

# Notice to Members

MARCH 2003

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Senior Management

## KEY TOPICS

MSRB Rules G-12  
MSRB Rules G-14  
Transaction Reporting

## MSRB Rules G-12 and G-14

NASD Reminds Firms about Transaction Reporting Requirements and Announces Enforcement Actions Against Firms for Violations of MSRB Transaction Reporting Rules G-12 and G-14

### Executive Summary

NASD reminds member firms about the obligations imposed by Municipal Securities Rulemaking Board (MSRB) Rules G-12 and G-14, particularly the requirement that member firms report their municipal securities transactions to the MSRB accurately and on time. Accurate and timely automated comparison and reporting of municipal securities transaction information is critical to a member firm's trade processing function, the accurate dissemination of transaction information, price transparency, and efficient and effective regulatory oversight of municipal securities trading and sales practices.

### Questions/Further Information

Questions about this *Notice* may be directed to Malcolm Northam, Director, Fixed Income Securities, at (202) 728-8085, or Cynthia Friedlander, Regulatory Specialist, at (202) 728-8133, in the Department of Member Regulation.

### Background and Discussion

The MSRB disseminates, on a daily basis, municipal transaction price data reported by firms. An increasing number of investment-related Web sites are republishing this data for viewing by the public. Ensuring the timely and accurate reporting of municipal transactions has therefore become the subject of increased

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regulatory focus. Importantly, MSRB Rule G-14 is a frequently cited rule violation in examinations of NASD member firms.<sup>1</sup> Among other things, member firm conduct that interferes with the fundamental integrity of MSRB transaction data and results in the dissemination of inaccurate or incomplete information to multiple media sources creates investor protection and regulatory concerns.

NASD staff have observed that non-compliance with municipal transaction reporting requirements is often symptomatic of systemic problems with both the clearing firm's and the correspondent's transaction reporting processes and procedures. When a clearing firm repeatedly receives inaccurate or untimely municipal transaction information from a correspondent or contra party, the clearing firm has a responsibility to communicate with that correspondent or contra party in an effort to correct the problem. Such efforts will help clearing firms avoid being subject to regulatory inquiry or discipline stemming from problems of their correspondents. A firm's failure to follow up on chronic transaction-related problems may be considered inadequate supervision of the municipal transaction reporting function by the clearing firm, the introducing firm, or both.

NASD has recently instituted and settled formal disciplinary proceedings against several member firms for failing to provide accurate and timely information regarding their inter-dealer municipal securities transactions during 2000 and 2001. Each of these firms attained National Securities Clearing Corporation (NSCC) T-input percentages significantly below the industry average. The fines

ranged from \$1,500 to \$7,500 for each firm. NASD continues to monitor both municipal inter-dealer and customer transaction submissions for compliance with MSRB Rules G-12 and G-14 and will be seeking sanctions in appropriate instances. We encourage firms to monitor the timeliness and accuracy of transaction reporting and take appropriate steps to ensure compliance.

Until recently, two information sources allowed firms to monitor their compliance with MSRB transaction reporting requirements: the NSCC Participant Information and Efficiency Report (PIER) and MSRB's Dealer Feedback System (DFS). Until February 1, 2003, the PIER, which is provided to firms that are direct correspondents of NSCC, included among other information, a firm's T-input percentage, which was one measure of compliance with MSRB *inter-dealer* transaction reporting requirements. The NSCC discontinued distribution of its Municipal Bond Report Card and T-input percentages on this date.<sup>2</sup>

The DFS allows all firms that are registered with the MSRB and that report transactions in municipal securities to access statistics that measure their compliance with *inter-dealer and/or customer* transaction reporting requirements.<sup>3</sup> These statistics are provided to regulators for use in firm compliance examinations. Since the T-input statistic is no longer available, it is now even more important for firms that clear or effect transactions in municipal securities to access the information available to them from the MSRB's DFS on a regular basis as part of a comprehensive municipal compliance program.

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This *Notice to Members* contains a memorandum developed and issued jointly by NASD and MSRB that provides a description of the requirements for compliance with Rules G-12 and G-14, and describes each of the statistics made available via DFS and what compliance problems may be indicated by those statistics.

## Endnotes

- 1 See *"Improving Examination Results"* on the NASD Web Site.
- 2 See *NSCC Important Notice* dated December 20, 2002.
- 3 For more information about the DFS, please see the MSRB's Web Site, [www.msrb.org](http://www.msrb.org), and "Municipal Transaction Reporting Compliance Information," *Regulatory & Compliance Alert* (Summer 2002).

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## MEMORANDUM

**TO: NASD Member Municipal Securities Brokers or Dealers**

**DATE: March 3, 2003**

**SUBJECT: MSRB Rule G-14 Transaction Reporting**

The Municipal Securities Rulemaking Board ("MSRB") and NASD would like to remind brokers, dealers and municipal securities dealers (collectively "dealers") about the requirements of MSRB Rule G-14, on transaction reporting. This document also describes services provided by the MSRB designed to assist dealers in complying with Rule G-14.

