



Route to:

- Manager, Muni Dept.
- Underwriting
- Trading
- Sales
- Operations
- Public Finance
- Compliance
- Training
- Other _____

**Continuing Disclosure Information/
Electronic Submission System**

Facility Filed

The Board has filed with the SEC a plan for an electronic system for the collection and dissemination of official disclosures about municipal securities issues in the secondary market. The proposed system would:

- accept disclosures voluntarily made by issuers and trustees in specified electronic formats;
- electronically disseminate those disclosures to all system subscribers simultaneously, within minutes after the disclosure is released by the issuer or trustee; and
- recoup the operational costs of the system from fees paid by subscribers.

On June 22, 1990, the Board filed with the Securities and Exchange Commission a proposed facility to accept and to disseminate disclosures made by issuers and trustees concerning municipal securities issues in the secondary market. The proposed system is called the "CONTINUING DISCLOSURE INFORMATION/ELECTRONIC SUBMISSION" system (the "CDI/ES system").¹ The facility will not be operational until it is approved by the Commission. The Board requested that the Commission approve the proposed rule change by October 1, 1990, at which time the Board believes that the system can be ready for operation. The request for approval by this date is based on the Board's observation of problems relating to investor protection which currently exist because of the unavailability of certain types of disclosure information in the

market. The Board believes that the proposed facility will help to address those problems.

Background

In the course of its rulemaking activities, the Board has observed a critical need for improved access to information about municipal securities bought and sold in the secondary market. In particular, the Board has observed that market participants often do not have access to official disclosure documents that have been prepared by issuers and trustees during the life of the an issue ("Continuing Disclosure Information" or "CDI").

Examples of CDI include periodic financial reports prepared by issuers, reflecting the credit quality of the issuer's outstanding securities. Other types of CDI may be provided by the trustee for an issue. The security for many outstanding issues is structured around revenue from specific sources or specific assets (e.g., a hospital, a retirement center, a housing project). Trustees for these "structured" issues sometimes generate CDI in the form of notices or reports which relate to the financial status of these issues and the likelihood of the issue defaulting or being redeemed early.

Board rules require dealers to explain to a potential customer all material facts about a proposed transaction,² to recommend the transaction to the customer only if it is suitable for the customer,³ and to price the transaction correctly.⁴ These requirements are for the protection of customers and are similar or identical to the requirements placed on dealers in other securities markets. It has become apparent to the Board that, in today's market, access to CDI is necessary for dealers to determine the material facts about a transaction, to determine if

Questions about this notice may be directed to
Harold L. Johnson, Deputy General Counsel.

¹ SEC File No. SR-MSRB-90-4. Comments filed with the Commission should refer to the file number and should be addressed to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 5th Street, N.W., Washington, D.C. 20549.

² Rule G-17.

³ Rule G-19.

⁴ Rule G-30.

a transaction is suitable for a specific customer, and to price the transaction correctly. The Board believes that, in many cases, lack of ready access to CDI is preventing dealers from fully satisfying their investor protection obligations under Board rules.

As an example of a typical problem, trustees currently produce notices, sometimes called "pre-default" notices, which are designed to inform bondholders of certain facts that are within the direct knowledge of the trustee, e.g., that a reserve fund has been invaded by the trustee. The events described in these notices, once known by the market, may significantly affect the price of the issue. However, the notices often are made available exclusively to bondholders, providing an opportunity for bondholders to sell the securities before the information reaches the market. The market may not become aware of the existence of the notices until weeks or even months after the trustee has provided the information to bondholders. Dealers who are buying and selling the securities during this time may not be providing their customers with the full disclosures required by Board rules. Similar situations may occur when an issuer makes known its intent to pre-refund one of its outstanding issues.

