

Client Alert

Current Issues Relevant to Our Clients

February 20, 2014

SEC Seeks Comments on MSRB Fair Pricing Rule

The Securities and Exchange Commission (the “SEC”) recently published a notice seeking comments on the Municipal Securities Rulemaking Board’s (the “MSRB”) rule proposal on fair pricing obligations of dealers in municipal securities. The proposed rule change would consolidate the requirements of current MSRB Rule G-18 (Execution of Transaction), Rule G-30 (Prices and Commissions) and related interpretive guidance into a single general fair pricing rule, Rule G-30 (Fair Pricing). The text of the proposed rule is available [here](#) and the full SEC notice is available [here](#).

Background

In August 2013, the MSRB sought comments on its proposal to consolidate existing MSRB Rules G-18 and G-30 and related interpretive guidance into a single general Rule G-30. The goal of the rule proposal was to ease the burden of understanding and complying with municipal bond fair-pricing requirements. The MSRB received five comments which generally supported the proposal. The MSRB proposal recently filed with the SEC does not substantively change the earlier proposal. This Client Alert briefly summarizes the proposed rule. For more information, please see our August 8, 2013 Client Alert available [here](#).

Revised Rule G-30 Obligations

The revised rule seeks to preserve the substance of the fair-pricing obligations imposed on broker-dealers in current MSRB Rules G-18 and G-30 and various interpretive notices and letters. With respect to principal transactions, the proposed rule 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, the proposed rule 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 rule would also prohibit a dealer from purchasing or selling municipal securities as agent for a customer for a commission or service charge in excess of a fair and reasonable amount.

Proposed supplementary material to the rule would specify five general principles:

- A dealer must exercise diligence in establishing the market value of the security and the reasonableness of the compensation received in all transactions (agency or principal);
- A dealer effecting an agency transaction must exercise the same level of care as if acting for its own account;
- A “fair and reasonable” price bears a reasonable relationship to the prevailing market price of the security;
- Dealer compensation on a principal transaction is considered to be a mark-up or mark-down computed from the inter-dealer market price prevailing at the time of the customer transaction; and
- Reasonable compensation differs from fair pricing. Even if a dealer’s compensation is reasonable, a dealer could violate the rule if the dealer does not make an adequate effort to obtain a fair and reasonable bond price for a customer.

The proposed supplementary material provides lists of non-exhaustive factors relevant in determining the fairness and reasonableness of prices, commissions and service

charges. The proposed supplementary material also addresses application of fair-pricing requirements to situations which create large intra-day price differentials. Proposed supplementary material also discusses the general duty of dealers operating alternative trading systems to act to investigate alleged pricing irregularities on their systems which are brought to their attention. For additional detail on the proposed supplementary materials, see our August 2013 Client Alert linked above.

FINRA Rule Proposal

The proposed MSRB rule changes apply to transactions in municipal securities. The Financial Industry Regulatory Authority, Inc. ("FINRA") has also proposed rule changes related to fair pricing, markups, markdowns and commissions. For information on the FINRA rule proposals, see our February 5, 2013 Client Alert available [here](#).

Submitting Comments

You may submit comments to the SEC on the proposed MSRB rule changes on or before March 12, 2014 by submitting a hard copy, sending an email to: rule-comments@sec.gov with File Number SR-MSRB-2014-01 in the subject line, or through the SEC's Internet comment form available [here](#).

For More Information

To discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group, or visit us online at Chapman.com.

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