Transactions reported to the MSRB under Rule G-14 are made available to the NASD and other regulators for their market surveillance and enforcement activities. The MSRB also makes public price information on municipal securities transactions using data reported by dealers. One product is the Daily Report of Frequently Traded Securities ("Daily Report") that is made available to subscribers each morning by 7:00 am. Currently, it includes details of transactions in municipal securities issues that were "frequently traded" the previous business day.<sup>1</sup> The Daily Report is one of the primary public sources of municipal securities price information and is used by a variety of industry participants to evaluate municipal securities.<sup>2</sup>

Dealers can monitor their municipal transaction reporting compliance in several ways. For customer and inter-dealer transaction reporting, the MSRB Dealer Feedback System ("DFS") provides monthly statistical information on transactions reported by a dealer to the MSRB and information about individual transactions reported by a dealer to the MSRB. For daily feedback on customer trades reported, the MSRB provides dealers a "customer report edit register" on the day after trades were submitted. This product indicates trades successfully submitted and those that contained errors or possible errors.<sup>3</sup> For inter-dealer transactions, National Securities Clearing Corporation ("NSCC") provides to its members daily files, sometimes called "contract sheets," that can be used to check the content and status of the transactions the member has submitted.

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1 The Daily Report is available by subscription at no cost. Currently, "frequently traded" securities are those that traded two or more times during a trading day. As noted below, inter-dealer transactions must be compared on trade date to be eligible for this report.

2 The MSRB also publishes a "Daily Comprehensive Report," providing details of all municipal securities transactions that were effected during the trading day one week earlier. The Daily Comprehensive Report is available by subscription for \$2,000 per year. Along with trades in issues that are not "frequently traded," this report includes transactions reported to the MSRB late, inter-dealer trades compared after trade date, and transaction data corrected by dealers after trade date.

3 A dealer may call the MSRB at (703) 797-6600 and ask to speak with a Transaction Reporting Assistant who can check to see if its firm is signed up for this free service.

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## Inter-Dealer Transactions

Even before Rule G-14 imposed requirements for transaction reporting, MSRB Rule G-12(f), on use of automated comparison, clearance and settlement systems, required dealers to submit data on their inter-dealer transactions in municipal securities to a registered clearing agency for automated comparison on trade date ("T"). NSCC provides the automated comparison services for transactions in municipal securities. The same inter-dealer trade record dealers submit to NSCC for comparison also is used to satisfy the requirements of MSRB Rule G-14 to report inter-dealer transactions to the MSRB. NSCC forwards the transaction data it receives from dealers to the MSRB so that dealers do not have to send a separate record to the MSRB. However, satisfying the requirements for successful trade comparison under Rule G-12(f) does not, by itself, necessarily satisfy a dealer's Rule G-14 transaction reporting requirements. In addition to the trade information necessary for a successful trade comparison, Rule G-14 requires dealers to submit accrued interest, time of trade (in military format) and the effecting brokers' (both buy and sell side) four-letter identifiers, also known as executing broker symbols ("EBS"). Failure to include accrued interest, time of trade and EBS when submitting transaction information to NSCC's automated comparison system is a violation of MSRB Rule G-14 on transaction reporting even though the trade may compare on T.

As noted above, the MSRB provides dealers with statistical measures of compliance with some important aspects of MSRB Rules G-12 and G-14 through its Dealer Feedback System.<sup>4</sup> The statistics available for inter-dealer trades include:

**Late or Stamped** – The frequency with which a dealer causes an inter-dealer trade not to compare on trade date is reflected in the "late or stamped" statistic. Trades that do not compare on trade date are ineligible for the Daily Report. The statistic is an indication of how often a dealer submits a trade late or stamps its contra-party's advisory, and is expressed as a percentage of the dealer's total compared trades. Because this statistic includes both "when, as and if issued" and regular-way trades, it provides a comprehensive analysis of the timeliness with which a dealer reports its trades.

**Invalid Time of Trade** – This statistic reflects the total number of trade records submitted by a dealer in which the time of trade is null or not within the hours of 0600 to 2100. Accurate times of trade are essential to regulatory surveillance because they provide an audit trail of trading activity.

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<sup>4</sup> A complete description of the service is available at [www.msrb.org](http://www.msrb.org) in the Municipal Price Reporting / Transaction Reporting System section. NASD also has informed dealers of this service in "Municipal Transaction Reporting Compliance Information," *Regulatory & Compliance Alert* (Summer 2002).

