

# **Bond Case Briefs**

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## **MSRB Requests Comment on Proposed Fair-Pricing Rule.**

The Municipal Securities Rulemaking Board (MSRB) is seeking comment on a proposed rule that would consolidate MSRB Rule G-18 on execution of transactions and Rule G-30 on prices and commissions, and streamline and codify existing guidance regarding fair pricing currently set forth in interpretive guidance to MSRB Rules G-17 and G-30. The proposed changes would create a single general rule, G-30, on prices and remuneration.

Comments should be submitted no later than September 20, 2013, and may be submitted in electronic or paper form. Comments may be submitted electronically by clicking [here](#). Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1900 Duke Street, Suite 600, Alexandria, VA 22314. All comments will be available for public inspection on the MSRB's website.[1]

Questions about this notice should be directed to Damon D. Colbert, Assistant General Counsel, at 703-797-6600.

### **BACKGROUND**

Market participants have expressed concern regarding the difficulty of reviewing years of interpretive guidance to determine fair pricing obligations. Separately, the MSRB has conducted a review of Rules G-17 and G-30, which have been expanded upon through numerous interpretive notices and interpretive letters. The MSRB has examined its interpretive guidance concerning fair pricing and is proposing to consolidate this guidance by codifying it into a new fair-pricing rule. Consolidating this guidance into rule language would ease the burden on brokers, dealers, and municipal securities dealers (dealers) and other market participants who seek to understand, comply with, and enforce fair-pricing requirements.

In addition, to further promote regulatory efficiency, the MSRB is proposing to consolidate Rules G-18 and G-30, thereby consolidating the MSRB's fair-pricing requirements into the single new fair-pricing rule.

### **PROPOSED FAIR-PRICING RULE**

The proposed fair-pricing rule, which includes the codified interpretive guidance, preserves the substance of the existing fair-pricing requirements.[2] The structure of the proposed rule (rule language followed by supplementary material) is the same structure the MSRB recently has begun to follow in order to streamline its rules.[3]

### **CURRENT INTERPRETIVE GUIDANCE**

The MSRB has identified three interpretive notices and one interpretive letter under Rule G-30 that would be superseded in their entirety by the proposed rule, and the MSRB proposes to delete the notices and letter.[4] The MSRB intends, in a subsequent rulemaking initiative, to move the remaining Rule G-30 interpretive guidance, which addresses topics other than fair pricing, to other

applicable general rules. Interpretive guidance under Rule G-17 that addresses topics other than fair pricing also will remain intact at this time.

## REQUEST FOR COMMENT

The MSRB is requesting comment from the industry and other interested parties on the proposed rule set forth below. In addition to any other subjects related to the proposal that commenters may wish to address, the MSRB specifically requests that commenters address the following questions:

Will the proposed codification of existing guidance impose any particular burden on dealers or provide any material benefit to dealers?

Will the proposed new rule format impose any particular burden on dealers or provide any material benefit to dealers?

August 6, 2013

## TEXT OF PROPOSED RULE

### Fair Pricing

#### (a) Principal Transactions.

No broker, dealer or municipal securities dealer shall 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 (including any mark-up or mark-down) that is fair and reasonable.

#### (b) Agency Transactions.

(i) Each broker, dealer and municipal securities dealer, when executing a transaction in municipal securities for or on behalf of a customer as agent, shall make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.

(ii) No broker, dealer or municipal securities dealer shall purchase or sell municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount.

-- Supplementary Material:

#### .01 General Principles.

(a) Each broker, dealer or municipal securities dealer (each, a "dealer," and collectively, "dealers"), whether effecting a trade on an agency or principal basis, must exercise diligence in establishing the market value of the security and the reasonableness of the compensation received on the transaction.

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

(c) A "fair and reasonable" price bears a reasonable relationship to the prevailing market price of the security.

(d) Reasonable compensation differs from fair pricing. A dealer could restrict its profit on a transaction to a reasonable level and still violate this Rule if the dealer fails to consider market value. For example, a dealer may fail to assess the market value of a security when acquiring it from

another dealer or customer and as a result may pay a price well above market value. It would be a violation of fair-pricing responsibilities for the dealer to pass on this misjudgment to another customer, as either principal or agent, even if the dealer makes little or no profit on the trade.

## .02 Relevant Factors in Determining the Fairness and Reasonableness of Prices.

(a) The most important factor in determining whether the aggregate price to the customer is fair and reasonable is that the yield should be comparable to the yield on other securities of comparable quality, maturity, coupon rate, and block size then available in the market.

