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Request for Comment

Comment Deadline

May 25, 2016

Category

Uniform Practice

Affected Rules

[Rule G-15](#)

Request for Comment on Draft Amendments to MSRB Rule G-15(f) on Minimum Denominations

Overview

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on proposed draft amendments to MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers. Specifically, the MSRB is seeking comment on whether Rule G-15(f), which generally prohibits brokers, dealers and municipal securities dealers (collectively “dealers”) from effecting transactions with customers below the minimum denominations specified in bond documents, should be amended. The proposed draft amendments are designed to support the practical implementation of Rule G-15(f) by recognizing exceptions that are consistent with the rule’s original intent to protect investors that own municipal securities in amounts below the minimum denomination without creating an additional number of below-denomination positions where there once was one.¹

Comments should be submitted no later than May 25, 2016, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board, 1300 I Street NW, Suite 1000, Washington, DC 20005. Generally, all comments will be made available for public inspection on the MSRB’s website.²

¹ Securities Exchange Act Release No. 45174 *Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Minimum Denominations* (December 19, 2001), 66 FR 67342 (December 28, 2001).

² Comments generally are posted on the MSRB website without change. For example, personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.



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Questions about this notice should be directed to Gail Marshall, Associate General Counsel – Enforcement Coordination; David Saltiel, Chief Economist; or Michael Cowart, Associate General Counsel, at 202-838-1500.

Summary of the Draft Amendments

The MSRB is charged by Congress to promote a fair and efficient municipal securities market and to protect investors and the public interest.³ Under this mandate, the MSRB has developed and adopted a detailed set of regulatory requirements regarding customer transactions. In 2002, Rule G-15 was amended to prohibit dealers in most cases from effecting transactions with customers in amounts below the minimum denomination.⁴ An issuer may state a “minimum denomination” larger than the typical \$5,000 par value (typically \$100,000) in official documents for a bond issue.⁵

The 2002 amendment establishing Rule G-15(f) provided two exceptions to the prohibition in order to help preserve liquidity for customers’ below-minimum denomination positions (Rule G-15(f)(ii) and (iii)).⁶ Rule G-15(f)(ii) permits a dealer to purchase from a customer in an amount below the minimum denomination if the dealer determines, either by relying upon customer account information in its possession or upon a written statement by the customer as to its position in the issue, that the customer is selling its entire position. Rule G-15(f)(iii) permits a dealer to sell to a customer an amount below the minimum denomination if the dealer determines that the

³ *E.g.*, Securities Exchange Act of 1934 § 15B(b)(2)(C), 15 U.S.C. 78q-4(b)(2)(C).

⁴ Securities Exchange Act Release No. 45338 *Order Granting Approval of Proposed Rule Change Relating to Minimum Denominations* (January 25, 2002), 67 FR 6960 (February 14, 2002); Securities Exchange Act Release No. 45174 *Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Relating to Minimum Denominations* (December 19, 2001), 66 FR 67342 (December 28, 2001).

⁵ For example, an issuer may opt to establish a high minimum denomination to qualify for one of several exemptions from Securities Exchange Act Rule 15c2-12 or due to the bond being non-investment grade, credit risk, or other reasons, often suggesting that the securities may not be appropriate for those retail investors likely to purchase securities in relatively small amounts. The proscriptions of Rule G-15(f) apply to all transactions with customers regardless of whether the securities are suitable for the customer.

⁶ Customers may have positions below the minimum denomination due to, for example, as a result of a death or divorce, a call provision that allows calls in amounts less than the minimum denomination, investment advisors who may split positions they purchase among several clients, or knowingly or unknowingly purchasing an amount below the minimum denomination.

position being sold is the result of a customer liquidating an entire position below the minimum denomination, provided that the dealer provides written disclosure to the customer that the quantity of securities being sold is below the minimum denomination for the issue, which may, unless the customer has other securities from the issue that can be combined to reach the minimum denomination, adversely affect the liquidity of the position.

The MSRB believes that certain other transactions that are not currently contemplated under the rule would be consistent with the intent of the exceptions provided under Rule G-15(f)(iii). The MSRB is seeking comment on whether the following two additional trading scenarios should be excluded from the prohibition on sales to customers below the minimum denomination.

1. If the dealer determines that the below-minimum position being sold is the result of a customer liquidating an entire position below the minimum denomination, the dealer would be permitted to effect a sale below the minimum denomination with one or more customers that currently own the issue so long as the increment(s) being sold to the customer(s) is consistent with any restrictions in the issuer's authorizing documents even if the transaction does not result in a customer increasing its position to an amount at or above the minimum denomination. Under this scenario, a dealer would still be permitted to sell a portion of the below-minimum position to a maximum of one customer that currently does not own a position in the issue.⁷ For example, if a customer sells their entire 75,000 position, a dealer could sell 25,000 of that to a customer that does not currently have a position; sell 35,000 to a customer that owns an existing 10,000 position; and sell 15,000 to a customer that owns an existing 85,000 position. A dealer could not, however, sell portions of the 75,000 position to more than one customer that does not currently have a position in the issue.

