

## COMPLIANCE RESOURCE

# Underwriter Considerations for Assessing Written Supervisory Procedures Regarding New Issue Pricing

## OVERVIEW

The Municipal Securities Rulemaking Board (MSRB) is providing this resource for brokers, dealers, and municipal securities dealers (collectively, “dealers” and, individually, each a “dealer”) to enhance understanding of certain of their fair dealing obligations under MSRB Rule G-17, on conduct of municipal securities and municipal advisory activities, and certain of dealers’ supervisory obligations under MSRB Rule G-27, on supervision, when acting as an underwriter to an issuer of municipal securities.

This resource is comprised of three parts: the first part is a summary of relevant rule requirements that are applicable to underwriters with respect to pricing of a new issuance of municipal securities; the second part answers Frequently Asked Questions (FAQs) to provide examples of the application of the obligations and duties of the relevant rules; and the third part offers questions for consideration to aid dealers in designing and assessing their compliance policies and written supervisory procedures (WSPs). The MSRB recognizes that the substantive steps taken with respect to the pricing of a new issuance of municipal securities can vary from offering to offering. Therefore, this compliance resource is not meant to be all inclusive of the considerations a dealer should consider in developing its compliance policies and WSPs.

This compliance resource should not be read to suggest that there is a widespread problem with new issue pricing, and it is not meant to instruct or provide specific guidance to dealers with respect to the substantive steps they undertake when pricing a new issuance of municipal securities. The MSRB recognizes that dealers provide a wide range of underwriting services to issuers.

**The MSRB does not require or expect dealers to implement any specific practices regarding their underwriting activities that are described in this resource. This compliance resource does not create new legal or regulatory requirements or new interpretations of existing requirements.**

This resource is not a rule, has not been filed with the U.S. Securities and Exchange Commission (SEC), and has not been approved nor disapproved by the SEC. Regulated entities, examining authorities and others should not interpret this resource as a rule or establishing new or additional obligations for any person. However, as cited to in this resource’s *Summary of Relevant Rule Requirements* below, there are established legal requirements under existing MSRB rules that underwriters are expected to fulfill.

Dealers may find this resource to be a useful tool in supporting their continuing compliance efforts and in assessments of their applicable policies and procedures, as the concepts discussed in this compliance resource reflect the relevant MSRB rules and/or interpretive guidance. While this resource focuses on key rule provisions and interpretations that are applicable to an underwriter with respect to

its conduct with municipal issuers when pricing a new issuance of municipal securities, the MSRB notes that a dealer's general fair dealing obligation applies to any municipal securities activity conducted in the course of an underwriting engagement, among other potential obligations depending on the facts and circumstances. As a result, this compliance resource should be read in conjunction with applicable MSRB rules and interpretations, as this resource does not provide a comprehensive list of considerations for ensuring compliance with all applicable rules.

[The complete text of all MSRB rules and interpretations is available here.](#) The MSRB is also publishing a companion compliance resource for municipal advisors regarding municipal advisory services related to pricing of a new issuance of municipal securities.<sup>1</sup>

## SUMMARY OF RELEVANT RULE REQUIREMENTS

MSRB Rule G-17, Rule G-27, and the other rules summarized below may not speak directly to every aspect of new issue pricing activities but are applicable to a dealer's underlying fair dealing obligations and the development and implementation of appropriate compliance policies and WSPs.

### Rule G-17: Conduct of Municipal Securities and Municipal Advisory Activities

**Basic Fair Dealing Obligation.** Rule G-17 precludes a dealer, in the conduct of its municipal securities activities, from engaging in any deceptive, dishonest, or unfair practice with any person, including issuers and investors. Rule G-17's fair dealing obligation includes an anti-fraud prohibition. Underwriters must not misrepresent or omit the facts, risks, potential benefits, or other material information about municipal securities activities undertaken with a municipal issuer. Rule G-17 also establishes a general duty of a dealer to deal fairly with all persons (including, but not limited to, issuers

and other market participants), even in the absence of fraud.

**Excessive Compensation.** Depending on the specific facts and circumstances, an underwriter's compensation for services related to a new issuance may be so disproportionate to the nature of the underwriting and related services performed as to constitute an unfair practice in violation of Rule G-17. Among the factors relevant to whether an underwriter's compensation is disproportionate to the nature of the underwriting and related services performed, are:

- the credit quality of the issue,
- the size of the issue,
- market conditions,
- the length of time spent structuring the issue, and
- whether the underwriter is paying the fee of the underwriter's counsel, or any other relevant costs related to the financing.

