

Regulatory Notice

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Stakeholders

Municipal Securities
Dealers, Investors

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Fair Practice

Affected Rules

[Rule G-17](#); [Rule G-18](#);
[Rule G-30](#); [Rule G-48](#)

MSRB to Consolidate Dealers' Fair-Pricing Obligations into MSRB Rule G-30

Overview

The Municipal Securities Rulemaking Board (MSRB) received approval from the Securities and Exchange Commission (SEC) on May 8, 2014 to amend MSRB Rule G-30, on prices and commissions, to delete MSRB Rule G-18, on execution of transactions, and to delete various interpretive guidance.¹

These amendments and corresponding deletions streamline and codify existing guidance regarding MSRB fair-pricing standards previously set forth in MSRB Rules G-30 and G-18 and in interpretive guidance under those rules and Rule G-17 into a single fair-pricing rule, MSRB Rule G-30. The consolidated fair-pricing rule preserves the substance of dealers' existing fair-pricing obligations.

These amendments are part of a multi-year initiative of the MSRB to review and streamline its Rule Book with the objective of providing fair, efficient and transparent regulation of the municipal securities market. The new fair-pricing rule is designed to enhance regulated entities' ability to understand and comply with fair-pricing obligations by organizing previously dispersed obligations together in a single location. Further, the relevant information from the existing interpretive guidance has been succinctly stated in the new rule to allow for more efficient referencing by market participants.

The rule changes will become effective on July 7, 2014.

Questions about this notice may be directed to Michael L. Post, Deputy General Counsel, or Benjamin Tecmire, Counsel, at 703-797-6600.

¹ See Exchange Act Release No. 72129 (May 8, 2014), File No. SR-MSRB-2014-01 (Jan. 29, 2014).

Summary of Amendments and Deletions

Before these amendments, fair-pricing provisions were organized in two separate rules, Rule G-18 and Rule G-30, with interpretive guidance under Rule G-30 as well as under a third rule, Rule G-17, on fair dealing. The amendments consolidate the provisions of Rules G-18 and G-30 into a single fair-pricing rule, and consolidate the existing interpretive guidance under Rules G-17 and G-30 and codify that guidance in the same rule. To that end, the pricing standard for agency transactions formerly contained in Rule G-18 has been included in paragraph (b)(i) of Rule G-30. As a result, amended Rule G-30 will now contain all pricing standards for both principal and agency transactions and reflect the differing statements of the fair-pricing standard for the two types of trades.

In addition, the MSRB has issued extensive interpretive guidance under MSRB Rules G-17 and G-30 discussing fair pricing in general, as well as in specific scenarios. The supplemental material added to Rule G-30 reflects the consolidation of the substance of this guidance and codifies it into the rule text. These amendments do not contain any substantive guidance that was not already contained in the MSRB's rules, interpretative notices or interpretive letters.

Supplementary Material .01 specifies five general principles concerning the fair-pricing requirements: (a) that a dealer, 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) that a dealer effecting an agency transaction must exercise the same level of care as it would if acting for its own account; (c) that a fair and reasonable price bears a reasonable relationship to the prevailing market price of the security; (d) that dealer compensation on a principal transaction is considered to be a mark-up or mark-down that is computed from the inter-dealer market price prevailing at the time of the customer transaction; and (e) that reasonable compensation differs from fair pricing.²

Supplementary Material .02 provides a non-exhaustive list of relevant factors in determining the fairness and reasonableness of prices in principal and agency transactions.³ Yield of the security remains the most important factor

² Supplemental Material .01 is derived from the notice [Review of Dealer Pricing Responsibilities \(Jan. 26, 2004\)](#) (the "2004 Notice").

³ Supplemental Material .02(a) is derived from the [2004 Notice](#). Supplemental Material .02(b) is derived from Rule G-30(a), the [2004 Notice](#), [MSRB Interpretive Letter – Rules G-21,](#)

when determining whether the aggregate price of a security is fair and reasonable. Other factors codified under this provision are: the expense involved in effecting the transaction; the services provided in effecting the transaction; the availability of the securities in the market; and other such factors that were previously contained in the text of the fair-pricing rules or relevant interpretive guidance.

Supplementary Material .03 provides a non-exhaustive list of relevant factors in determining the fairness and reasonableness of commissions or service charges in agency transactions.⁴ The factors contained in this section include: the availability of the securities involved in the transaction; the expense of executing or filing the customer's order; the value of the services rendered by the dealer; and other factors that were previously contained in the text of fair-pricing rules or interpretive guidance.

Supplementary Material .02 and .03 will make it easier for market participants to identify and utilize the clearly identified relevant factors.

Supplementary Material .04 discusses the application of fair-pricing requirements to some of the situations that may create large intra-day price differentials.⁵ This provision codifies previous interpretive guidance into a format that market participants will be able to more readily reference and understand.

