

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



## Other Information:

- [Compliance Advisory for Municipal Advisors](#) (August 2018)
- [Rule G-17 Webinar on Duties of Underwriters to State and Local Governments](#)

## Purchase of new issue from issuer - December

**Purchase of new issue from issuer.** This is in response to your letter in which you ask whether Board rule G-17, on fair dealing, or any other rule, regulation or federal law, requires an underwriter to purchase a bond issue from a municipal securities issuer at a “fair price.”

Rule G-17 states that, in the conduct of its municipal securities business, each broker, dealer and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. Thus, the rule requires dealers to deal fairly with issuers in connection with the underwriting of their municipal securities.

Whether or not an underwriter has dealt fairly with an issuer is dependent upon the facts and circumstances of an underwriting and cannot be addressed simply by virtue of the price of the issue. For example, in a competitive underwriting where an issuer reserves the right to reject all bids, a dealer submits a bid at a net interest cost it believes will enable it to successfully market the issue to investors. One could not view a dealer as having violated rule G-17 just because it did not submit a bid that the issuer considers fair. On the other hand, when a dealer is negotiating the underwriting of municipal securities, a dealer has an obligation to negotiate in good faith with the issuer. If the dealer represents to the issuer that it is providing the best market price available on this issue, and this is not the case, the dealer may violate rule G-17. Also, if the dealer knows the issuer is unsophisticated or otherwise depending on the dealer as its sole source of market information, the dealer’s duty under rule G-17 is to ensure that the issuer is treated fairly, specifically in light of the relationship of reliance that exists between the issuer and the underwriter. *MSRB interpretation of December 1, 1997.*

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## Description provided at or prior to the time of trade - April

**Description provided at or prior to the time of trade.** This is in response to your February 27, 1986 letter and our prior telephone conversation concerning the application of Board rules to the description of municipal securities exchanged at or prior to the time of trade. You note that it is becoming more and more common in the municipal securities secondary market for sellers, both dealers and customers, to provide only a “limited description” and CUSIP number for bonds being sold. Recently you were asked by a customer to bid on \$4 million of bonds and were given the coupon, maturity date, and issuer. When you asked for more information, you were given the CUSIP number. You then bid on and purchased the bonds. After the bonds were confirmed, you discovered that the bonds were callable and that, when these bonds first came to market, they were priced to the call. You state that the seller was aware that the bonds were callable.

Your letter was referred to a Committee of the Board which has responsibility for interpreting the Board's fair practice rules. That Committee has authorized this response.

Board rule G-17 provides that

In the conduct of its municipal securities business, *each broker, dealer, and municipal securities dealer* shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice. (emphasis added)

The Board has interpreted this rule to require that, in connection with the purchase from or sale of a municipal security to a customer, at or before execution of the transaction, a dealer must disclose all material facts concerning the transaction which could affect the customer's investment decision and not omit any material facts which would render other statements misleading. The fact that a municipal security may be redeemed in-whole, in-part, or in extraordinary circumstances prior to maturity is essential to a customer's investment decision and is one of the facts a dealer must disclose.

I note from our telephone conversation that you ask whether Board rules specify what information a customer must disclose to a dealer at the time it solicits bids to buy municipal securities. Customers are not subject to the Board's rules, and no specific disclosure rules would apply to customers beyond the application of the anti-fraud provisions of the federal securities laws. I note, however, that a municipal securities professional buying securities from a customer should obtain sufficient information about the securities so that it can accurately describe these securities when the dealer reintroduces them into the market.

In regard to inter-dealer transactions, the items of information that professionals must exchange at or prior to the time of trade are governed by principles of contract law and essentially are those items necessary adequately to describe the security that is the subject of the contract. As a general matter, these items of information may not encompass all material facts, but must be sufficient to distinguish the security from other similar issues. The Board has interpreted rule G-17 to require dealers to treat other dealers fairly and to hold them to the prevailing ethical standards of the industry. Also, dealers may not knowingly misdescribe securities to another dealer. *MSRB interpretation of April 30, 1986.*

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### **Put option bonds: safekeeping, pricing - February**

**Put option bonds: safekeeping, pricing.** I am writing in response to your recent letter regarding issues of municipal securities with put option or tender option features, under which a holder of the securities may put the securities back to the issuer or an agent of the issuer at par on certain stated dates. In your letter you inquire generally as to the confirmation disclosure requirements applicable to such securities. You also raise several questions regarding a dealer's obligation to advise customers of the existence of the put option provision at times other than the time of sale of the securities to the customer.

Your letter was referred to a committee of the Board which has responsibility for interpreting the Board's confirmation rules, among other matters. That committee has authorized my sending you the following response.

Both rules G-12(c) and G-15, applicable to inter-dealer and customer confirmations respectively, require that confirmations of transactions in securities which are subject to put option or tender option features must indicate that fact (*e.g.*, through inclusion of the designation "puttable" on the confirmation). the date on which the put option feature first comes into effect need be stated on the confirmation only if the transaction is effected on a yield basis and the parties to the transaction specifically agree that the transaction dollar price should be computed to that date. In the absence of such an agreement, the put date need not be stated on the confirmation, and any yield disclosed should be a yield to maturity.

Of course, municipal securities brokers and dealers selling to customers securities with put option or tender option features are obligated to disclose adequately the special characteristics of these securities at the time of trade. The

customer therefore should be advised of information about the put option or tender option feature at this time.

In your letter you inquire whether a dealer who had previously sold securities with a put option or tender option feature to a customer would be obliged to contact that customer around the time the put option comes into effect to remind the customer that the put option is available. You also ask whether such an obligation would exist if the dealer held the securities in safekeeping for the customer. The committee can respond, of course, only in terms of the requirements of Board rules; the committee noted that no Board rule would impose such an obligation on the dealer.

In your letter you also ask whether a dealer who purchased from a customer securities with a put option or tender option feature at the time of the put option exercise date at a price significantly below the put exercise price would be in violation of any Board rules. The committee believes that such a dealer might well be deemed to be in violation of Board rules G-17 on fair dealer and G-30 on prices and commissions. *MSRB interpretation of February 18, 1983.*

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### **"Wooden tickets" - March**

**"Wooden tickets."** This is in response to your letter of February 4, 1981 asking whether the practice of a broker-dealer using "wooden tickets" is prohibited by Board rule G-17. According to your letter, this practice refers to the mailing of confirmations of sales to customers who, in fact, have not placed orders to purchase securities. Thereafter, if any customer objects, stating that it never authorized the transaction, the sale is canceled. You state that, in some cases, customers accept the transaction and make payment.

The Board has determined that the practice by a municipal securities dealer of knowingly issuing confirmations of sales to customers who have not placed orders to purchase the bonds is a deceptive, dishonest, and unfair practice under rule G-17. *MSRB interpretation of March 3, 1981.*

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