

Client Alert

Current Issues Relevant to Our Clients

August 8, 2013

MSRB Proposes New Consolidated Fair Pricing Rule

The Municipal Securities Rulemaking Board (the “MSRB”) recently requested public comment on a consolidated fair pricing rule. The rule change would consolidate the requirements of current MSRB Rule G-18 (Execution of Transactions), Rule G-30 (Prices and Commissions) and related interpretive guidance into a single general fair pricing rule, Rule G-30 (Fair Pricing). The MSRB proposal seeks to preserve the substance of the existing fair-pricing requirements. The MSRB request is available [here](#).

Background

The MSRB municipal security fair pricing obligations for broker-dealers currently fall under MSRB Rules G-18 and G-30 as well as various interpretive notices and interpretive letters under those and other rules. In an effort to ease the burden of understanding and complying with fair-pricing requirements, the MSRB is now proposing to consolidate the current rules and guidance into a single revised Rule G-30 governing fair pricing. The revised rule seeks to preserve the substance of the existing fair-pricing requirements and would codify and supersede existing guidance.

Revised Rule G-30 Obligations

With respect to principal transactions, proposed Rule G-30 would provide that no broker, dealer or municipal securities dealer (collectively, a “dealer”) may purchase municipal securities for its own account from a customer, or sell municipal securities for its own account to a customer, except at an aggregate price that is “fair and reasonable” (including any mark-up or mark-down). Under MSRB rules, the term “customer” generally means any person other than (1) another broker, dealer, or municipal securities dealer or (2) an issuer in transactions involving the sale by the issuer of a new issue of its securities.

With respect to agency transactions, proposed Rule G-30 would provide that a dealer must make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions when executing a transaction for or on behalf of a customer as agent. The proposed rule would further provide that no dealer may purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount. Proposed supplementary material would provide that a dealer

effecting an agency transaction must exercise the same level of care as it would if acting for its own account.

Dealers Must Exercise “Diligence” in Assessing Market Value and Reasonableness of Compensation

The proposed supplementary material provides that in all transactions a dealer must exercise diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction. The supplementary material further provides that a “fair and reasonable” price bears a reasonable relationship to the prevailing market price of the security. The supplementary material also notes that the lack of a well-defined and active market for a security would not negate the need for diligence in determining the market value as accurately as reasonably possible in satisfying fair-pricing obligations. The proposal also provides that a dealer may be required to use greater efforts to establish a security’s value when the dealer is unfamiliar with a security. The proposal also notes that a bid-wanted procedure is not always a conclusive determination of market value. Therefore, the supplementary material provides that a dealer may need to check the results of a bid-wanted process against other objective data to fulfill its fair-pricing obligations, particularly when the market value of an issue is unknown.

Fair Pricing and Reasonable Compensation

The supplementary material distinguishes “reasonable compensation” from “fair pricing”. For example, a dealer could restrict its profit on a transaction to a reasonable level (reasonable compensation) and still violate the rule if the dealer fails to adequately assess the market value of a security and, as a result, pays a price well above market value (failure to achieve fair pricing). The proposal notes that this could be a violation of fair-pricing responsibilities

even if the dealer makes little or no profit on the trade. The supplementary material sets forth a list of factors to be considered for both “reasonable compensation” and “fair pricing” determinations.

Fair and Reasonable Price. The proposed supplementary material sets forth a list of relevant factors to be used in determining whether a price is “fair and reasonable”. This list states that the most important factor is determining whether the yield is comparable to that of other securities of comparable quality, maturity, coupon rate, and block size then available in the market. Other factors would include: (i) the best judgment of the dealer concerning the current fair market value of the securities; (ii) expense involved in effecting the transaction; (iii) that the dealer is entitled to a profit; (iv) total dollar amount of the transaction; (v) service provided in effecting the transaction; (vi) availability of the securities in the market; (vii) the rating and call features of the security (including the possibility that a call feature may not be exercised); (viii) the maturity of the security; (ix) the nature of the dealer’s business; and (x) the existence of material information about a security available through the MSRB’s Electronic Municipal Market Access (“EMMA”) or other established industry sources.

Fair and Reasonable Compensation. The proposed supplementary material provides that a variety of factors can affect the determination of whether a commission or service charge is “fair and reasonable” under the rule. The supplementary material sets forth certain factors, including: (i) the availability of the securities; (ii) expense; (iii) the value of the services rendered; (iv) the amount of any other compensation received or to be received by the dealer in connection with the transaction; (v) that the dealer is entitled to a profit; (vi) the total dollar amount and price of the transaction; (vii) the best judgment of the dealer concerning the fair market value of the securities when the transaction occurs; and (viii) for municipal fund securities (such as 529 plans), whether the dealer’s commissions or other fees fall within the sales charge schedule specified in NASD Rule 2830.

Superseded Guidance

If adopted, the new rule and supplementary material would supersede the following interpretive notices and letter in their entirety: Review of Dealer Pricing Responsibilities (Jan. 26, 2004); Republication of September 1980, Report on Pricing (Oct. 3, 1984); Interpretive Notice on Pricing of Callable Securities (Aug. 10, 1979); and Factors in pricing (Nov. 29, 1993). The MSRB intends to move the remaining current Rule G-30 interpretive guidance in a subsequent rulemaking initiative to other applicable general rules. Interpretive guidance under Rule G-17 that addresses topics other than fair pricing also will remain in effect at this point.

Submitting Comments

You may submit comments on the proposed rule changes by submitting a hard copy or by submitting comments electronically at this link. You may submit comments on the proposed rule until September 20, 2013.

For More Information

To discuss any topic covered in this client alert, contact any attorney in our Investment Management Group or visit us online at Chapman.com.

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