⁷ Consistent with the current rule, this proposed exemption would require a dealer effecting a sale to a customer of an amount below the minimum denomination to provide, at or before the completion of the transaction, a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. This disclosure would be required with respect to each sale to a customer of a position below the minimum denomination, even if the customer maintains a position in the issue that is above the minimum denomination.

2. If a dealer has a position (whether below, at or above the minimum denomination amount) the dealer would be permitted to effect a sale below the minimum denomination with a customer that currently owns a below-minimum position provided that effecting such transaction results in the customer owning a position at or above the minimum denomination amount; the dealer could then sell any remaining below-minimum position to one or more customers that currently own the issue so long as the increments sold were consistent with any restrictions in the issuer's authorizing documents regarding incremental amounts.⁸ A dealer could not, however, sell any portion to a customer that does not currently have a position in the issue because the transaction would create a below-minimum position where there once was none. For example, a dealer could sell 25,000 of a 100,000 position to a customer that has a position of 75,000 because that transaction would result in the customer owning a position at the minimum denomination of 100,000. Thereafter, the dealer could sell the remaining 75,000 to one or more customers that had a position in the issue.

Consistent with the current rule, a dealer would be able to rely upon customer account records in its possession or upon a written statement provided by the customer to whom the securities are purchased or sold that the customer owns a position in the issue in an amount at or below the minimum denomination. In addition, at or before the completion of any sale in an amount below the minimum denomination, a dealer would be required to provide the customer, even if the customer already owns a position in the securities, a statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination.⁹

⁸ Consistent with the current rule, this proposed exemption would also require a dealer effecting a sale to a customer of an amount below the minimum denomination to provide, at or before the completion of the transaction, a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. Likewise, this disclosure would be required with respect to each sale to a customer of a position below the minimum denomination, even if the customer maintains a position in the issue that is above the minimum denomination.

⁹ If the MSRB were to proceed with draft amendments to Rule G-15(f), a housekeeping amendment to MSRB Rule G-8(a)(ix), on books and records to be made by brokers, dealers

The MSRB believes the above trading scenarios strike the appropriate balance of enhancing liquidity for investors that hold positions in below-denomination amounts while preventing the creation of an additional number of below-denomination positions. The MSRB reminds dealers that Rule G-18, on best execution; Rule G-19, on suitability of recommendations and transactions; and Rule G-47, on time of trade disclosure, impose regulatory requirements on dealers regarding customer transactions that supplement the protections afforded by Rule G-15(f) with respect to minimum denominations.¹⁰ For example, while selling a customer a position below the minimum denomination of an issue may be permitted under Rule G-15(f)(iii) or (iv), a dealer would have an obligation to have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security or municipal securities is suitable for the customer, bearing in mind that, among other things, the issue has a minimum denomination and the customer's liquidity needs and risk tolerance. Moreover, whether unsolicited or recommended, a dealer has an obligation under Rule G-47 to disclose to a customer, orally or in writing, at or prior to the time of trade, all material information known about the transaction, as well as material information about the security that is reasonably accessible to the market, including the fact that a sale of a quantity of municipal securities is below the minimum denomination authorized by the bond documents and the potential adverse effect on liquidity of a customer position below the minimum denomination.

Economic Analysis

1. The need for the draft amendments to Rule G-15(f) and how the draft amendments to Rule G-15(f) will meet that need.

As noted above, the need for the draft amendments arises primarily from a recognition that there are trading scenarios prohibited by the existing rule that, if allowed, would likely not result in a net increase in the number of below-denomination positions and may reduce the number of below-denomination positions, increase the ability of investors currently holding below-denomination positions to exit those positions and/or reduce the burden on dealers associated with implementing Rule G-15(f).

and municipal securities dealers, would be required to correspond to the revised numbering under Rule G-15(f).

¹⁰ The obligations of a dealer may differ if the dealer reasonably concludes the customer is a Sophisticated Municipal Market Professional. See MSRB Rule G-48.

While the existing rule does provide a mechanism for an investor with a below-denomination position to either exit their position entirely or purchase a portion of an issue below the minimum denomination so that they own a position at or above the minimum denomination, in practice those options may be unattractive to dealers that might, as a result of such trades, be left with a below-denomination position themselves for which a willing customer may be difficult to identify. As a result, investors with below-denomination positions, including those that acquired those positions as a result of divorce or inheritance, may find accessing liquidity difficult.

The draft amendments may provide additional exceptions that may make it easier for these investors to access liquidity.

