**Joint Recommendations for Communicating with the Beneficial Owners of Defaulted Municipal Securities**

American Bankers Association  
Government Finance Officers Association  
National Association of Bond Lawyers  
National Association of State Auditors, Comptrollers &Treasurers  
National Federation of Municipal Analysts  
The Bond Market Association

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After several years of study and negotiation, the organizations listed above, in consultation with The Depository Trust Company, have developed and approved for adoption by their associations and the market generally the attached "Joint Recommendations for Communicating with Beneficial Owners of Defaulted Municipal Securities." While the document itself gives background and explanation, the groups want to highlight that this effort is the result of initiative on the part of the groups to improve current market practices voluntarily and without federal regulation.

The Joint Recommendations provide practical advice to issuers, their counsel, nominee holders, and agents of issuers on how to get notices on defaults through to beneficial owners in the era of book-entry-only bonds. They provide procedures for issuer control of the communications process and make recommendations about the format of notices, the payment of reasonable expenses by the issuer, and the provision of notices by the issuer for retransmission through the chain of nominee holders. This is intended for use in the case of defaults but may prove instructive in the case of other notices as well.

These organizations are publicly releasing this document so that issuer and other organizations and regulatory bodies can be informed of their recommendations. It is hoped others will see the benefits of these recommendations and adopt the practices recommended.

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**JOINT RECOMMENDATIONS FOR COMMUNICATING**

**WITH THE BENEFICIAL OWNERS OF DEFAULTED MUNICIPAL SECURITIES**

**Introduction**

This paper has been prepared by a working group composed of representatives of the National Association of Bond Lawyers; The Bond Market Association;***1*** the American Bankers Association; the Government Finance Officers Association; the National Association of State Auditors, Comptrollers and Treasurers; and the National Federation of Municipal Analysts.***2*** In addition, this paper has been reviewed by representatives of The Depository Trust Company (commonly known as DTC), who have provided information to the working group regarding the operations and purposes of DTC.***3*** The working group has been meeting informally, beginning in 1994, to discuss ways to facilitate the process of communicating with the beneficial owners of defaulted***4*** municipal securities.***5***

The participating groups believe that if the recommendations proposed herein are consistently followed, beneficial owners of defaulted municipal securities will receive notices***6*** from issuers*7* and others on a timely basis.***8*** Following these recommendations will preserve for all of the groups involved in the municipal market the benefits of the book-entry system.

These uniform practices are intended to set forth procedures that will assist issuers in contacting beneficial owners of defaulted securities to transmit and obtain important and time-sensitive information.***9*** They are not intended to create any new substantive disclosure obligations, nor are they intended to create new obligations for nominees to review, disclose, and/or transmit any notices which they may receive through any Nationally Recognized Municipal Securities Information Repository ("NRMSIR"), State Information Depository ("SID"), or the DTC computerized Legal Notice System (the "LENS" system).***10*** The procedures provide for issuer control of the communication proess;***11*** recommendations for format and identifying information to be included in notices; the payment of reasonable expenses by the issuer, as is the practice in the private sector; and the provision of additional copies of notices by the issuer for retransmission. Also included are recommendations that market participants who serve as nominees respond to issuer requests for information about bondholders and/or retransmit information from issuers to beneficial owners in a timely fashion.

**Background**

In the 15-year period since the effective elimination of bearer bonds from municipal finance,***12*** the municipal bond industry has also virtually eliminated direct holding and physical delivery of new municipal securities issues. This has been accomplished largely through the use of immobilized certificates registered in the names of securities depositories.***13*** The largest of the depositories is DTC.

