1 SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

2 MSRB Notice 2016-02 (January 6, 2016).

I. The Close-Out Process and Duties of Short Sellers and Buyers

There are a number of reasons why securities may fail to settle, such as operational errors, trading desk errors, customer-based execution errors, a failure to receive securities (creating chains of fails) or a partial call of the securities in between the trade and settlement dates. These reasons, and changing market conditions, may make it difficult or impossible for brokers, dealers, or municipal securities dealers ("broker dealers") to buy-in securities or find similar securities.

There are challenges associated with resolving existing inter-dealer fails within the 90-calendar day grace period. These challenges include the fact that the current MSRB Close-Out Procedures are voluntary, without repercussions, and don't put mandatory duties on any party. Also, shorts as a result of partial calls are a challenge because there are necessarily less securities to potentially buy-in as a result of the partial call. Finally, fails that have been outstanding for an extended period of time may be part of a chain of failed transactions. Despite these challenges, SIFMA and its members feel that it is necessary for the MSRB to mandate that existing inter-dealer fails be resolved within 90-calendar days of the effective date of the proposed amendments. However, with respect to the 90-day period and the standard period for close-outs, we recommend that purchasers who exercise commercially reasonable efforts to close out the transaction should not be liable for failure to close out.

Regarding MSRB's question whether there are circumstances under which a customer long allocated to a firm short may realize a benefit from not resolving the inter-dealer fail, the customer assumedly is still receiving interest payments. However, the interest payment may be treated as taxable to the customer. This situation is a condition the proposal is seeking to eliminate.

In the procedures, a firm can cancel a transaction or delivery of securities when effecting a close-out only if both sides agree; it cannot be unilateral. What happens if a bi-lateral agreement cannot be reached to close-out the outstanding fail? Firms do not typically seek to resolve or have the authority to resolve inter-dealer fails outside of the mechanisms identified in Rule G-12(h), so G-12 must provide for solutions that are workable. SIFMA and its members request guidance regarding the documentation needed for the situation where one dealer is trying to resolve a fail, but the other party is not willing, or cooperative. As part of that effort, the MSRB might consider permitting a party to unilaterally cancel a transaction if the related counterparty is non-responsive, after the requesting party has taken reasonable steps to resolve the fail.

Most buyers of municipal bonds in National Securities Clearing Corporation's ("NSCC's") systems take delivery in DTCC ("Depository Trust & Clearing Corporation") from the NSCC's Continuous Net Settlement ("CNS")

system on Settlement Date or within a few days thereafter. SIFMA and its members feel fails should be kept in CNS if at all possible, to avoid increasing counterparty risk. If the counterparty is CNS, however, there are logistical challenges for the buyer to determine who caused the short into CNS. Currently, a broker dealer failing to receive a security can do a Web Inquiry Notification System ("WINS") inquiry, or alternatively, contact NSCC CNS operations who, in turn, will contact the broker with the oldest short position and ask that their name be given to the broker that is long. The name "give-up" is only optional, which can be problematic if the only party that is able to provide a resolution through their long position is unwilling to be contacted. Although these services can provide some aid in determining the identity of the counterparty, most resolutions require the dealer to exit the trade from CNS. Unfortunately, when a dealer exits a trade from CNS, they lose the guaranty on the trade, which is a significant disincentive for firms.

Invitation to Cover Short Request ("ICSR") is a DTCC service that can be used to help participants that have failed to deliver, find long participants that have the security within DTCC, outside of CNS. ICSR is a costly service, and has a fee of $300 per use. Also, firms being requested to sell securities to cover another's deficit understandably typically will only sell at a premium. If a counterparty still does not agree to be given up in WINS or ICSR, then a firm needs to file a notice to buy-in the securities through the DTCC's SMART/Track system.

A particular problem for broker dealers occurs in accounts that have been received through the Automated Customer Account Transfer Service ("ACATS"). An account that has been received by a dealer through ACATS may be failing to deliver or may be short the securities. The transfer of the account to a different dealer may complicate the disclosure due to the purchasing party from the seller that failed to deliver. MSRB Rule G-26(e) regarding fail contracts on customer account transfers should continue to require broker dealers to close-out pursuant to Rule G-12(h). Broker dealers need a regulatory requirement to rely on in order to close-out customer accounts where they have no discretion.

Requiring inter-dealer fails to be resolved within 30 calendar days will necessarily result in the resolution of any customer long positions allocated to a firm short position. Five days from the date of execution of the close-out notice is sufficient time for either party to forward any moneys due on the transaction.

In theory, a purchaser should not be required to accept a partial delivery on an inter-dealer fail. At the time of trade, the buyer and the seller contracted to buy a certain amount of bonds at a set price. It is understood on trading desks that orders are all-or-none unless otherwise stated. Fundamentally, a partial delivery may be unfair to the client. A partial delivery may not fit a purchaser's investment criteria or goals, or may violate the minimum denomination or lot requirement. Although the firms have a comparison contract with NSCC and are participants in CNS, the

delivery of the securities through the clearance and settlement process is merely an operational issue. Currently, CNS will make a partial delivery if the full amount of the securities is not available through CNS, and a buyer in CNS is not able to reject a partial delivery from CNS and return the securities to CNS. We also understand that allowing buyers to reject partial deliveries in CNS would be extremely problematic for the system. SIFMA and its members would like to continue the dialog with the MSRB and DTCC on this issue; further consideration of this issue may yield a reasonable and workable solution.

