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## **MSRB Files Standalone Minimum Denomination Rule With SEC.**

WASHINGTON - The Municipal Securities Rulemaking Board is asking the Securities and Exchange Commission to approve its slightly revised proposal for a standalone minimum denomination rule that is designed to help liquidity and respond to concerns from dealers.

The new standalone MSRB Rule G-49 would contain requirements added to Rule G-15 in 2002 that prohibit dealers from engaging in transactions with customers in amounts below the minimum denominations of municipal securities that are set by issuers. It would also include two exceptions to the prohibition added in 2002, as well as one more exception proposed in April 2016.

The April proposal originally contained two new added exceptions to the rule, but subsequent concerns from the Securities Industry and Financial Markets Association that one was redundant led the MSRB to only include one of the new exceptions in its SEC filing. 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.

The other, more restrictive exception that the MSRB chose to eliminate would have allowed 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 would then have been able to sell the remaining below-minimum position to any number of customers that already held the bonds.

The MSRB said its filing keeps the purpose of the existing rule and exceptions - to decrease the number of customers holding minimum denomination positions while maintaining liquidity. The filing also helps dealers by eliminating a prior requirement they had said hurt trading in below minimum positions, the board said.

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.

The MSRB's SEC filing met with some resistance from dealers.

Mike Nicholas, chief executive officer of Bond Dealers of America, said BDA is opposed to the MSRB's "complex rule filing" that will "harm the very investors it is purportedly designed to protect and impose entirely unnecessary compliance costs on overburdened small and medium-sized dealers."

"We look forward to having the opportunity to convey our views to the commission," he said.

Leslie Norwood, managing director and co-head of municipal securities with SIFMA, said the group is still reviewing the rule filing but is "disappointed that at first blush the amendments appear to eliminate flexibility in the rule regarding transactions with dealers." She added that SIFMA anticipates filing a comment letter with the SEC responding to the MSRB's filing.

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 its customer but rather 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 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 also affect the new exception that the MSRB proposed in April and decided to keep in the version of the rule filed with the SEC.

The MSRB’s proposal to eliminate the liquidation statement follows prior comments from dealers to the MSRB that said 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 it discourages traders from bidding on below-minimum positions.

While the MSRB is proposing to delete the requirement for liquidation statements, it makes clear in its proposal 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 also proposed a new “safeguard” in light of its liquidation statement changes. The safeguard would prohibit a dealer engaged in an interdealer 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 MSRB has said.

The other current exception to the MSRB’s minimum denomination rule would not be affected by the liquidation statement changes. That exception allows dealers to buy munis below the minimum denomination from customers if the dealer determines, based on the customer’s account information or written statement, that the customer is selling its entire position in the bonds.

The proposed rule now filed with the SEC carries over provisions that applied to past exceptions and requires 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.

However, the MSRB is also changing its proposed rule by not requiring a dealer to make such a written statement to a customer who is brought up to, or past, the minimum denomination for the municipal issuance in a transaction. The requirement would otherwise not make sense as a customer in that situation would no longer have a below-minimum position and would not have the accompanying potential consequences.

## **The Bond Buyer**

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