As a result of the relatively recent development of the DTC book-entry system, not all of the consequences of the book-entry system have been addressed in a systematic way by market participants. For example, most indentures***14*** and resolutions relating to municipal securities still contain elaborate provisions relating to the registration of ownership of securities, the transfer of ownership, giving notice to registered security holders, and voting by registered holders that do not take into account in any meaningful way the existence of the DTC book-entry system.***15*** Under most legal documents related to municipal securities, notices are only required to be given to the registered holder, who for most purposes is the legal owner of the securities.***16***

The lack of extensive experience in dealing with the book-entry system results in a dearth of customs and practices dictating the proper actions to be taken by market participants to assure that important notices intended for the beneficial owners of securities held through the book-entry system are actually received by the intended recipients. Further, the absence of uniform practice in this area has produced the anomalous result that potential purchasers of securities -- non-owners -- may be more likely to receive information regarding defaulted municipal securities***17*** than the average beneficial owner of an issue who holds through a nominee. The purpose of this paper is to address some of these issues.

**Recommended Uniform Practices**

***General***

The participating groups believe that the recommended uniform practices set forth below are appropriate to improve the handling of notices related to defaulted municipal securities. These recommended uniform practices have been prepared after extensive discussions that explored the importance of communications related to defaulted municipal securities as well as the operational constraints affecting firms responsible for transmitting notices to beneficial owners. It is believed that most of these recommended uniform practices are usually implemented by many market participants with respect to defaulted municipal securities; however, it is the belief of the participating groups that consistent application of these recommendations by all market participants will assure that beneficial owners receive notices related to defaulted municipal securities, which will benefit all market participants. These recommendations should be implemented with respect to all defaulted municipal securities, but it may be practical to implement some of the recommendations only with respect to municipal securities issued under documents that are amended or originally prepared after the date of this paper.

***Issuer Practices***

Dealing with municipal securities that are held exclusively through the book-entry system requires some specific changes to the documentation related to the securities. In particular, the bond documents should direct the issuer (either directly or through its agent) to :***18***

(i) request as promptly as possible a securities position listing ("SPL") from DTC’s Proxy Department***19*** as of the record date***20*** for mailing of the security holder notice;

(ii) mail copies of the notice in the format recommended below to each of the DTC participants listed on the SPL, and to each other nominee identified to the issuer;

(iii) request from each nominee other than DTC an undertaking to retransmit the notice to all persons for which it serves as nominee, including nonobjecting beneficial owners,***21*** or such an undertaking with respect to objecting beneficial owners and a list of all nonobjecting beneficial owners;***22***

(iv) provide an undertaking of the issuer to pay to the nominee other than DTC the reasonable costs***23*** of transmitting the notice to persons for whom the participant acts as nominee, including the nonobjecting beneficial owners if the nominee has notified the issuer that it will mail the notice to nonobjecting beneficial owners in lieu of providing the listing requested;

(v) provide to each nominee other than DTC the requested number of copies of each notice for retransmission; and

(vi) mail a copy of the notice directly to each beneficial owner identified to the issuer.***24***

Issuers’ bond documents should permit individual beneficial owners to identify themselves to the issuer for purposes of also receiving direct mailings of notices. Bond documents should also explicitly require that the form of any notice with respect to the securities follow that set forth below.

***Notice Format and Transmission25***

The form of any notice to be filed with DTC with respect to defaulted municipal securities should prominently include in the title block, separate from the body of the notice, the following items:

(i) the complete title of the securities,

(ii) the complete name of the issuer and of any conduit borrower,

(iii) the entire nine-digit CUSIP number for each affected maturity,***26***

(iv) the record date, if any, for the notice, and

(v) a summary of no more than 500 characters of the subject of the notice, including a statement that the notice relates to defaulted municipal securities.

The bond documents should specify the notice address for DTC.***27*** Issuers are strongly encouraged to provide copies of the notices on diskette in ASCII format as well as paper copies to DTC’s Proxy Department in order to facilitate retransmission of notices. The participating groups believe that following the recommended form for notice and transmission practices for all notices to the extent feasible, whether or not so provided in the bond documents (in many cases bond documents will pre-date these recommendations), will facilitate their handling by DTC. In addition, even if filing of the notice with the NRMSIRs and SID is not required under Rule 15c2-12, the participating groups strongly recommend that issuers file notices with respect to defaulted municipal securities with the NRMSIRs and the relevant SID, if any.