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**Uncompared Input** – A high percentage of uncompared trades may indicate that a dealer is submitting duplicative trade information, inaccurate information, or is erroneously submitting buy-side reports against syndicate takedowns.<sup>5</sup> The uncompared input statistic reflects trade records that a dealer inputs for comparison that never compare and are expressed as a percentage of a dealer's total number of compared trades.

It is a violation of Rule G-14 to submit trade reports that do not accurately represent trades. Moreover, Rule G-12(f) requires that dealers follow-up on inter-dealer trade submissions that do not compare in the initial trade cycle by using the post-original comparison procedures at NSCC. Trade reports made to MSRB and NSCC that never compare are a concern because they either represent inaccurate trade input or indicate that the dealer is not following-up on uncompared trades using the post-original comparison procedures provided by NSCC.

**Compared but Deleted or Withheld** – This statistic represents deleted or withheld trade records and is a percentage of all compared trade records. Compared trade records that are subsequently deleted or withheld are a concern because these trades may have previously appeared on the Daily Report. While it is sometimes necessary to correct erroneous trade submissions using delete or withhold procedures, this will be an infrequent occurrence if proper attention is paid to transaction reporting procedures. Dealers that have a high percentage of such trades should review their procedures to determine why transaction data is being entered inaccurately.

**Executing Broker Symbol (EBS) Statistics** – These statistics indicate the percentage of trade submissions for which the field identifying the dealer that effected the trade is either empty or contains an invalid entry. These statistics are compiled for every member of NSCC.<sup>6</sup> It provides information on three types of EBS errors: 1) null EBS, where a dealer left the EBS field blank; 2) numeric EBS, where a dealer entered a number in the EBS field; and 3) unknown EBS, where a dealer populated the EBS field with a symbol that is not a valid NASD-assigned EBS. A large number of EBS errors may indicate that both clearing firm and correspondent dealer reporting procedures and/or software need to be reviewed to ensure that the EBS is entered correctly and does not “drop out” of the data during the submission process. The compatibility of correspondent dealer and clearing broker reporting systems also may need to be examined.

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5 Under NSCC procedures, no buy-side trade report should be submitted for comparison against a syndicate “takedown” trade submitted by the syndicate manager. Syndicate transactions are “one-sided submissions” and compare automatically after being submitted by the syndicate manager. Paragraph (a) (ii) of Rule G-14 procedures thus requires that only the syndicate manager submit the trade.

6 The EBS statistics reflect the aggregate number of such errors found in transaction data submitted by a particular NSCC member firm for itself and/or for its correspondents. This statistic cannot be generated individually for each correspondent because the EBS needed to identify the correspondent is itself missing or invalid. EBS statistics only measure the validity of the input the submitter provides to identify its own side of the trade and do not measure the accuracy with which a dealer uses EBSs to identify its contra-parties.

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## Note on Stamped Advisories

Firms often stamp advisories on T+1 after failing to submit accurate inter-dealer transaction information on trade date. A stamped advisory essentially is a message sent through the NSCC comparison system by the clearing firm on one side of a trade indicating that it agrees with the trade details submitted by the contra party.

A significant percentage of stamped advisories is a concern for two reasons. First, trades compared via a stamped advisory cannot be published in the Daily Report because they do not compare on trade date. Second, unless the dealer stamping the advisory verifies every data element submitted by the contra party (including accrued interest, time of trade and EBS) stamping the advisory may effectively confirm erroneous data about the trade, which will be included in the surveillance data provided to market regulators. With particular respect to EBS, both the MSRB and the NASD have observed that dealers do not always include accurate contra parties' EBSs in transaction reports. As a result, when a firm "stamps" a contra party's submission, its own EBS may not be correctly included in the transaction report sent to the MSRB.

In lieu of stamping an advisory, it is possible for a dealer to submit an "as of" trade record to match an advisory pending against it. This serves the same purpose as stamping an advisory but in addition allows the dealer to input its own EBS (and other data elements) and thus ensure the accuracy of the information about its side of the trade. While the trade will still be reported late, the data about the trade will be more likely to be correct.

## Note on Clearing Broker-Correspondent Issues

While Rule G-14 notes that accurate and timely transaction reporting is primarily a responsibility of the firm that effected a trade, it also notes that a firm may use an agent or intermediary to submit trade information on its behalf. For inter-dealer trades, a direct member of NSCC must be used to input transaction data if the dealer effecting the transaction is not itself a direct member. This Rule G-14 requirement that a clearing broker and correspondent work together to submit transaction reporting data in a timely and accurate manner is the same as exists in Rule G-12(f) on inter-dealer comparison.

