Effective on June 14, 2018, changes to Rule G-34 (the Rule) of the Municipal Securities Rulemaking Board (MSRB) will include an exception to the CUSIP requirements for certain direct purchase transactions with a bank or related entity (Direct Purchase Exception). The changes also clarify that the CUSIP-related requirements of the Rule apply to placement agents acting in private placement transactions, as well as to brokers, dealers and municipal securities dealers when acting as underwriters and certain municipal advisors in competitive sales of municipal securities (unless the Direct Purchase Exception has application).

Click here to view the amended rule and interpretive guidance from the MSRB.

Increased transparency and balancing risk were two of the primary considerations of formulating the amended Rule. MSRB Executive Director Lynnette Kelly stated, “[c]larifying who must obtain CUSIP numbers for which types of transactions aligns the rule with current market practices. ...In the case of private placements, our goal is to provide greater transparency of transaction details if the securities do later trade in the secondary market.” However, balancing those concerns with instances when there is little risk of a security being traded in the secondary market, the amended Rule includes a principles-based exception to the CUSIP requirements when the initial purchaser’s present intent is to hold the securities to maturity,
earlier redemption or mandatory tender, subject to certain conditions.

The MSRB cites industry-wide confusion about the application of the CUSIP requirements as a reason for the changes, particularly with respect to dealers acting as placement agents in private placement transactions. According to the MSRB, the amended Rule codifies longstanding MSRB interpretations of the Rule concerning the application CUSIP requirements to municipal securities, including application of the amended Rule to all municipal advisors when advising on competitive transactions, including non-dealer municipal advisors. While the amended Rule makes it clear that the CUSIP requirements will have application to dealers acting as placement agents in private placement transactions involving municipal securities and to municipal advisors on competitive transactions, the Direct Purchase Exception will effectively override the general application of the CUSIP requirements of the Rule.

In order for the Direct Purchase Exception to have application, an underwriter or municipal advisor must reasonably believe the present intent of the purchasing entity is to hold the municipal security to maturity. The amended Rule provides that the basis for an underwriter’s or municipal advisor’s reasonable belief that a municipal security will be held to maturity must be a written representation from the purchaser of the municipal security.

Many direct purchasers and other lenders do not require a CUSIP number be obtained as part of a private placement transaction, and as part of the amended Rule, it is clear that this practice may continue. Yet, in earlier versions of the amended Rule, CUSIP numbers would have been required for all private placement transactions, which could have dampened the bank loan and direct purchase markets, “putting issuers in the unfavorable position of either not using a financing structure that is in their best interest, or having to pay more for those financings,” said Emily Brock, director of the Government Finance Officers Association Federal Liaison Center.

Despite the clarifications, some industry participants believe the amended Rule still leaves critical questions unanswered, such as the process for applying for CUSIP numbers in competitive transactions when an issuer doesn’t have a municipal advisor, or when an issuer uses multiple municipal advisors on the same transaction.

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