***Disclosure Regarding Notice Transmission***

Issuers also should consider adding to the section of an official statement that contains disclosure regarding the book-entry registration system a discussion of steps that beneficial owners can take to augment their receipt of notices related to the municipal securities.***28***

While these changes to the legal documentation (or the implementation, to the extent feasible, of similar procedures in the case of security issues already outstanding) should help to assure that the notices reach the DTC participants and beneficial owners without imposing unreasonable cost burdens on the participants or DTC, the ability of the issuer to further affect the notice delivery process is very limited.

***Nominee Practices***

Firms that hold nominee positions***29*** in municipal securities should make reasonable efforts, upon receipt of an undertaking for reimbursement of reasonable costs, to transmit notices related to those municipal securities to the person for whom the nominee firm holds, whether that is another brokerage or bank, a mutual fund, or an individual owner. Nominees should make known***30*** the name and contact information***31*** of the person in their organization to whom notices concerning municipal securities should be directed. Persons who are designated by nominees to serve as contacts should have adequate training and resources available to them to assure that notices that are received can be promptly***32*** retransmitted to the person for whose benefit the nominee serves as the registered holder of the securities. In addition, reasonable assistance must be provided to issuers who are seeking to contact the beneficial owners of their security issues. That assistance includes responding promptly to requests for nonobjecting beneficial owner lists,***33*** and to requests for information concerning the numbers of copies of notices to be provided to the nominee for remailing to the objecting beneficial owners by the nominee. The participating groups strongly recommend that nominees, wherever they may be in the chain of title of a security, upon receipt of reasonable assurance of reimbursement for their costs, either

(i) provide a list of nonobjecting beneficial owners to the issuer, and retransmit the furnished notices to the objecting beneficial owners, or

(ii) retransmit to the appropriate parties such notices or communications promptly upon receipt.

**Conclusion**

The participating groups believe that issuers and nominees can improve the notice distribution process by adhering to these recommendations. The recommendations set forth in this paper will assist market participants in communicating information to beneficial owners regarding defaulted municipal securities.

APPENDIX A

THE DEPOSITORY TRUST COMPANY

DTC is a limited-purpose trust company organized under New York banking law, and acts as a clearing corporation for trades in the securities industry.***34*** It was originally organized in the late 1960s to address the back office crisis in paper work related to the booming stock market.***35*** It is owned by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., the National Association of Securities Dealers, Inc., and its other participants and supported by fees charged to participants for its services provided to issuers and participants. The participants in DTC are firms involved in the securities industry, such as securities brokers and dealers, banks, trust companies, and clearing corporations.

Under the DTC book-entry system for securities, which is used for both municipal and other securities, an issuer of securities directs the registrar for the security issue to register the entire issue in the name of the nominee***36*** of DTC, and not to permit others to become registered holders of the securities. DTC then maintains records of the participants for whom it holds the securities that are registered in the name of its nominee. The participants in turn typically hold most of their positions as nominees for others, including both other firms (which may hold as nominees for still others) and individual account customers of the participant.

As a result of this system, most of those who participate in the municipal market experience significant benefits. Issuers of municipal securities no longer incur the substantial costs associated with printing municipal securities certificates, transportation of securities to the point of initial delivery, and charges from the registrar associated with transfers involving physical certificates evidencing security ownership.

Registrars and corporate trustees are able to substantially reduce the costs associated with providing their services as a result of the elimination of handling of physical certificates, reductions in the costs of maintaining records of ownership of securities, and reductions in the costs of making payments and sending notices with respect to securities.

Municipal securities dealers are able to offer their account customers better, faster service through the use of the DTC book-entry system since physical certificates are not required for trades to be completed, and payments are received in a more uniform manner and can be credited to accounts more rapidly.

Investors in municipal securities are able to reduce the costs of custody arrangements for security holdings, to trade more easily, to receive payment for the principal or redemption price of their securities without being required to surrender, at remote places of payment, physical certificates evidencing securities, and to avoid delays in payment resulting from failure to receive notices of redemption. In addition, all who participate in the system benefit from reduced risks related to loss, destruction, theft, and counterfeiting of certificates.