**General Fair Pricing.** The duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issuance at the time it is priced. The MSRB has previously observed that whether an underwriter has dealt fairly with an issuer for purposes of Rule G-17 is dependent upon all of the facts and circumstances of an underwriting and is not dependent solely on the price of the new issue.

- **Competitive Underwritings.** In general, a dealer purchasing bonds in a competitive underwriting for which the issuer may reject any and all bids will be deemed to have satisfied its duty of fairness to the issuer with respect to the purchase price of the issuance as long as the dealer's bid is a bona fide bid (as defined in MSRB Rule G-13) that is based on the dealer's best judgment of the fair market value of the securities that are the subject of the bid. The MSRB views competitive offerings narrowly to mean

<sup>1</sup> Because underwriters and municipal advisors often perform complementary roles in connection with the pricing of a new issuance of municipal securities, underwriters may find it helpful to review the municipal advisor compliance resource as well. See [Considerations for Assessing Written Supervisory Procedures for Municipal Advisory Services \(including the Process for New Issue Pricing\)](#).

new issues sold by the issuer to the underwriter on the basis of the lowest price bid. As an example, the fact that an issuer publishes a request for proposals and potential underwriters compete to be selected based on their professional qualifications, experience, financing ideas, and other subjective factors would not be viewed as representing a competitive offering for purposes of an underwriter's fair dealing obligations to an issuer.

- **Negotiated Underwritings.** In a negotiated underwriting, the underwriter has a duty under Rule G-17 to negotiate in good faith with the issuer. This duty includes the obligation of the dealer to ensure the accuracy of representations made during the course of such negotiations, including representations regarding the price negotiated and the nature of investor demand for the securities (e.g., the status of the order period and the order book). If, for example, the dealer represents to the issuer that it is providing the "best" market price available on the new issuance, or that it will exert its best efforts to obtain the "most favorable" pricing, the dealer may violate Rule G-17 if its actions are inconsistent with such representations.

## Rule G-11: Primary Offering Practices

In general, Rule G-11 establishes terms and conditions for sales by dealers of a new issuance of municipal securities in primary offerings. Consistent with the rule, an issuer may provide direction to an underwriter with respect to the issuer's terms and conditions, the priority of orders, and retail order period requirements (including eligibility criteria for participation in the retail order period).

## Rule G-27: Supervision

**Supervision.** Rule G-27 requires, among other things, that each dealer establish and maintain a supervisory system, including WSPs, to supervise the municipal securities activities of each registered representative, registered principal and associated person that is reasonably designed to achieve compliance with all applicable rules, including their Rule G-17 fair dealing obligations.

## Rules G-8 and G-9: Books and Records to be Made by Dealers and Preservation of Records

**Maintenance and Preservation of Records.** Dealers are subject to certain general obligations under MSRB Rule G-8 that encompass the maintenance of certain records related to primary offerings. Under Rule G-8(a)(viii), sole underwriters and syndicate managers, respectively, are required to maintain records regarding, among others, the par value of the securities, all terms and conditions required by the issuer (including, those of any retail order period, if applicable), all orders received for the purchase of the securities, all allotments of securities, and the price at which sold.

MSRB Rule G-9(a)(iv) requires that the records listed in Rule G-8(a)(viii) be preserved for no less than six years.

Additionally, Rule G-9(b)(viii)(c) also requires a dealer to preserve for at least four years any written or electronic communication received or sent, including any inter-office memoranda, relating to the conduct of the activities of such municipal securities broker or municipal securities dealer with respect to municipal securities. This four-year preservation requirement includes written or electronic communication received or sent in the course of an underwriting. In fulfilling a firm's Rule G-27 obligations with respect to the supervision of its underwriting activities and that of its associated persons, a firm may create additional books and records to evidence compliance with its policies and procedures and, therefore, such records would be required to be retained by the dealer.