In the event the purchasing dealer has multiple transactions in an inter-dealer fail status with one or more counterparties, the purchasing dealer should utilize the FIFO (first–in-first-out) method for determining which contract date for use for the failing quantity.

Rule G-12(h)(i)(G) regarding "cash" transaction is still relevant and necessary, particularly for premium transactions.

II. Suggestions and Alternatives

The goals of the amendments are to reduce risk and costs to broker dealers while giving investors greater certainty. With that in mind, SIFMA suggests the failed transactions should be closed out no later than 15 calendar days after settlement, and urges the MSRB to shorten the proposed mandatory closeout deadline in the amendments. Almost universally, failed transactions don't get better with age, and it is easier to have conversations about close-outs for failed transactions sooner rather than later.

The proposed alternatives identified in the Notice represent a comprehensive set of reasonable regulatory alternatives. Some SIFMA member firms feel consideration should be given to a simpler rule in which more onus is placed on the dealer failing to deliver to take responsibility for and action on resolving the short position. Particularly if the seller made an error, the seller that fails to deliver needs to be able to break the trade or resolve the fail in some manner. The simplest way to resolve a short is to require the dealer failing to deliver to either buy back the position at the current prevailing market price or to break the trade. In connection therewith, the parties should have the opportunity to make claims to recoup reasonable and necessary costs and expenses related to the close-out, which may vary in nature in view of the circumstances of the transaction.[3]

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[3] *See also*: http://www.msrb.org/msrb1/pdfs/Close-Out-Procedures.pdf (these procedures will need to be updated to reflect the rule amendments, and should include greater detail regarding the close-out process and recoupable cost and expenses).

For self-directed customer accounts, it would be extremely helpful to have guidance that in the instance where the customer won't cancel the trade by giving the position in the bonds back to the seller, the broker dealer should have the authority to close-out the position by returning the position to the seller. It is important to note that in self-directed customer accounts, broker dealers are not allowed to use discretion; without discretion, broker dealers do not have the authority to buy or sell positions without the express consent of the customer.

Finally, SIFMA members do suggest the MSRB make another minor change to the proposed amendments. We suggest an exemption to the proposed required time period to resolve a short if the buyer affirmatively consents to an extended period of time. This exception would be helpful if the dealer failing to deliver is on the cusp of resolving the fail, but needs a short amount of additional time to deliver or close-out the position. SIFMA and its members suggest that this exception should permit the dealer failing to deliver at most another 15 days, for an aggregate total of 30 days.

III. Cost and Benefit Analysis

SIFMA and its members feel that mandating shorter timeframes for the resolution of close-outs will be more difficult for and require more resources from broker dealers than the current rule. However, SIFMA and its members feel that the draft amendments are a benefit to customers by providing greater certainty in their securities transactions. Whether the new rule requires municipal securities transactions to be closed-out no later than 30 days, as stated in the Notice, or per our recommendation, 15 calendar days after settlement date or 30 days total with the consent of the buyer, there are clearly benefits to limiting the time any customer's fully paid for securities are long in their account, but allocated to a firm short. Resolving shorts promptly also minimizes issues and concerns about the tax characterization of the interest paid during the settlement period. Further, the amendments reduce costs and market risk by facilitating the timely resolution of inter-dealer fails. SIFMA and its members believe that the benefits of the amendments as stated in the Notice outweigh the costs and generally support their adoption.

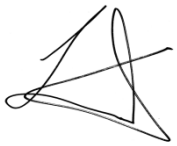
IV. Implementation Period

SIFMA and its members feel it is important to have an implementation period of at least 90 days after approval of the amendments by the SEC to allow for the grace period to resolve outstanding fails. This time period should give broker dealers ample opportunity to alter systems and business procedures to comply with the proposed amendments.

V. Conclusion

Again, SIFMA and its members largely support the MSRB's proposed amendments to the MSRB's Close-Out Procedures in Rule G-12. We agree with MSRB's efforts to eliminate existing aged municipal fails over 90 days, and believe this proposed change will improve the safety and soundness of the U.S. markets. SIFMA urges the MSRB to shorten the proposed mandatory closeout deadline in the amendments for new failed transactions to no later than 15 calendar days after settlement, with an exception that would permit the dealer failing to deliver at most another 15 days, with consent of the buyer, for an aggregate total of 30 days. We would be pleased to discuss any of these comments in greater detail, or to provide any other assistance that would be helpful. If you have any questions, please do not hesitate to contact the undersigned at (212) 313-1130.

Sincerely yours,



Leslie M. Norwood
Managing Director and
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cc: ***Municipal Securities Rulemaking Board***
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