



DIVISION OF  
MARKET REGULATION

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

122-4

JUN 29 1988

The Honorable John D. Dingell  
Chairman  
U.S. House of Representatives  
Committee on Energy and Commerce  
Rayburn House Office Building  
Room 2125  
Washington, D.C. 20515

Re: Correspondence from Mr. Steven Schlusel, Esq.  
and Mr. and Mrs. Earl Boofter

Dear Chairman Dingell:

Your letter dated May 17, 1988 to Chairman Ruder and a copy of your letter to Mr. and Mrs. Earl Boofter dated May 23, 1988 were referred to this Office for reply. You have asked for our findings with regard to correspondence that you received from Mr. Steven Schlusel, Esq. concerning the failure of broker-dealers to advise their customers of the existence of call provisions. Mr. Schlusel states that he recently sued a major investment company on behalf of a client for failing to include the existence of call provisions on its confirmation slips, monthly statements, or delivery tickets or otherwise advising his client as to the existence of call provisions in connection with a purchase of municipal securities. In addition, you have forwarded a copy of correspondence from Mr. and Mrs. Boofter concerning the failure of bank trust departments to notify their bondholders of early redemptions or calls.

Lack of Notice of Called Bonds

The Commission is concerned about the problems that have arisen with municipal bond calls. Although these problems with municipal calls will be reduced over time as a result of the enactment in 1982 of the Tax Equity and Fiscal Responsibility



Act of 1982 (TEFRA), 1/ the Commission is attempting to address these problems at present. For instance in November 1986, staff members met with representatives of industry organizations, self-regulatory organizations, and other Federal regulatory agencies to develop voluntary minimum standards. Subsequent to this meeting, the Commission authorized the Division of Market Regulation to send a letter to twelve organizations endorsing the standards and encouraging all municipal securities issuers and their agents to adhere to the standards in processing redemptions. 2/ The standards were generally as follows: notice of municipal bond redemptions should contain certain items of information including CUSIP numbers; redemption notices should be sent in a secure fashion (e.g., registered or certified mail or overnight delivery service); the standard notice period for municipal bond redemptions should be 30 days from publication date to redemption date; redemption notices should be sent to registered securities depositories in advance of publication date; second notices of advance refundings of municipal securities should be given 30 days prior to the redemption date; and CUSIP number identification should accompany all redemption payments. Securities Exchange Act Release No. 23856 (December 3, 1986). (Attachment A.)

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- 1/ Section 310 of TEFRA removed the federal income tax exemption for interest earned on publicly offered long-term bonds issued by state and local governments unless those bonds are issued in registered form. The constitutionality of this provision was recently affirmed by the Supreme Court. South Carolina v. Baker, \_\_\_\_\_ U.S. \_\_\_\_\_, 108 S.Ct. 1355 (1988). Since the passage of this law, all municipal securities have been issued in registered form. Registration allows municipal issuers to notify bond holders directly of bond calls.
- 2/ The letter was sent to the following organizations: American Bankers Association; Dealer Bank Association; Government Finance Officers Association; National Association of Bond Lawyers; National Association of State Auditors, Comptrollers and Treasurers; Public Securities Association; Securities Industry Association; Depository Trust Company; Midwest Securities Trust Company; Pacific Securities Depository Trust Company; Philadelphia Depository Trust Company; Investment Company Institute; and Securities Transfer Association, Inc. All organizations except the last two were present at the meeting to develop the standards.

The Commission also noted in the release that bondholders whose certificates are held individually or by custodians other than depositories are often the least informed about the redemption process and bear significant financial loss due to missed redemptions and late redemption payments. The Commission suggested ways to improve the situation such as secured mailings to all registered bondholders, follow-up notices to bondholders who have failed to deliver called bonds, mailed notices to holders of bearer bonds who provide their names and addresses for that purpose, and redemption notice publication in sources most likely to reach bondholders. In 1987, the Depository Trust Company made the standards listed in Securities Exchange Act Release No. 23856 part of its depository eligibility requirements (Attachment B). The staff continues to monitor and evaluate bond redemptions. In an October 23, 1987 speech, Chairman Ruder recommended a grant of direct authority to the Commission to regulate timely notice of puts and calls in connection with the Commission's regulation of the national clearance and settlement system. (Attachment C).