Where there is a clearing-correspondent relationship between dealers, timely and accurate submission of trade data to NSCC generally requires specific action by both the direct member of NSCC (who clears the trade) as well as the correspondent firm. The MSRB has noted that the responsibility for proper trade submission is shared between the correspondent and its clearing broker.<sup>7</sup> Clearing brokers, their

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7 In 1994, the MSRB stated that, "introducing brokers share the responsibility for complying with [Rule G-12(f)] with their clearing brokers. Introducing brokers who fail to submit transaction information in a timely and accurate manner could subject either or both parties to enforcement action for violating [Rule G-12(f)]." See "Enforcement Initiative," *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 35. NASD has since reiterated this policy; see the following articles in *Regulatory & Compliance Alert*: "Introducing Firm Responsibility When Reporting Municipal Trades Through Service Bureaus and Clearing Firms" (Winter 2000) and "Municipal Securities Transaction Reporting Compliance Information" (Spring 2001).

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correspondents and their contra-parties all have a responsibility to work together to resolve inaccurate or untimely information on transactions in municipal securities. A clearing firm's use of a large number of stamped advisories may indicate systemic problems with the clearing broker's procedures, the correspondents' procedures, or both.<sup>8</sup>

## Customer Transactions

Dealers that engage in municipal securities transactions with customers also are required to submit accurate and complete trade information to the MSRB by midnight of trade date under Rule G-14. MSRB customer transaction reporting requirements include the reporting of time of trade and the dealer's EBS for each trade.

Dealers have flexibility in the way they report customer transactions to the MSRB Transaction Reporting System. The three options available allow dealers to: 1) transmit customer transaction data directly to NSCC, which, using its communications line with MSRB, forwards trade data to the MSRB the evening on which it is received; 2) send the data via an intermediary, such as a clearing broker or service bureau, to NSCC, which forwards the data to the MSRB; or 3) submit the data directly to the MSRB using a PC dial-up connection and software provided by the MSRB.

The MSRB Dealer Feedback System also provides dealers with performance statistics for customer trade reporting. These statistics include:

**Ineligible** – This statistic reflects the percentage of a dealer's initial customer trade records that were ineligible for the Daily Report, because either the trade reports were submitted after trade date or they contained some other dealer error that caused it to be rejected by the MSRB Transaction Reporting System.

**Late** – Initial customer trade records that were submitted after trade date are indicated in this statistic and are a subset of ineligible trades. This percentage is reported separately because late reporting is the most common reason for trade records to be ineligible for the Daily Report.

**Cancelled** – This is the percentage of a dealer's initial customer trade records that were cancelled by the dealer after initial submission. Cancelled trades are a cause for concern because the data in the trade record submitted prior to cancellation may have already been included in the Daily Report.

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<sup>8</sup> As explained above, one of the problems often associated with stamped advisories is that the EBS on transaction records may be missing or inaccurate. Since a clearing broker may have many correspondents, stamping an advisory can make it impossible for market regulators to know which correspondent actually effected the trade.



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**Amended** – This is the percentage of a dealer’s initial customer trade records that were amended by the dealer after initial submission. Amended trades are a cause for concern because the data in the trade record may have already been included in the Daily Report. While it is important that customer trades be immediately amended if any of the required information was incorrectly reported, dealers sometimes amend customer trade records unnecessarily. If trade details solely for internal dealer recordkeeping or delivery are changed, the dealer should ensure that its processing systems do not automatically send MSRB an “amend” record. For example, if a transaction is reported correctly to the MSRB on trade date, the dealer should not amend the transaction (or cancel and resubmit another transaction record to the MSRB) simply because customer account numbers or allocation and delivery information is added or changed in the dealer’s own records.<sup>9</sup>

Amendments to change settlement dates for when-issued transaction also are generally unnecessary. Since MSRB monitors settlement dates for new issues through other sources, dealers should not send amended trade records merely because the settlement date becomes known. Dealers may find that their automated systems are sending amended trade records to the MSRB in these cases, even though amendments are unneeded.

Attention to these areas could greatly reduce the number of amendments sent to MSRB by some dealers.

**Invalid Time of Trade** – This statistic reflects the total number of trade records submitted by a dealer in which the time of trade is null or not within the hours of 0600 to 2100. Accurate times of trade are essential to regulatory surveillance as they provide an audit trail of trading activity.

## Questions / Further Information

Questions about this notice may be directed to staff at either MSRB or NASD. At MSRB, contact P. John Baughman, Senior Data Analyst, or Justin R. Pica, Uniform Practice Specialist, at (703) 797-6600. At NASD’s Department of Member Regulation, contact Malcolm Northam, Director, Fixed Income Securities, at (202) 728-8085, or Cynthia Friedlander, Regulatory Specialist, at (202) 728-8133. For more information on transaction reporting, including questions and answers and the customer transaction reporting system user guide, or to sign up for the Dealer Feedback System, we encourage dealers to visit the MSRB Web site at [www.msrb.org](http://www.msrb.org), particularly the Municipal Price Reporting / Transaction Reporting System section.

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<sup>9</sup> Of course, if the initial information reported to the MSRB, such as total par value, is changed, the trade record must be amended to make it correct.