

Rule G-13 Quotations Relating to Municipal Securities



NOTICE OF INTERPRETATION OF RULE G-13 ON PUBLISHED QUOTATIONS - April 21, 1988

The Board has received complaints regarding published quotations, such as those appearing in *The Blue List*. The complaints, which have been referred to the appropriate enforcement agency, state that municipal securities offerings published by dealers often do not reflect prices and amounts of securities that currently are being offered by the quoting dealer.

Board rule G-13, on quotations, prohibits the dissemination of a quotation relating to municipal securities unless the quotation represents a bona fide bid for, or offer of, municipal securities. The term quotation is defined to mean any bid for, or offer of, municipal securities. A quotation is deemed to be bona fide if the dealer on whose behalf the quotation is made is prepared to purchase or sell the municipal securities at the price stated and in the amount specified at the time the quotation is made.

Under rule G-13, the price stated in a quotation for municipal securities must be based on the best judgment of the dealer making the quotation as to the fair market value of such securities at the time the quotation is made. The Board has stated that the price must have a reasonable relationship to the fair market value of the securities, and may take into account relevant factors such as the dealer's current inventory position, overall and in respect to a particular security, and the dealer's anticipation of the direction of the market price for the securities.

Rule G-13 also prohibits a dealer from entering a quotation on behalf of another dealer if the dealer entering the quotation has any reason to believe that the quotation does not represent a bona fide bid for, or offer of, municipal securities. In addition, participants in a joint account are prohibited from entering quotations relating to municipal securities which are the subject of the joint account, if such quotations indicate more than one market for the same securities. Rule G-13 does not prohibit giving "nominal" bids or offers or giving indications of price solely for informational purposes as long as an indication of the price given is clearly shown to be for such purposes.

A dealer that publishes a quote in a daily or other listing must stand ready to purchase or sell the securities at the stated price and amount until the securities are sold or the dealer subsequently changes its price. If either of these events occur, the dealer must withdraw or update its published quotation in the next publication. Stale or invalid quotations violate rule G-13. Rule G-13 does permit a dealer to publish a quotation for a security it does not own if the dealer is prepared to sell the security at the price stated in the quotation. If the dealer knows that the security is not available in the market or is not prepared to sell the security at the stated price, the quotation would violate rule G-13.

Quotation of municipal securities - February 24, 1977

Quotation of municipal securities. This will acknowledge receipt of your letter dated February 9, 1977 concerning the Board's proposed rule G-13 on quotations relating to municipal securities. In your letter you raise certain questions concerning the intent and application of paragraph (b)(ii) of proposed rule G-13, which prohibits a municipal securities professional from distributing or publishing a municipal securities quotation, or causing such a

quotation to be distributed or published, unless the quotation is based upon the professional's best judgment as to the fair market value of the security.

While the provision in question would undoubtedly apply to situations involving outright fraud, the Board believes the rule to have appropriate application in other circumstances as well. Thus, the Board has attempted in paragraph (b) (ii) to proscribe conduct which, in the Board's opinion, constitutes bad business practice but may not, depending on the circumstances, constitute fraud. The Board firmly believes that as a matter of just and equitable principles of trade in the municipal securities industry and with a view to promoting free and open markets in municipal securities, certain practices should not be condoned, even though they do not necessarily rise to the level of fraud or cannot be proven to constitute fraud.

Some examples of how paragraph (b)(ii) would operate may be useful. First, assume that a dealer submits a bid for bonds, knowing that they have been called by the issuer. The bonds are not general market bonds and the fact that they have been called is not widely known. While called bonds ordinarily trade at a premium, the dealer's bid is based on the value of the bonds as though they had not been called and is accepted by the dealer on the other side of the trade who is unaware of the called status of the bonds. In these circumstances, the bid clearly would not have been based upon the best judgment of the dealer making it as to the fair market value of the bonds. While one might argue that the dealer accepting the bid should have known of the called status of the bonds, the dealer making the bid acted unethically and in a manner not conducive to free and open markets in municipal securities. In the Board's view, the actions of the dealer making the bid should not be condoned, although a charge of fraud might be difficult to sustain in dealings between professionals and might be inappropriate. The improper nature of the dealer's conduct would be exacerbated, of course, if the person on the other side of the transaction is a non-professional. However, difficulties in proof that the conduct of the dealer was fraudulent suggest that the best judgment rule would provide an appropriate alternative basis for enforcement action.

Another situation that would be covered by the best judgment rule is one in which a dealer submits a bid for bonds based on valuations obtained from independent sources, which in turn are based on mistaken assumptions concerning the nature of the securities in question. The circumstances indicate that the dealer submitting the bid knows that the securities have a substantially greater market value than the price bid, but the fact that independent valuations were obtained, albeit based on mistaken facts, clouds the dealer's culpability.

A third situation to which the best judgment rule would apply is one in which a dealer makes a bid for or offer of a security without any knowledge as to the value of the security or the value of comparable securities. While the Board does not intend that the best judgment of a dealer as to the fair market value of a security be second-guessed for purposes of the proposed rule, the Board does intend that the dealer be required to act responsibly and to exercise some judgment in submitting a quotation. In other words, a quotation which has been "pulled out of the air" is not based on the best judgment of the dealer and, in the interests of promoting free and open markets in municipal securities, should not be encouraged.

Given the manner in which the Board intends the "best judgment" rule to operate, the Board concluded that it would not have an anti-competitive impact on the municipal markets. The proposed rule is not intended to prohibit legitimate price discounts or mark-ups, as the case may be, based upon a dealer's anticipation of the direction of the movement of the markets and other factors. The Board does not intend to interfere with legitimate pricing mechanisms and recognizes that there may be a variety of quotations with respect to a given security, each of which would comply with the terms of the proposed rule.

While it is not possible to anticipate all of the specific fact situations that might run afoul of the "best judgment" rule, I would like to make some general observations concerning the operation of the proposed rule. As you know, one of Congress' principal purposes in calling for the establishment of the Board was to promote the development of a body of rules for the municipal securities industry that would furnish guidelines for good business conduct. The Senate Committee on Banking, Housing and Urban Affairs observed in its Report on the Securities Acts Amendments of 1975 that prior to the legislation, the conduct of municipal market professionals could be controlled only after the fact through enforcement by the Commission of the fraud prohibitions of the federal securities laws. The Senate Committee expressed hope that a self-regulatory body like the Board would develop prophylactic rules for the industry which would deter unethical and fraudulent practices in the first instance. See Senate Report 94-75, 94th Cong., 1st Sess., 42-43. *MSRB interpretation of February 24, 1977.*