#### Call Provision Disclosure

Although municipal securities issuers are not subject to the registration provisions of the Securities Act of 1933 or the periodic reporting requirements of the Securities Exchange Act, and municipal securities are exempt from the Commission's confirmation rule, the antifraud provisions apply to transactions in municipal securities. In addition, the Municipal Securities Rulemaking Board ("MSRB"), which has primary rule-making authority over municipal securities, subject to Commission oversight, requires that transactions in municipal securities be confirmed and that those confirmations contain yield calculations and information as to the existence of call provisions. The Commission is currently evaluating the effectiveness of the MSRB's customer confirmation rule.

#### Additional Recommendation

Another concern closely related to notifying buyers of call provisions involves the general availability of information concerning the municipal securities markets. In an October 1987 speech, Chairman Ruder also indicated that repeal of the Tower Amendment 3/ may be desirable to allow the

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3/ The Tower Amendment is the 1975 amendment to the securities laws that prohibits the Municipal Securities Rulemaking Board from requiring municipal  
(continued...)

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MSRB to effect uniform procedures to make certain that sufficient numbers of offering statements are made available in time to be delivered to customers purchasing new issues.

If I can be of any further assistance to you or your staff, please contact me at (202) 272-2844.

Sincerely,



Larry E. Bergmann  
Associate Director

Attachment A - Securities Exchange Act Release No. 23856  
(December 3, 1986)

Attachment B - Securities Exchange Act Release No. 24818  
(August 18, 1987)

Attachment C - Chairman Ruder's Speech to the Public Securities Association of October 23, 1987.

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3/ (...continued)

bond issuers to prepare offering material or to distribute such documents to dealers or purchasers of their securities.

**SECURITIES AND EXCHANGE COMMISSION**

**Release No. 34- 23856**

**Municipal Bond Redemptions**

**AGENCY: Securities and Exchange Commission.**

**ACTION: Publication of a Letter Identifying Voluntary Minimum Standards for Processing Redemptions of Debt Securities.**

**SUMMARY: On November 14, 1986, representatives of industry organizations, self-regulatory organizations, and Federal regulatory agencies met to discuss problems associated with municipal bond call processing and reached a consensus that issuers and their agents, in processing municipal securities redemptions, should adhere to certain minimum standards as set forth in the text of the letter below. The Securities and Exchange Commission endorses those standards and encourages all municipal securities issuers and their agents to adhere to the standards in processing existing and future redemptions.**

**FOR FURTHER INFORMATION CONTACT: Jerry Greiner at 202/272-2066 or Ester Saverson, Jr. at 202/272-2826, Division of Market Regulation, Securities and Exchange Commission, Washington, D.C. 20549.**

**SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") authorized the Division of Market Regulation to send the following letter discussing certain problems in processing**

redemptions of municipal bonds. 1/ The letter identifies six steps issuers and their agents can take to reduce these problems.

### I. Introduction

The Commission understands that recent interest rate declines have caused a significant increase in the incidence of full and partial redemptions of debt securities, particularly municipal securities. The Commission also understands that recent high redemption volume and the procedures used to initiate and complete redemptions have caused operational problems to financial intermediaries, delayed redemption processing, and resulted in financial loss to affected bondholders and intermediaries. The Commission believes the voluntary guidelines set forth below help ameliorate redemption processing problems and minimize adverse effects on bondholders. The Commission also intends to continue to monitor and evaluate bond redemptions.