ABA Activities

In August 1989, the Board wrote the American Bankers Association (ABA) regarding the Board's market regulation concerns stemming from trustee disclosure practices. In October 1989, representatives of the ABA informed the Board that their organization was engaged in efforts to establish voluntary guidelines for trustee disclosure. The ABA noted the need for a central repository to accept trustee disclosure notices and to provide the notices to the market. In January 1990, the Board stated that providing this capability would be an immediate priority for the Board. The ABA continued its work on guidelines for trustees and, in May 1990, Board representatives attended an ABA-sponsored drafting meeting on the guidelines. These meetings included representatives from a number of issuer groups, the National Association of Bond Lawyers (NABL), the Public Securities Association, rating agencies, and other groups. After considering comments offered at this meeting, the ABA, in June 1990, released "Proposed Disclosure Guidelines for Corporate Trustees," for comment (ABA Draft Guidelines).⁵

The ABA Draft Guidelines are designed to assist trustees in determining the content and timing of various types of disclosures on a voluntary basis. The intent of the Draft Guidelines is to ensure that appropriate disclosure notices are made available to the entire market. The Draft Guidelines state that the establishment of a central repository to receive CDI should be mandated by legislative or regulatory action.

Need for Central Repository of CDI

As noted above, the Board believes that improved access to CDI is necessary so that dealers can comply with the Board's investor protection rules. In addition, the Board believes that this will enhance the integrity and efficiency of the market. Lack of access to CDI not only creates problems in specific transactions, but also creates general inefficiency in the market. Market participants who are aware that their transactions may be based on incomplete or erroneous information necessarily take that fact into account when making bids and offers on municipal securities, thereby eroding the accurate pricing of those securities and the general efficiency of the market.

Finally, the Board believes that the existence of a central repository for CDI, by providing a neutral, fair and timely dissemination mechanism for disclosure information, would not only increase the availability of the CDI currently produced, but also would spur voluntary efforts in the municipal securities market to improve the content and timing of CDI. As evidenced by the ABA efforts, the existence of a central repository, which provides a neutral, fair and timely dissemination mechanism for disclosure information, will encourage production of CDI by issuers and trustees and will facilitate voluntary efforts to address the information problems that continue to exist in the municipal securities market.

CDI/ES System

Based upon the considerations above, the Board has determined that it should establish a central facility to accept voluntary submissions of CDI from issuers and trustees and to provide those disclosures to any interested party in a manner that will ensure accurate, quick and fair access. Because CDI may have an immediate effect on the market price of securities, the Board believes that it is important for a system to exist which can disseminate information within minutes of its receipt. In addition, it is important for any system operated by the Board to provide total accuracy in reproducing information. These requirements have led the Board to conclude that a system for electronic submission and dissemination of the CDI is required. The Board therefore is proposing to establish and operate the CDI/ES system to accomplish these objectives.

Relationship to MSIL System

The Board plans to operate the CDI/ES system as part of the Board's planned MUNICIPAL SECURITIES INFORMATION LIBRARY™, or MSIL™, system.⁶ The MSIL system includes the OFFICIAL STATEMENT/ADVANCE REFUNDING DOCUMENT system (OS/ARD system).⁷ The OS/ARD system will accept and electronically record paper copies of official statements and advance refunding documents. The OS/ARD system will

⁵ The ABA Draft Guidelines are reprinted on pages 31 through 34 of this issue.

⁶ MUNICIPAL SECURITIES INFORMATION LIBRARY and MSIL are trademarks of the Board. The MSIL system was filed with the Commission on June 22, 1990 (File No. SR-MSRB-90-2).

⁷ The Board's general plan for the MSIL system and the OS/ARD system is discussed on pages 7 through 14 of this issue.

disseminate those documents electronically and on paper, with the purpose of increasing the availability of descriptive information on municipal securities issues. The CDI/ES system will accept only electronic submissions. The Board later may develop plans to accept paper submissions of certain types of CDI or electronic submissions of official statements and advance refunding documents.

CDI will be offered from the CDI/ES system only in electronic format because of the time-sensitive nature of the documents. The Board expects that private information vendors will be actively engaged in disseminating CDI obtained from the CDI/ES system and that these information vendors will provide individual market participants and end users with a variety of services, including services which convert CDI to paper form for end users.

