Bond Case Briefs

Municipal Finance Law Since 1971

How Groups Want To See Minimum Denomination Exceptions Changed.

WASHINGTON – Dealer groups are asking the Municipal Securities Rulemaking Board for more flexibility with exceptions to its rule preventing dealers from buying or selling bonds below issuers' prescribed minimum denominations.

"Below minimum denomination bond positions are often created in the marketplace and the rule needs to provide dealers with flexibility to manage these situations since a below minimum denomination quantity of bonds is a hard-to-sell position with limited liquidity," Mike Nicholas, Bond Dealers of America's chief executive officer, wrote in a letter to the board.

The comments from BDA and others respond to two proposed amendments to MSRB Rule G-15 on customer transactions that the self-regulator circulated in early April. The goal of the amendments is to ensure no additional customers with holdings below the minimum denominations are created as a result of exceptions.

The minimum denomination for a bond is the lowest amount of the bond that can be bought or sold, as determined by the issuer in its official bond documents, usually $5,000. Issuers sometimes set higher minimum denominations on bonds that are risky to discourage retail investors from buying them. In addition to a minimum denomination, an issuer can also set a trading "increment" for its bonds. An increment of $10,000 for example would mean a dealer could sell a customer $110,000 of bonds but not $105,000.

Although dealers are required to adhere to any minimum denominations set in transactions, some investors can be left with amounts below the stated minimums if they received allocations in a managed account or took control of a share of someone else's holdings, such as from a settlement after a divorce or an inheritance after a death. The MSRB exceptions allow those customers to avoid being stuck with these holdings.

BDA requested the MSRB consider including language in the draft amendments that could curb the risk of depreciation. The dealer group suggested allowing portions of holdings that would meet the minimum denomination threshold to be sold off instead of requiring the account to be liquidated as is the case now. It also asked that the MSRB expand the exceptions to allow sales below the minimum denomination to any customer who has an existing position in the bonds, whether it is above or below the designated minimum. Additionally, it wants the board to allow firms to correct transactions that violate the rule without punishment if the fix is done "within a reasonable timeframe."

Marc Joffe, president of the Center for Municipal Finance in California, went even further, asking the MSRB to eliminate minimum denominations in an effort to lower the barrier to entry in the market for potentially interested retail investors. In other words, the $5,000 minimum denomination found in most deals would no longer apply.

"Small investors are not protected from other types of risky investments," like penny stocks, Joffe

said in his letter.

“Many Americans would undoubtedly welcome the opportunity to invest in their communities by purchasing municipal bonds,” he said. “High minimum authorized denominations provide little meaningful protection, while excluding a large group of investors from the socially important municipal bond market.”

Leslie Norwood, managing director, associate general counsel, and co-head of munis for SIFMA, who authored that group’s letter, made clear that SIFMA believes the proposed amendments change current law by narrowing the existing exceptions. She said it is important for the MSRB to recognize that fact in order to guide dealer examinations and future enforcement efforts. However, Norwood said SIFMA supports the change and believes it would be a “positive change to the rule moving forward.”

The current rule allows dealers to sell to a customer at an amount below the minimum denomination if the sale is a result of another customer liquidating his or her entire position in an issue. The other current exception allows dealers to buy from a customer below the minimum denomination if the dealer determines, based on customer account information or a written statement from the customer, that the customer is selling its entire position in the issue.

The first new exception would allow a dealer that has bought a customer’s liquidated position that is less than the minimum denomination to sell these bonds, in amounts below the minimum, to one customer with no prior holdings in the bonds and to any customers who already have positions in the bonds. The second would allow a dealer to sell bonds to any customer with a prior position as long as the sale brings the customer to or past the minimum denomination. The dealer could then sell the remaining below-minimum position to any number of customers that already hold the bonds, so long as the sale is consistent with the issuer’s stated increment.

Both SIFMA and BDA told the MSRB to make changes to allow exceptions for interdealer trades, especially those done on alternative trading systems.

“At a time when dealers believe that the [Securities and Exchange Commission] and other regulators are trying to encourage the use of alternative trading system platforms, this rule creates significant compliance challenges for those dealers using an ATS platform that anonymizes the counterparties,” Norwood wrote. She added it would be helpful if the MSRB would waive the requirement that a dealer needs to determine if their dealer counterparty’s selling customer has liquidated his or her entire position that was below the minimum denomination.

BDA’s Nicholas said it should be the burden of the selling dealer in such a transaction to ensure the customer has liquidated his or her entire position. He added BDA believes that for interdealer transactions, dealers should only have to send a disclosure letter explaining the risks to a customer in instances where the customer is “known” and not have to do a “look through” to identify the counterparty customer.

Additionally, he requested the MSRB exempt sophisticated municipal market participants from the rule’s protections.

Norwood also asked that the MSRB consider two other potential obstacles regarding information gathering for dealers trying to follow the rule. Some private placement memorandum documents are not currently on the MSRB’s EMMA system and Norwood said that means some dealers cannot check minimum denomination and increment information that those documents would contain. If dealers are going to comply with the amendments, the MSRB should change its Rule G-32 on

primary offering disclosures to require filing of all minimum denomination and increment information on EMMA.

Introducing increments in the rule language will also cause a delay in compliance, Norwood said, because increment amounts are not uniform across the industry and dealers would want to take time to reconfirm the information available through information service providers. If increments are to be included in the final rule, she asked that dealers have a longer implementation window.

The Bond Buyer

By Jack Casey

May 26, 2016

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com