*This compliance resource is not a rule and does not alter nor amend applicable rules and regulations. This compliance resource has neither been approved nor disapproved by the SEC and does not create new legal or regulatory requirements nor new interpretations of existing requirements. While there are established legal requirements under existing MSRB rules that underwriters are expected to fulfill, this compliance resource is not meant to instruct underwriters on the substantive steps they undertake when pricing an issuance of municipal securities or require them to implement any specific practices regarding the process for pricing an issuance of municipal securities.*

## FREQUENTLY ASKED QUESTIONS

The following FAQs are intended to provide examples of the application of the duties and obligations underwriters owe issuers in the course of pricing a new issuance of municipal securities under Rule G-17 and G-27. Dealers may be able to use these FAQs as a resource in developing and assessing their compliance and supervisory programs.

### **1. May an underwriter consider additional factors to those described above when evaluating whether its compensation is consistent with the fair dealing obligations of Rule G-17?**

Yes. In addition to the credit quality of the new issue, the size of the issue, market conditions, the length of time spent structuring the issue, and whether the underwriter is paying the fee of the underwriter's counsel (or any other relevant costs related to the financing), an underwriter may take into consideration any other relevant factors, such as the time and complexity of marketing a new issuance, among others.

### **2. Must a fair and reasonable price necessarily be the "best" price for the issuer?**

No. The final purchase price paid by the underwriter to an issuer must be a fair and reasonable price under Rule G-17, which need not be the "best" price for the issuer. MSRB rules reflect the fact that underwriting engagements are arm's-length commercial transactions where underwriters have financial and other interests that differ from those of issuers. Consistent with Rule G-17, a firm may place its own commercial interests ahead of the issuer's interests when pricing a new issuance, such as by ensuring that the firm receives adequate compensation for the underwriting services it performs and/or by attempting to limit the financial risks associated with an underwriting (like risks resulting from unsold maturities).

### **3. Is the final purchase price paid to an issuer solely determinative of whether an underwriter has met its fair pricing obligation?**

No. As discussed above, the duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the new issuance at the time it is priced. In this way, MSRB rules make clear that the pricing process inherently involves a degree of subjectivity; and an underwriter's best judgment can only be informed with the market information reasonably available up to and at the time a new issuance is priced. So, while the final purchase price paid to an issuer is a key piece of information, it is one fact in the context of many others. For example, the lone fact that the final purchase price paid is relatively inconsistent with contemporaneous market pricing, or that the municipal securities may have subsequently traded up in price in the secondary market, is not conclusive of whether an underwriter has acted inconsistently with Rule G-17. In such circumstances, the process by which an underwriter arrives at and documents its best judgment of the fair market value of a new issuance can be helpful to affirming compliance with Rule G-17.

### **4. Beyond the final purchase price paid, what other facts and circumstances might be relevant to the analysis of whether an underwriter has met its fair pricing obligations?**

All of the facts and circumstances of the underwriting are relevant, including all of the facts in the pricing process that led up to the final purchase price paid. The MSRB understands that these could include:

- Market dynamics leading up to and at the time of pricing (which may include the pricing of comparable transactions or the impact of other transactions in the market at the same time);
- Movements of benchmark curves and corresponding impacts to any preliminary pricing scales;
- Whether the underwriting is solely managed or managed by a syndicate;
- Whether the underwriting is for a complex structure;
- Any unique or uncommon features of the underwriting;
- Any specific instructions or other communications related to pricing from the issuer or the issuer's municipal advisor (such as specific limitations regarding price(s), coupon(s), or other characteristics of the issuance);
- Whether the underwriting is for a new and/or unknown credit;
- The type and nature of investor demand for the issuance (e.g., how price adjustments might alter demand on a maturity-by-maturity basis and/or as a whole); or
- The changing status of the order book as pricing evolves.

The MSRB recognizes that no two issuances may be exactly alike, so a firm's supervisory process may not fully capture every aspect of the pricing process for every transaction and supervision might differ based on the type of transaction.

#### **5. Do MSRB rules account for the potentially limited role that underwriters may play in the final purchase price of a new issuance?**

Yes. The MSRB acknowledges that aspects of the pricing process may be subject to underlying market dynamics beyond the underwriter's control. In this regard, MSRB rules recognize that the borrowing interests of an issuer are generally in competition with the economic interests of investors; and the pricing of a new issuance of municipal securities can be subject to the input and agreement of multiple parties (including, the input and agreement of the issuer itself). As a result

of these factors and the unique facts and circumstances of the pricing process for each transaction, the MSRB does not expect firms to be able to fully document and recreate every aspect of the pricing process for supervisory and examination purposes. Consistent with Rule G-27, a firm may employ a risk-based methodology, or other reasonable supervisory methodology, for these aspects of its underwriting activities.