### II. Discussion

The Commission realizes that the endorsed standards primarily will affect issuers, their agents, and bond indenture trustees. The Commission encourages voluntary compliance, which should promote more efficient redemption processing for all persons involved, including issuers, agents, intermediaries, and bondholders. The Commission realizes that the six endorsed standards are minimum guidelines and encourages issuers and their

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1/ The letter was sent to the organizations listed in footnote 1 of the letter below.

agents to consider taking additional steps to promote maximum efficiency and safety in the bond redemption process.

In today's environment of securities immobilization and automated book-entry processing of securities transactions, a significant percentage, often a majority, of the ownership interests in a securities issue is held at central registered securities depositories through financial intermediaries. Because financial intermediaries and their beneficial owner customers must depend on the securities depositories, as registered owner or custodian, to receive notice of and process redemptions, the Commission urges cooperation and increased automation for depository-processed redemptions. Issuers, their agents, and trustees should review current procedures and consider certain additional steps to ensure timely completion of redemption processing by depositories and other custodians, including automated tape transmission of redemption information to depositories, increased communication with depositories, and follow-up notices to depositories.

At the same time, however, the Commission also recognizes that many bondholders' certificates are not held by depositories, but are held individually or through other custodians. These bondholders, in the Commission's view, are often the least informed about the redemption process and bear significant financial loss due to missed redemptions and late redemption payments. The Commission, therefore, encourages voluntary efforts to improve the process by which these bondholders are informed of redemptions

and are paid redemption proceeds. Issuers, their agents, and trustees should consider secured mailings to all registered bondholders, follow-up notices to bondholders who have failed to deliver called bonds, mailed notices to holders of bearer bonds who provide their names and addresses for that purpose, and redemption notice publication in sources most likely to reach bondholders.

By the Commission.

Jonathan G. Katz  
Secretary

Dated: December 3, 1986



Re: Processing Municipal Bond Calls

As you know, the recent decline in interest rates has resulted in a tremendous increase in redemptions of municipal securities. On November 14, 1986, representatives of several industry organizations met to discuss problems associated with municipal bond call processing, and reached unanimous agreement that issuers, trustees and their agents, in processing municipal securities redemptions, should be encouraged to adhere to the six minimum standards set forth below. 1/ These representatives agreed to distribute notice of these standards to their membership and to take appropriate steps to endorse the standards. Accordingly, please be advised that the Securities and Exchange Commission ("Commission") endorses these standards and encourages all municipal securities issuers and their agents to adhere to these standards in processing existing and future redemptions.

I. Summary of the Standards

Representatives unanimously agreed with the following standards:

- Notice of municipal bond redemptions should contain, at a minimum: CUSIP number; certificate numbers and called amounts of each certificate (for partial calls); publication date; redemption date; redemption price; redemption agent name and address; date of issue; interest rate;

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1/ Industry organizations represented at the meeting were: American Bankers Association; Dealer Bank Association; Government Finance Officers Association; National Association of Bond Lawyers; National Association of State Auditors, Comptrollers and Treasurers; Public Securities Association; Securities Industry Association; and the four registered securities depositories --- Depository Trust Company; Midwest Securities Trust

maturity date; and other descriptive information that accurately identifies the called security.

- All redemption notices should be sent, in a secure fashion (e.g., registered or certified mail or overnight delivery service), at least to all four registered securities depositories and to national information services that disseminate redemption notices.
- Redemption notices should provide for 30 days from publication date to redemption date.
- Redemption notices should be sent to the registered securities depositories in advance of publication date.
- Second notices of advance refundings of municipal securities should be given 30 days prior to the redemption date.
- CUSIP number identification should accompany all redemption payments.

## II. Need for the Standards

Custodians of called municipal bonds and National Clearance and Settlement System ("National System") processors stressed their need for early and complete notices of redemption to afford sufficient redemption processing time and to allow timely presentment of called securities to redemption agents. They also urged resolution of certain redemption payment problems.

