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MSRB Proposes Standalone Minimum Denomination Rule.

WASHINGTON - The Municipal Securities Rulemaking Board proposed on Tuesday to create a standalone minimum denomination rule that would revise current and proposed requirements because of dealer complaints.

The new standalone Rule G-49 would contain requirements added to Rule G-15 in 2002 to prohibit dealers from engaging in transactions with customers in amounts below the minimum denominations of municipal securities set by the issuers. It would also include two exceptions to the prohibition added in 2002, as well as two more exceptions proposed in April of this year to help maintain liquidity for below-minimum positions.

Under the proposed Rule G-49, one of the existing exceptions and one of the exceptions proposed in April would be modified in response to market participants' comments.

The MSRB has asked for public comments to be submitted on proposed Rule G-49 by Oct. 18.

"As a result of input from industry and other commenters, the MSRB believes that creating a clearer, stand-alone rule on minimum denominations will facilitate understanding and compliance with these investor protections," said MSRB executive director Lynnette Kelly. "We want to support the practical application of the prohibition while emphasizing the overall importance of adhering to the minimum denomination for certain transactions."

The minimum denomination is the lowest amount of bonds that can be bought or sold, as determined by the issuer in its official statement for the bonds. In addition to a minimum denomination, issuers can also set a trading "increment" for their bonds. An increment of \$10,000 for example would mean a dealer could sell a customer \$110,000 of bonds but not \$105,000.

Rule G-49 would eliminate the current requirement that a dealer, in some situations, must obtain a "liquidation statement" from a party that isn't the dealer's customer and is the party from which the dealer purchased the securities. The liquidation statement must be obtained before the sale of securities to another customer and confirm that the original selling customer fully and completely liquidated its below-minimum position.

The liquidation statement is key to one of the existing exceptions that was adopted as part of Rule G-15. Under that exception a dealer could sell a below- minimum denomination amount of a bond to a customer if the sale is a result of another customer liquidating his or her entire position in the bonds.

The elimination of the liquidation statement requirement would affect another exception that was proposed in April. That exception would allow a dealer that has bought a customer's liquidated position in an amount less than the minimum denomination to sell those bonds to one customer with no prior holdings of the bonds and to any customers who already have positions in the bonds. There was also a liquidation statement required for that.

The MSRB is proposing to eliminate the liquidation statement requirement after dealers said in comments in April that the requirement can be an impediment to using alternative trading systems or broker's brokers to sell below-minimum denomination positions.

Dealers were concerned that they could be subject to disciplinary action if they could not prove a liquidation had occurred. They would need to rely on another dealer, an ATS, or a broker's broker to obtain such a statement and were wary of such reliance. They were also concerned traders would be discouraged from bidding on below-minimum positions.

While the MSRB is proposing to delete the requirement for liquidation statements, it makes clear in its request for comment that it would still require a dealer purchasing a below minimum position from one of its customers and selling it to another to confirm that the selling customer has fully liquidated its position.

The MSRB has proposed a "new safeguard" in light of its elimination of the need for a liquidation statement. The safeguard would prohibit a dealer engaged in an inter-dealer trade from selling less than all of a below-minimum denomination position that the dealer acquired either from a customer that fully liquidated its below-minimum position or from another dealer. That prohibition would satisfy the MSRB's goal by preventing the creation of additional below-minimum denomination positions, the board said.

The MSRB is separately proposing to eliminate a condition it had put into its two additional exceptions proposed in April that would have required a dealer's sale to a customer to be consistent with any restrictions in the issuer's official statements regarding increment amounts.

Commenters had said the increment condition would unnecessarily limit the transfer of positions held by customers instead of providing more flexibility.

In addition to the two exceptions that would be affected by the liquidation statement's elimination, G-49 would incorporate two others, one that is already in existence and another that was proposed in April. The exception already in place allows dealers to buy from customers munis 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 bonds.

The second exception, proposed in April and added to G-49, 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.

The draft rule will carry over provisions that applied to past exceptions and require a dealer to use account records it has or written statements the customer provides when the dealer is buying from or selling to a customer. Dealers will also still be required to give or send to purchasing customers written statements telling them that the quantity of securities being sold is below the minimum denomination for the bonds and that its below-minimum nature may adversely affect the liquidity of the customer's position.

The rule would not, however, require such a written statement to be made to a customer who is brought up to or past the minimum denomination for the munis under the second proposed exception to the rule.

The Bond Buyer

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September 27, 2016

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