The following is an explanation of the operation of the CDI/ES system.

Use of System to Make Disclosures

Any use of the CDI/ES system would be completely voluntary on the part of the information provider. During the initial operations phase, input to the CDI/ES system would be limited to issuers and trustees (CDI providers). If parties other than issuers or trustees seek to become CDI providers, the Board will consider the appropriate policies and procedures to determine whether such sources are authorized by the issuer of the securities to provide official documents with respect to an issue.

Prior to accepting CDI from any source, CDI/ES personnel will establish a CDI provider file which includes the name of the organization, the person or persons responsible for the CDI and certain other information, including telephone numbers of the responsible persons. Procedures followed by CDI/ES personnel will ensure that any person seeking to establish a CDI provider file, in fact, does represent an issuer or trustee of municipal securities issues.

Once the authenticity of the CDI provider is established, a file will be created in the CDI/ES system for that information provider. The CDI provider will be given a password and telephone number that will allow access to the input side of the CDI/ES system. The CDI provider then can input information using established input procedures. Use of CDI/ES to input information will, as described below, require the CDI/ES provider to have access to a personal computer, modem and certain software. CDI/ES personnel will work with the CDI provider to ensure that the system can be readily used.

There would be no charge to issuers or trustees to use the CDI/ES system to make disclosures. As discussed below, the Board will assess fees from persons receiving information from the system.

In its initial operations phase, the CDI/ES system will accept short (one to three pages) textual disclosure documents (disclosure notices) that may be of immediate interest to the market. An example would be an issuer's intent to pre-refund an issue. The system also is being designed to accept standardized

electronic files of information as may be generated by commercially available electronic spreadsheet programs (electronic files). This capability may be added during the initial operations phase. An issuer's financial reports, for example, may be put in this form. The technical specifications and certain other format standards for electronic files would have to be established prior to incorporation in the system. This would be necessary to ensure that the system can process the files accurately and to ensure that recipients of the files are able to use them properly. The Board will work with issuers, trustees and their organizations to arrive at formats of electronic files that can be accepted and disseminated by the CDI/ES system. The Board will focus on inclusion of electronic files that meet uniform formats arrived at by issuer and trustee organizations.

Bank trustees would be able to use the system to disseminate disclosure notices that market participants sometimes refer to as "pre-default notices." By disseminating the notices through the proposed CDI/ES system, trustees will be able to ensure that all market participants have equal access to the same information at the same time and reduce the possibility that their release of information will cause inequities in the market.

After the initial operations phase, the Board also may expand the system to incorporate longer, more complex textual documents, which include charts and tables and images. Analysis and development of this system enhancement will proceed during the initial operations phase.

Input Procedures

The CDI/ES input procedures provide that CDI will be "echoed back" to the CDI provider to verify that the information received is an exact electronic copy of the information which an authorized CDI provider wishes to disseminate. The planned input procedures are described below.

- The CDI provider enters the CDI into a personal computer at the CDI provider's office. The CDI provider will use special, public domain software (provided by the Board free or at nominal cost) to convert the notice into an electronic format that can be accepted and disseminated by the system. The software will prompt the CDI provider to include information with the notice which identifies the CDI provider and the issue to which the CDI relates. This will include CUSIP numbers. Using a commercially available computer modem (approximate cost \$200 to \$500), the CDI provider dials the CDI/ES input telephone number, enters a password or personal identifying number, and sends the disclosure notice to the CDI/ES system. A two page notice should take several seconds to send. (The modem need not be dedicated to CDI/ES use.)
- CDI/ES system personnel receive the CDI over a personal computer, index the CDI, and assign a unique control number to it. The CDI is then printed out in hard copy form, with the identifying information and control number printed on it.
- CDI/ES system personnel telefax the hard-copy notice, with

control number, to a telefax number which the CDI provider previously has provided and which is contained in the CDI provider file. (This and the preceding step may be further automated by use of the modem to "echo back" the CDI to the CDI provider.)