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### (Continued Footnote)

Company; Pacific Securities Depository Trust Company and Philadelphia Depository Trust Company. Staff members from the Securities and Exchange Commission; Municipal Securities Rulemaking Board; Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation also attended the meeting.

The Investment Company Institute was not represented at the meeting but has agreed to distribute this letter to its members. The Securities Transfer Association, Inc., also not represented at the meeting, is considering whether to send this letter to its members.

A. Contents of Redemption Notices

Representatives stressed the need for inclusion of CUSIP numbers on all redemption notices. The CUSIP number is the unique identification number assigned to each maturity of an issue, which is usually printed on the face of each individual certificate of the issue. Because CUSIP numbers provide an efficient way to identify different issues and maturities, these numbers are used extensively in automated recordkeeping systems throughout the securities and banking industry. For example, ownership interests in municipal securities held by securities depositories are maintained exclusively by reference to CUSIP number. Thus, representatives agreed that redemption notices must contain, at a minimum: CUSIP number; certificate numbers and called amount for each certificate (for partial calls); publication date; redemption date; redemption price; redemption agent name and address; date of issue; interest rate; maturity date; and other identifying information.

B. Redemption Notices Should be Sent to Depositories and to One or More National Information Services

Securityholders, depositories 2/ and other custodians often have difficulty learning of redemptions, particularly when redemption notices for bearer bonds are published only in

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2/ The four registered securities depositories are user-governed, not-for-profit corporations that provide safekeeping and other securities processing services. The securities depositories do not trade securities for their own accounts and are self-regulatory organizations

local newspapers that are not covered by national call dissemination services. Representatives stressed that it is crucial for issuers and trustees to send redemption notices to the four registered securities depositories, regardless of other publication or notice requirements specified in the indenture. 3/ Moreover, notices to depositories should be

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(Continued Footnote)

registered with the Commission under the Securities Exchange Act of 1934. As members of the Federal Reserve System, they are also subject to examination by the Board of Governors of the Federal Reserve System. Approximately 47% of all municipal securities are held by securities depositories for their member banks and broker-dealers. Thus, notice to securities depositories will facilitate prompt notice to a significant proportion of bondholders.

3/ Redemption notices should be sent to:

(i) Corporate calls:

The Depository Trust Company  
23rd Floor  
7 Hanover Square  
New York, New York 10004  
Fax-(212) 709-6895 or 6896

Municipal calls:

The Depository Trust Company  
711 Stewart Avenue  
Garden City, New York 11530  
Attention: Diana DiFiglia  
Fax-(516) 227-4039 or 4190

(ii) Midwest Securities Trust Company  
Capital Structures-Call Notification  
440 South LaSalle Street  
Chicago, Illinois 60605  
Fax-(312) 663-2343

(Footnote Continued)

sent in a fashion more secure than first class mail, such as, registered or certified mail and overnight mail. 4/ Representatives also agreed that, to ensure nationwide access to redemption notices, 5/ trustees and issuers also should send

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(Continued Footnote)

(iii) Registered bond calls:  
Pacific Securities Depository Trust  
Company  
Pacific and Company  
P.O. Box 7041  
San Francisco, California 94120  
Fax-(415) 393-4128

Bearer bond calls:  
Pacific Securities Depository Trust  
Company  
Pacific and Company  
P.O. Box 7042  
San Francisco, California 94120  
Fax-(415) 393-4128

(iv) Philadelphia Depository Trust Company  
Reorganization Division  
1900 Market Street  
Philadelphia, Pennsylvania 19103  
Attention: Bond Department  
Dex-(215) 496-5058

4/ All depositories have offered to pay the expense of overnight delivery of redemption notices. Telecopying notices to the depositories also is an acceptable method of delivery. (See note 3 for telephone numbers.)