#### **6. Are underwriters expected to have WSPs that speak to the review and supervision of new issue pricing and, if so, are there any common elements that are expected to be included in the WSPs?**

Yes. Rule G-27 requires dealers to develop a system to supervise the activities of the firm and its associated persons that is reasonably designed to achieve compliance with applicable rules.

Under Rule G-27, a firm's WSPs should have sufficient detail to demonstrate that the WSPs are tailored to the nature and scope of the firm's pricing activities, recognizing that there is no one-size-fits-all approach to supervision. In tailoring WSPs to their pricing activities and/or assessing whether their WSPs are appropriately tailored, dealers may wish to utilize the *Summary of Relevant Rule Requirements*, *Frequently Asked Questions*, and *Questions for Consideration* discussed in this compliance resource. Most importantly, pursuant to Rule G-27, large and small firms should assess whether their WSPs are sufficiently tailored to identify:

- The individual(s) responsible for supervising the firm's pricing activities;
- The supervisory process those individual(s) undertake;
- The frequency of such activities undertaken by those individual(s) responsible for supervision; and
- The document(s) the individual(s) responsible for supervision review or maintain to reflect that the supervisory procedure was undertaken.

WSPs that are appropriately tailored with these firm-specific details help to ensure that a dealer firm's

supervisory procedures are reasonably designed to achieve compliance with applicable MSRB rules.<sup>2</sup>

A dealer's WSPs can be consistent with Rule G-27 even though the WSPs reasonably differ from that of other dealers as to specificity with respect to the review of pricing-related activities and as to supervisory oversight (based on facts and circumstances in tailoring such WSPs to the firm's activities). For example, depending on its business model, a firm's supervisory policies and procedures do not need to be extensive in detail.

### **7. May a firm's supervisory processes rely on after-the-fact oral explanations to supplement the records it otherwise is required to maintain and preserve?**

Yes. MSRB rules permit firms to adopt supervisory processes and procedures that afford a reasonable degree of deference and flexibility in supervising their municipal securities activities. While firms do not need to document every aspect of the pricing process, there is an expectation, consistent with Rules G-8 and G-9, that a dealer will maintain and preserve material records related to primary offerings. Maintaining and preserving books and records facilitate inspections and examinations of dealers and assist the examining authorities in evaluating a dealer's compliance with Section 15B of the Exchange Act, the rules and regulations thereunder, and MSRB rules. Given the pace, complexity, and variety of pricing activities, the MSRB understands that certain details may not be reduced to a written record and certain material aspects may not be reduced to a written record in real time (e.g., material aspects may be memorialized in a closing memorandum or other similar post-closing record).

It is also reasonable that oral explanations may be necessary and reasonably relied upon to provide additional context to the material information the firm maintains and preserves as part of its books and records.

## **SAMPLE QUESTIONS FOR CONSIDERATION**

The MSRB has developed sample questions that dealers who act as underwriters may choose to consider, in assessing their compliance policies and written supervisory procedures (WSPs) with respect to pricing-related activities. As noted, this resource does not address all regulatory obligations applicable to dealers who act as underwriters and one firm's approach to compliance may not necessarily be appropriate or reasonable for another firm. Therefore, dealers who act as underwriters should consider their own business models, practices, and activities in reviewing the following questions.

1. Do the firm's compliance policies and WSPs identify the obligation related to compensation that is potentially so disproportionate to the nature of the underwriting and related services performed to be considered excessive underwriter compensation and an unfair practice under Rule G-17?
2. Do the firm's compliance policies and WSPs address the dealer's fair pricing obligation owed to an issuer under Rule G-17?
  - ▶ For example, do the firm's compliance policies and WSPs identify that an underwriter has to balance its duty to purchase securities from the issuer at a fair and reasonable price with its duty to sell municipal securities to investors at prices that are fair and reasonable?
3. What written information does the firm's underwriting personnel reference as a possible resource when developing their best judgment as to the fair market value of a new issuance?
4. What aspects of the pricing process can the firm's underwriting personnel reasonably and routinely document, whether in real time or after the fact?
  - ▶ What aspects of the pricing process are not able to be captured and preserved in writing?
  - ▶ Can any of these aspects be material to the pricing process?