DTC is essentially an industry-owned cooperative, which was created to perform specific, narrowly defined activities. DTC serves as the registered holder of over 1.07 million municipal security issues, with new issues being added at the rate of approximately 120,000 issues per year.***37*** As a result, DTC receives a substantial volume of notices daily related to the municipal securities held by it.

In order to enable DTC participants to become aware of the contents of notices received by DTC, and to immediately request copies of notices, the LENS system was developed by DTC.***38*** This system is an electronic system, approved by the SEC, which communicates over DTC’s long-established "PTS" computer linkage with its participants and contains a listing of identifying information regarding each notice received by DTC. CUSIP numbers***39*** of the securities to which the notice relates are indicated. The listing only reproduces the title or reference line of the notice, and is limited to 504 characters.***40*** The LENS system enables the DTC participant to query the system to determine whether the DTC participant held a position in the security as of the record date for the notice input by the participant if the notice indicates a record date.***41*** The participants can order paper copies of all notices, or of only those notices that they desire.

**FOOTNOTES**

* ***1*** Formerly known as PSA The Bond Market Trade Association.
* ***2*** These groups are referred to hereafter as the "participating groups."
* ***3*** For a thorough description of DTC and its role, see Appendix A.
* ***4*** As used in this paper, the term "default" is understood to include failure to pay amounts due with respect to securities when due, as well as any event or condition that is defined in the documents related to the securities as an event of default or an event or condition that with giving of notice or passage of time would constitute an event of default under the documents, and also includes material breaches of material covenants in documents that do not explicitly contain definitions of "default" or "event of default."
* ***5*** The initial impetus for these meetings arose out of the bond defaults resulting from the insolvency of Executive Life Insurance Company of Los Angeles. That situation persuaded several of the groups involved that because of the relative rarity of municipal security defaults, a number of market participants had not fully considered and addressed the changes needed in the process of communicating with beneficial owners of a widely dispersed defaulted municipal security issue that is held through the book-entry system.
* ***6*** Although it is expected that these practices will apply to all notices distributed by or on behalf of issuers that relate to defaulted municipal securities, the common types of notices would be the initial notice that a default has occurred, notices ordered to be sent to beneficial owners as a result of court proceedings, solicitations of consent, or votes in favor of plans of reorganization and similar workout efforts, and notices detailing developments in the case, including bond calls and tenders.
* ***7*** As used herein, "issuer" is intended to include obligated persons within the meaning of Rule 15c2-12 with respect to the issue, as well as the conduit issuer of the issue. In this paper, references to Rules, unless otherwise indicated, are rules of the Securities and Exchange Commission (the "SEC") adopted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). §17 CFR §240.1 et seq.
* ***8*** While the focus of this paper is notices related to defaulted municipal securities, the recommendations may be utilized for any type of notice to beneficial owners holding through the book-entry system.
* ***9*** Issuers may hire agents to assist them in performing their obligations and responsibilities under these recommended practices.
* ***10*** See Appendix A for a description of the LENS system.
* ***11*** Issuer control is, of course, subject to the obligations of the issuer under the securities laws. In addition, beneficial owners may obtain information through whatever mechanisms are established in the bond documents.
* ***12*** Section 149(a) of the Internal Revenue Code of 1986, as amended, provides that most bearer bonds issued after December 31, 1982 are not tax-exempt.
* ***13*** The securities depositories comprise a national system of clearing agencies mandated by Congress in Section 17A of the Exchange Act, and the Rules.
* ***14*** Trust indentures have been in use in American finance since the early days of the railroad system in the United States. (Rodgers, The Corporate Trust Indenture Project, 20 Bus. Law. 551 (1965)). Provisions related to ownership and notices have developed by trial and error over that period of approximately 170 years. (SEC, Preliminary Report on the Practice of Recording the Ownership of Securities in the Records of the Issuers in Other Than the Name of the Beneficial Owner of Such Securities (1975)). The book-entry system began to develop in corporate finance in the last 30 years, and became widespread in municipal finance in the last 15 years.