(b) Other factors include:

(i) the best judgment of the dealer concerning the fair market value of the securities when the transaction occurs and, where applicable, of any securities exchanged or traded in connection with the transaction;

(ii) the expense involved in effecting the transaction;

(iii) that the dealer is entitled to a profit;

(iv) the total dollar amount of the transaction;

(A) To the extent that institutional transactions are often larger than retail transactions, this factor may enter into the fair and reasonable pricing of retail versus institutional transactions.

(v) the service provided in effecting the transaction;

(vi) the 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);

(A) A dealer should consider the effect of information from rating agencies, both with respect to actual or potential changes in the underlying rating of a security and with respect to actual or potential changes in the rating of any bond insurance applicable to the security.

(B) A dealer pricing securities on the basis of yield to a specified call feature should consider the possibility that the call feature may not be exercised. Accordingly, the price to be paid by a customer should reflect this possibility and the resulting yield to maturity should bear a reasonable relationship to yields on securities of similar quality and maturity. Failure to price securities in this manner may constitute a violation of this Rule because the price may not be "fair and reasonable" if the call feature is not exercised. That a customer in these circumstances may realize a yield greater than the yield at which the transaction was effected does not relieve a municipal securities professional of its responsibility under this Rule.

(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 EMMA or other established industry sources.

### .03 Relevant Factors in Determining the Fairness and Reasonableness of Commissions or Service Charges.

(a) A variety of factors may affect the fairness and reasonableness of a commission or service charge, including:

- (i) the availability of the securities involved in the transaction;
- (ii) the expense of executing or filling the customer's order;
- (iii) the value of the services rendered by the dealer;
- (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 of any securities exchanged or traded in connection with the transaction; and
- (viii) for a dealer that sells municipal fund securities, whether the dealer's commissions or other fees fall within the sales charge schedule specified in Rule 2830 of the National Association of Securities Dealers, Inc. (Such compliance with Rule 2830 may, depending upon the facts and circumstances, be a significant, though not dispositive, factor in determining whether a commission or other fee is fair and reasonable.)

### .04 Fair-Pricing Responsibilities and Large Price Differentials.

(a) A transaction chain that results in a large difference between the price received by one customer and the price paid by another customer for the same block of securities on the same day, without market information or news accounting for the price volatility, raises the question as to whether each of these customers received a price reasonably related to the market value of the security, and whether the dealers effecting the customer transactions (and any broker's brokers that may have acted on behalf of such dealers) made sufficient effort to establish the market value of the security when effecting their transactions.

(b) The lack of a well-defined and active market for an issue does not negate the need for diligence in determining the market value as accurately as reasonably possible when fair-pricing obligations apply. Although intra-day price differentials for obscure and illiquid issues might generally be larger than for more well-known and liquid issues, dealers must establish market value as accurately as possible using reasonable diligence. When a dealer is unfamiliar with a security, the efforts necessary to establish its value may be greater than if the dealer is familiar with the security.

(i) A dealer may need to review recent transaction prices for the issue or transaction prices for issues with similar credit quality and features as part of its duty to use diligence to determine the market value of municipal securities. When doing this, the dealer often will need to use its professional judgment and market expertise to identify comparable securities and to interpret the impact of recent transaction prices on the value of the block of municipal securities in question.

(ii) If the features and credit quality of the issue are unknown, it also may be necessary to obtain information on these factors directly or indirectly from an established industry source. For example,

the current rating or other information on credit quality, the specific features and terms of the security, and any material information about the security such as issuer plans to call the issue, defaults, etc., all may affect the market value of securities.

(c) A bid-wanted procedure is not always a conclusive determination of market value. Therefore, particularly when the market value of an issue is unknown, a dealer may need to check the results of the bid-wanted process against other objective data to fulfill its fair-pricing obligations.

[1] Comments are posted on the MSRB website without change. Personal identifying information such as name, address, telephone number, or email address, will not be edited from submissions. Therefore, commenters should submit only information that they wish to make available publicly.

[2] The MSRB notes that in response to its December 18, 2012, Request for Comment on MSRB Rules and Interpretive Guidance, a commenter urged the MSRB to preserve Rule G-30's standards for fair and reasonable pricing because the commenter believed the rule appropriately balances investor-protection interests with the need for efficient municipal markets. Although the proposed fair-pricing rule preserves the substance of Rule G-30, future changes in market practices or conditions may cause the MSRB to revise its fair-pricing requirements.

[3] See MSRB Notice 2013-04, Request for Comment on Codifying Time of Trade Disclosure Obligation, (Feb. 11, 2013).

[4] See 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).