Finally, Supplementary Material .05 discusses the duty under amended Rule G-30(b)(i) of dealers operating alternative trading systems (ATS) to act to investigate any alleged pricing irregularities on their systems brought to their attention. This duty applies equally to transactions effected for SMMPs; and a dealer operating an ATS may violate this provision of the rule if it fails to take remedial actions to cure system or participant pricing abuses.⁶

G-30 and G-32 (Dec. 11, 2001), [MSRB Interpretive Letter – Factors in Pricing \(Nov. 29, 1993\)](#), [Republication of September 1980, Report on Pricing \(Oct. 3, 1984\)](#), and [Interpretive Notice on Pricing of Callable Securities \(Aug. 10, 1979\)](#).

⁴ Supplementary Material .03 is derived from existing Rule G-30(b), the [2004 Notice](#) and [Republication of September 1980, Report on Pricing \(Oct. 3, 1984\)](#).

⁵ Supplementary Material .04 is derived from the [2004 Notice](#).

⁶ Supplementary Material .05 is derived from interpretive guidance that was previously filed with the Commission and which is separately being generally codified in Rule G-48 based on its relevance to SMMPs. See [Restated Interpretive Notice Regarding the Application of MSRB Rules to Transactions with Sophisticated Municipal Market Professionals \(Jul. 9, 2012\)](#).

Interpretive Guidance on Fair Pricing

The MSRB has identified three interpretive notices and one interpretive letter under Rule G-30 that are being superseded in their entirety by amended Rule G-30, and the MSRB is deleting the notices and letter from the MSRB Rule Book.⁷ The MSRB will archive this interpretive guidance, current as of January 1, 2013, on its website. To the extent that past interpretive guidance does not conflict with any MSRB rules or interpretations thereof, it remains potentially applicable, depending on the facts and circumstances of a particular case.

Finally, new MSRB Rule G-48 is being amended to update the reference to Rule G-30(b)(i) where it previously referred to Rule G-18. This is a non-substantive, technical change that is the result of consolidating Rule G-18 into revised Rule G-30(b)(i). New Rule G-48 is pending implementation and will become effective July 5, 2014.⁸

May 12, 2014

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Text of Amendments⁹

~~Rule G-18: Execution of Transactions~~ RESERVED

~~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.~~

RESERVED

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⁷ See the [2004 Notice; Republication of September 1980, Report on Pricing \(Oct. 3, 1984\); Interpretive Notice on Pricing of Callable Securities \(Aug. 10, 1979\);](#) and [Factors in Pricing \(Nov. 29, 1993\).](#)

⁸ See Exchange Act Release No. 71665 (Mar. 7, 2014), 79 FR 14321 (Mar. 13, 2014); [SEC Approves MSRB Rule G-47 on Time-of-Trade Disclosure Obligations, MSRB Rules D-15 and G-48 on Sophisticated Municipal Market Professionals, and Revisions to MSRB Rule G-19 on Suitability of Recommendations and Transactions, MSRB Notice 2014-07 \(Mar. 12, 2014\).](#)

⁹ Underlining indicates new language; strikethrough indicates deletions.

Rule G-30: Prices and Commissions

~~(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-down or mark-up) that is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the broker, dealer or municipal securities dealer as to the fair market value of the securities at the time of the transaction and of any securities exchanged or traded in connection with the transaction, the expense involved in effecting the transaction, the fact that the broker, dealer, or municipal securities dealer is entitled to a profit, and the total dollar amount of the transaction.~~

~~(b) *Agency Transactions.* 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, taking into consideration all relevant factors, including the availability of the securities involved in the transaction, the expense of executing or filling the customer's order, the value of the services rendered by the broker, dealer or municipal securities dealer, and the amount of any other compensation received or to be received by the broker, dealer, or municipal securities dealer in connection with the transaction.~~

(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) Dealer compensation on a principal transaction is considered to be a mark-up or mark-down that is computed from the inter-dealer market price prevailing at the time of the customer transaction. As part of the aggregate price to the customer, mark-up or mark-down also must be a fair and reasonable amount, taking into account all relevant factors.

(e) 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, but are not limited to:

(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 under the facts and circumstances. For example, 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.

.05 Pricing Irregularities on Alternative Trading Systems.

Although the duty under section (b)(i) of this rule to evaluate the prices of certain individual transactions is eliminated under Rule G-48 when they are effected for sophisticated municipal market professionals, a dealer operating an alternative trading system must, under the general duty set forth in section (b)(i), act to investigate any alleged pricing irregularities on its system brought to its attention. Accordingly, a dealer operating an alternative trading system may be in violation of section (b)(i) if it fails to take actions to address system or participant pricing abuses.

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Rule G-48: Transactions with Sophisticated Municipal Market Professionals

(a) No Change.

(b) Transaction Pricing. The broker, dealer or municipal securities dealer shall not have any obligation under ~~Rule G-18~~ Rule G-30(b)(i) to take action to ensure that transactions meeting all of the following conditions are effected at fair and reasonable prices:

(i)-(iii) No Change.

(c) - (d) No Change.