5/ Although depositories are probably the largest recordholders of registered municipal securities and principal custodians of bearer municipal securities, some municipal issues, particularly those in bearer-form, are not eligible for depository services. Accordingly, special notice to information services appears to be particularly appropriate as a means of alerting securityholders to impending redemptions in a timely fashion.

redemption notices to one or more information services of national recognition that disseminate redemption information. 6/

C. The Standard Redemption Notice Period is 30 Days

Representatives agreed that 30 days from publication date to redemption date should be the standard notice period for municipal bond redemptions. Bond counsel and trustees at the meeting suggested that most trust indentures, even those specifying minimum notice of as little as ten days, provide the flexibility for 30 days notice. Representatives explained that 30 days notice of redemptions on municipal bonds is the minimum time frame within which they can prepare adequately for and complete municipal bond redemptions. Thirty days notice is critical because investors frequently own securities through several intermediaries including securities depositories and banks or broker-dealers, and each intermediary must allocate called certificates based on positions as of the close of business the day before the notice publication date.

Depository representatives emphasized the need for early notice of redemptions, especially with respect to partial calls of municipal bonds. Upon learning of a call, depositories must reconcile which among themselves is the net holder of

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6/ For example, some of these nationally-recognized services are: Financial Information, Inc.'s Financial Daily Called Bond Service; Interactive Data Corporation's Bond Service; Kenny Information Service's Called Bond Service; Moody's Municipal and Government; and Standard and Poor's Called Bond Record.

the affected issue. The net holder must then run a lottery to allocate the call among participants having a position in the affected issue. The lottery must be based on participants' positions as of record date, which is the close of business on the day before publication date. After the net holding depository's lottery has run, the other depositories can run their lotteries, also based on participants' positions as of record date. After the depositories' lotteries have been run, depository participants can run their own internal lotteries as necessary. This need for multiple, successive lotteries for partial calls means that sufficient processing time must be allowed.

D. Redemption Notices Should be Sent to Depositories Two Business Days In Advance of Publication Date

As noted above, depositories run their lotteries based on participants' positions as of record date, the day before publication date. Thus, anytime a depository receives a redemption notice after its record date, the depository must reconstruct record date positions. This entails locating and reconstructing historical files, a time-consuming process that creates further delays. Moreover, the further from record date a lottery is run, the greater the chance that depository participants will have sold or transferred their record date holdings in the called issue. If a participant's position is inadequate to meet its call allotment, a short position is created and the participant must cover its delivery obligation

with a cash deposit and often will need to buy securities in the open market. If the issue is thinly traded, significant financial losses can result. To avoid these problems, representatives agreed that issuers and trustees should send redemption notices to the depositories in advance of publication date whenever possible. All of the depositories have represented to the Commission that they would maintain confidentiality of the notices until publication date and would use their advance knowledge only to prepare timely lottery runs.

E. Second Notice of Advance Refunding of Bonds

Several representatives raised the concern that issuers will announce the refunding of a bond issue one to five years in advance of the redemption date without any other notice of the advance refunding. During the intervening years between the publication date and the redemption date, holders must keep track of bonds subject to the advance refunding and the date and price of the redemption. The representatives all concurred that a second notice, published and mailed 30 days prior to redemption date to all registered bondholders, including the four registered securities depositories, and to one or more of the national information services that disseminate redemption notices, would alleviate the processing problems that result from missed redemption dates.

F. CUSIP Number Identification of Redemption Payments

Depositories stressed the need for CUSIP number identification on redemption checks or wire payments to avoid



delays caused by researching payments to participants. Depository participants face financial risks when they pay their customers on redemption date without having received redemption proceeds from the depository or the redemption agent. Representatives therefore agreed that CUSIP number identification should accompany redemption checks or wire payments to depositories.

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The Securities and Exchange Commission today has issued a release encouraging all municipal securities issuers and their agents and National System processors to adopt these standards immediately. If you have questions or further suggestions about these standards, please contact Brandon Becker at 202/272-2866 or Jonathan Kallman at 202/272-2402.

Sincerely,

Richard G. Ketchum  
Director