- The CDI provider reviews the telefaxed CDI. If the notice is correct, the CDI provider uses the modem to provide the control number and his password.
- Upon receipt of the control number from the CDI provider, CDI/ES personnel have established that the CDI came from a legitimate source, is an accurate copy of the CDI which the provider intended to release, and is ready for dissemination. CDI/ES personnel then release the CDI to the output side of the system, where it is immediately ready for electronic dissemination to persons who have requested this service. The system will be designed so that the time period between authorization of release and dissemination is a maximum of a few minutes.

Dissemination of Information

The Board will operate the output side of the CDI/ES system to ensure that the information is available in a fair and non-discriminatory manner to all interested parties who wish to subscribe to the service. This service will be provided via a modem-to-modem telephone link with the subscriber. It is anticipated that the time-critical nature of the information will require subscribers to have dedicated telephone lines and modems at the CDI/ES facility to ensure immediate receipt of information. CDI would be sent simultaneously to each subscriber. As with all MSIL system services, this service would be available, on equal terms, to any party who requests it.

The Board believes that the parties interested in subscribing to the CDI/ES service will include information vendors who wish to resell the CDI through their own distribution networks. The Board also is looking at means to ensure that CDI/ES information is made available on computer network services that serve the general public as well as through information vendors specializing in the municipal securities market.

CDI will be stored by the CDI/ES system for three months. This will accommodate subscribers who may have missed transmission of the data due to technical problems. The Board also intends to index and archive the notices in the MSIL system for the life of the issue.

The CDI/ES system will be available to accept and disseminate CDI on business days on which the Board's offices are open (generally all business days except for federal holidays). The hours of operation will be from 9:00 a.m. Eastern Time until 4:30 p.m. Eastern Time.

Principles for Operation of the CDI/ES System

In August 1989, the Board announced the guiding principles for design and operation of a repository of official statements

and advance refunding documents.⁸ The Board will operate the CDI/ES system consistent with those guiding principles, as made applicable to CDI. The guiding principles for the CDI/ES system are:

1. The purpose of the CDI/ES system is to collect, electronically store and disseminate CDI for municipal securities issues to improve accessibility of information about municipal securities.
2. The CDI/ES system will be planned and operated in a manner that will provide equal access to documents to any interested person in a non-discriminatory manner, in a manner that will not confer special or unfair economic benefit to any person, and in a cost-effective manner supported by a combination of Board funds and user fees.
3. The Board will encourage and facilitate the development of information dissemination services by private vendors, but the CDI/ES system will be planned and operated in a manner to preserve its flexibility to meet additional information needs, beyond electronic dissemination of CDI, when there is a clear and continuing failure by private sector information sources to provide information that is essential to the integrity and efficiency of the market.
4. The CDI/ES system will be planned and operated in a manner to ensure as much flexibility as possible in adjusting to changes in technology of document storage and dissemination and to changes in disclosure practices in the market.

In addition, the Board's operation of the facility will be subject to several important legal and policy constraints:

1. The Board has no statutory authority to regulate the content of disclosure by municipal securities issuers or trustees or to require these parties to submit CDI to the system.
2. The CDI/ES system will not alter the substance of the CDI received or summarize the submissions.
3. The CDI/ES system will not store or transmit documents in any way that would be likely to introduce errors into the data.

Costs and Fees for Use of the System

Although Board funds will be expended to initiate the project, the Board intends that the operational costs of the CDI/ES system ultimately will be supported entirely from yearly subscription fees paid by persons who receive information from the system. The Board anticipates that operational costs will be in the range of \$100,000 per year or less. The Board plans to begin with an annual subscription fee of \$5,000 and to review costs and fees annually thereafter. The Board does not intend or expect to operate the CDI/ES system to generate net revenues for the Board. During its annual review of fees, the Board will adjust subscription fees in accordance with this principle.

July 2, 1990

⁸ *MSRB Reports*, Vol. 9, No. 2 (August 1989), at 3.