* ***15*** See, e.g., American Bar Foundation, Model Debenture Indenture Provisions, All Registered Issues, 1967.
* ***16*** Problems associated with these provisions have resulted in some voluntary changes, such as provisions in some resolutions and indentures permitting beneficial owners to request that notices be sent directly to them, and for the clearing corporations to receive copies of notices in advance of the general mailing date. Exchange Act Release No. 34-23856 (December 3, 1986) 51 F.R. 44398 (December 9, 1986).
* ***17*** Under Rule 15c2-12, broker dealers may not make recommendations to their customers regarding the purchase or sale of a municipal security that is subject to the Rule unless they have established procedures to receive prompt notice of material event notices that have been sent to the NRMSIRs relating to the recommended securities.
* ***18*** While not directly applicable, the Rules regulating the transmission of corporate proxy statements under Section 14 of the Exchange Act form the conceptual basis for many of the recommendations in this paragraph. Under those Rules, only the issuer is entitled to receive certain information related to the nominees' beneficial owners. The participating groups have intentionally attempted to streamline the procedures recommended here while preserving similar concepts.
* ***19*** It is currently the practice of DTC to respond to requests for SPLs within two business days. The participating groups believe that this is an appropriate response time.
* ***20*** It is not currently a common practice to establish a record date for notices other than notices of redemption or relating to voting of securities. The participating groups have suggested that the adoption of uniform record dates for various other types of notices would facilitate the processing of those notices. To the extent that record dates are not established for notices, nominees such as DTC cannot identify which of the entities holding through them held positions in securities affected by notices. Issuers should also establish a formal release date for mailing of notices in order to facilitate uniformity of disclosure of material information.
* ***21*** Non-objecting beneficial owners are those persons for whom the participant acts as nominee who have not objected to the disclosure of their names and security positions under Rule 14b-1. Beneficial owners who have indicated that they do object to disclosure are considered to be objecting beneficial owners under this Rule.
* ***22*** The participating groups believe that the option of turning over the nonobjecting beneficial owner list should be retained because it gives the issuer the opportunity to exercise greater control over costs and the process of distributing notices to those owners. In addition, identification of at least some of the owners may facilitate development of a dialogue between the issuer of the defaulted securities and the beneficial owners, which is generally of benefit.
* ***23*** It is anticipated that reasonable costs would not in any case be higher than the costs permitted with respect to mailings under Rule 14a-13(a)(5). Issuers should recognize that a nominee may hold a security on behalf of other nominees, which will result in additional communication costs and make adherence to these recommendations more important.
* ***24*** Response times should be reasonable in light of the circumstances. For example, by analogy to Rule 14a-13, the initial inquiry from the issuer should allow 20 business days before the proposed date for mailing of the notice where possible. The response from the nominee holder in clause (iii) should be provided within 7 business days following the request if the request is properly transmitted by the issuer. The issuer should take the actions referenced in clause (v) within 5 business days following the receipt of the response from the nominee and should mail to nonobjecting beneficial owners on the later of the date originally set for mailing or the fifth business day after the issuer is provided with a list identifying the nonobjecting beneficial owner.
* ***25*** The recommendations with respect to the format of notices should be followed in all cases, unless a conflicting format is required by existing legal requirements.
* ***26*** If the full nine-digit CUSIP numbers are not provided, nominee holders cannot be expected to correctly identify beneficial owners of the affected securities.
* ***27*** DTC's Proxy Department address is: The Depository Trust Company, Proxy Department, (telephone) 212/ 855-5200, (fax) 212/ 855-5181.
* ***28*** The participating groups understand that DTC is also considering, at the request of the participating groups, language similar to the following for the form of recommended disclosure that it provides to issuers for use in preparing official statements: "Prospective purchasers of the securities should be aware of steps that they can take to augment the transmission of notices of significant events with respect to the securities, such as redemptions, tenders, defaults and proposed amendments to the security documents. In order to be assured of receiving notice, beneficial owners of the securities may wish to ascertain that the nominee who holds the securities for their benefit has agreed to obtain and transmit notices to the beneficial owners, or in the alternative, beneficial owners may wish to provide their names and addresses to the issuer and request that copies of notices be provided directly to them."