<sup>2</sup> See, [NASD Notice to Members 99-45 \(June 1999\)](#) and [NASD Notice to Members 98-96 \(December 1998\)](#).

- ▶ Do any of these material aspects change based on the type or characteristics of the transaction, market dynamics, or other relevant factors?
  - ▶ To the extent material aspects of the pricing process are not reasonably able to be reduced to a written record in real time, how are such aspects documented and preserved (e.g., material aspects may be memorialized in a closing memorandum or other similar post-closing record)?
  - ▶ Can the firm supplement any available written documentation with an after-the-fact oral explanation for these material aspects?
5. If the firm utilizes a risk-based methodology to supervise aspects of its pricing activities, does this methodology reasonably enable the firm to identify and/or review aspects of its pricing activity in a manner appropriate for the firm's particular business model?
- ▶ Does the risk-based methodology incorporate documentation to supplement the records otherwise maintained and/or retained under MSRB rules?
6. Are the firm WSPs adequately tailored to its business and do the WSPs identify applicable elements, such as:
- ▶ The individual(s) responsible for supervising the firm's pricing activities;
  - ▶ The supervisory process those individual(s) undertake;
  - ▶ The frequency of such activities undertaken by those individual(s) responsible for supervision; and
  - ▶ The document(s) the individual(s) responsible for supervision review or maintain to reflect that the supervisory procedure was undertaken?
7. Do the firm's policies and WSPs speak to the timing of documentation? Do the firm's WSPs address whether certain information can be provided to the supervisory principal orally upon request to aid in their supervisory review?

## ADDITIONAL RESOURCES

This resource should be read in conjunction with the relevant rules and related guidance, including:

### **MSRB Rule G-17**

- [Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities \(March 31, 2021\)](#)
- [SR-MSRB-2019-10 \(August 1, 2019\) Proposed Rule Change to Amend and Restate the MSRB's August 2, 2012 Interpretive Notice Concerning the Application of Rule G-17 to Underwriters of Municipal Securities \(discussing the fair pricing obligations owed to issuers under Rule G-17\)](#)
- [Reminder Notice on Fair Practice Duties to Issuers of Municipal Securities, MSRB Notice 2009-54 \(July 14, 2009\)](#)
- [Purchase of New Issue from Issuer, MSRB Interpretation \(December 1, 1997\)](#)

### **MSRB Rule G-11**

- [Interpretation on Priority of Orders for Securities in a Primary Offering under Rule G-17](#)

### **MSRB Rule G-27**

- [Supervisory Responsibilities of Qualified Principals, MSRB Compliance Resource \(August 2018\)](#)
- [Compliance Advisory for Brokers, Dealers, and Municipal Securities Dealers, MSRB Notice 2018-17 \(August 14, 2018\)](#)
- [SEC Approves Amendments to Rule G-27 on Supervision, Rule G-8 on Recordkeeping, and Rule G-9 on Record Retention, MSRB Notice 2007-16 \(May 25, 2007\)](#)
- [SR-MSRB-2006-10 \(November 24, 2006\)](#) (discussing how Rule G-27 should be read consistently with the analogous NASD/FINRA supervisory provisions)

## FINRA/NASD Publications

- [Letter of Acceptance Waiver and Consent No. 20160491831-01, FINRA \(January 2018\)](#)
- [NASD Provides Guidance on Supervisory Responsibilities, NASD Notice to Members 99-45 \(June 1999\)](#)
- [NASD Elaborates On Member Firms' Supervision Responsibilities For Trade Reporting And Market-Making Activities, NASD Notice 98-96 \(December 1998\)](#)

## About the MSRB

The Municipal Securities Rulemaking Board (MSRB) protects and strengthens the municipal bond market, enabling access to capital, economic growth, and societal progress in tens of thousands of communities across the country. The MSRB fulfills this mission by creating trust in our market through informed regulation of dealers and municipal advisors that protects investors, issuers and the public interest; building technology systems that power our market and provide transparency for issuers, institutions, and the investing public; and serving as the steward of market data that empowers better decisions and fuels innovation for the future. The MSRB is a self-regulatory organization governed by a board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is overseen by the Securities and Exchange Commission and Congress.