* ***29*** There may be multiple nominee holders of the same security position; e.g., DTC may be a nominee holder for a bank or broker participant, which is a nominee holder for a clearing broker, which is the nominee for another broker, which in turn holds as nominee for a mutual fund, which holds for a beneficial owner. The recommendations set forth in this section are applicable to each nominee, except to the extent that special procedures apply to DTC, such as the use of the LENS system in lieu of retransmission of notices. "Nominee" here means the business organization that is holding a position in a security on behalf of another person or entity.
* ***30*** "Making known" includes providing the information to DTC's Proxy Department for each street name used by the nominee or making the information available to directory services such as The Bond Buyer's Municipal Marketplace (the "Red Book").
* ***31*** Contact information should include name of an individual who is responsible for processing notices related to defaulted securities, telephone number, telecopy number, and delivery address for overnight delivery service. The nominee may choose to act through an agent as many firms do for processing of proxy materials; however, contact information with respect to the agent should still be made available.
* ***32*** "Promptly" is a relative term that will vary depending upon the context, but retransmission within five business days should be reasonable and attainable. See Rule 14b-1(b)(2).
* ***33*** Under the recommendations contained in this paper, the nominee has the option, upon receipt of assurance of reimbursement of reasonable costs, of responding either by providing the list of nonobjecting beneficial owners to the issuer and undertaking to retransmit the furnished notices to objecting beneficial owners, or by providing an undertaking to retransmit the furnished notices to all appropriate parties.
* ***34*** It was granted temporary registration as a clearing agency under Section 17A of the Exchange Act on December 1, 1975,and full registration in Release No. 34-20221, September 23, 1983.
* ***35*** SEC, Study of Unsafe and Unsound Practices of Brokers and Dealers, H.R. Doc. No. 231, 92nd Cong., 1st Sess. 13 (1971).
* ***36*** The registered holder reflected on the registration books maintained by the registrar is generally CEDE & Co., which is a nominee name for DTC.
* ***37*** Over $1.6 trillion in principal amount of municipal securities, representing over 95% in dollar value of all outstanding municipal securities, was held by DTC as of August 31, 1997.
* ***38*** Even if physical sorting and distribution of notices that are received by DTC were practical, other problems would be presented, such as changes in beneficial ownership occurring on the records of DTC between the record date for the notice and the date that the notice was received by DTC, as well as the omission of record dates from many notices. It would not be practical for DTC to photocopy and distribute to the over 1,240 direct and indirect DTC participants all of the notices received daily, nor would it be practical to sort the notices by hand and photocopy and distribute to participants having positions in each security, especially given the difficulty under current practices in determining which securities are affected by some notices and which DTC participants are interested parties.
* ***39*** If the full nine-digit CUSIP number is provided on the notice by the originator of the notice, it is included on the LENS system. If the full nine-digit CUSIP number is not included by the originator, then DTC currently attempts on a best-efforts basis (consistent with sound business judgment) to determine a correct CUSIP number for the issuer (the first six digits of the CUSIP number), but not the particular issue or maturity, and (if the six-digit number is determined) to include that number with the notice information on the LENS system. DTC is not able to indicate the last three digits of missing CUSIP numbers, and may determine to cease its efforts to determine the initial six digits of CUSIP numbers in the future due to inherent ambiguities. Accordingly, issuers who do not include full nine-digit CUSIP numbers on notices risk placement of the notices on the LENS system without any CUSIP numbers.
* ***40*** The participating groups understand that DTC is exploring enhancements to make the LENS system more open, such as making lists accessible to the public on DTC's website @ www.dtc.org, but even those enhancements will require the changes to the form and content of notices recommended here.
* ***41*** This feature is only available if the full nine-digit CUSIP number is provided on the notice, and its usefulness is maximized if the title of the notice specifies a record date.