2. Relevant baselines against which the likely economic impact of elements of the draft amendments should be considered.

The relevant baseline against which the likely economic impact of the draft amendments should be considered is existing Rule G-15(f), which generally prohibits dealers from effecting transactions with customers below the minimum denominations specified in bond documents. In addition, as noted above, MSRB Rules G-18, G-19 and G-47 impose regulatory requirements on dealers regarding customer transactions that supplement the protections afforded by Rule G-15(f) with respect to minimum denominations.

3. Identifying and evaluating reasonable alternative regulatory approaches.

The MSRB recognizes that there are alternatives to the approach taken in the draft amendments. For example, the MSRB could propose additional exceptions and/or liberalize the existing exceptions. While the MSRB recognizes that such alternatives might reduce the burden on dealers and increase the liquidity of below-denomination positions, the MSRB believes that they would also be likely to increase the number of below-denomination positions that potentially put investors at risk.

4. Assessing the benefits and costs of the draft amendments.

The MSRB policy on economic analysis in rulemaking addresses consideration of the likely costs and benefits of the rule with the draft amendments fully implemented against the context of the economic baseline discussed above. The MSRB is seeking, as part of this request for comment, data or studies relevant to the determination of the number of existing below-denomination positions, the relative difficulty of exiting or adding to these positions, the

impact of these positions on investors, and the costs the existing rule imposes on dealers.

Preliminarily, the MSRB has evaluated the benefits and costs associated with the draft amendments as follows:

Benefits

The MSRB believes that the draft amendments may reduce the number of below-denomination positions, increase the ability of investors currently holding below-denomination positions to exit those positions and/or reduce the burden on dealers associated with implementing Rule G-15(f).

Costs

Our analysis of the potential costs does not consider all of the costs associated with the proposal, but instead focuses on the incremental costs attributable to it that exceed the baseline state. The costs associated with the baseline state are, in effect, subtracted from the costs associated with the draft amendments to isolate the costs attributable to the incremental requirements of the draft amendments.

The MSRB recognizes that some dealers may incur costs should they utilize either the two additional proposed exceptions, but as the choice of whether and when to exercise these exceptions is wholly within a dealer's volition, the MSRB does not believe that the creation of the exemptions *per se* would result in any new costs for dealers.

The MSRB does not believe that the draft amendments are likely to result in a net increase in the number of below-denomination positions. The MSRB also has no reason to believe that any new below-denomination positions associated with the draft amendments would be held by a significantly different or less sophisticated group of investors than the group currently holding below-denomination positions. Therefore, the MSRB does not believe that there are any additional costs for investors and may, as discussed above, actually reduce costs by increasing liquidity.

The MSRB is not aware of any available data that would support a quantitative estimate of the overall impact of the draft amendments. The MSRB specifically seeks comments that would inform a quantitative estimate of the benefits and costs associated with the draft amendments.

Effect on Competition, Efficiency and Capital Formation

The MSRB believes that the draft amendments may improve capital formation and efficiency to the extent they result in improved access to liquidity for those investors holding below-denomination positions.

The MSRB believes that larger dealers with larger inventories and larger numbers of customers may be better positioned to exercise these exceptions, but does not believe this significantly improves their competitive position or significantly burdens those dealers less able to exercise the exceptions.

Questions

The MSRB seeks public comment on all aspects of the proposal and specifically requests comment concerning the following questions, as well as any other comments on the subject of transactions in amounts below the minimum denomination. The MSRB welcomes information regarding the potential to quantify the likely benefits and costs of the draft amendments. The MSRB requests comment on any competitive or anticompetitive effects, as well as efficiency and capital formation effects of the draft amendments on any market participants. The MSRB particularly welcomes statistical, empirical and other data from commenters that may support their views and/or support or refute the views or assumptions or issues raised in this request for comment.

1. As designed, do the draft amendments serve to improve liquidity for investors without increasing the number of customers maintaining positions in municipal securities below the minimum denomination?
2. Would any or all exceptions continue to appropriately balance the interests of issuers, investors, dealers and the market as a whole?
3. Are there other trading scenarios that would likewise enhance liquidity for investors without increasing the number of customers maintaining a position below the minimum denomination?
4. Should the exception permitting a dealer to purchase from a customer a position below the minimum denomination apply when that customer's below-minimum position is a result of an allocation in a managed account from a position purchased in an amount equal to or above the minimum denomination?
5. Are there other scenarios not already identified that cause a customer's position to fall below the minimum denomination?
6. Should dealers have to provide the written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely

affect the liquidity of the position if the dealer has already determined that the sale to the customer below the minimum denomination results in the customer being at or above the minimum denomination?

7. Under what circumstances do customers seek positions below the minimum denomination?
8. Do the alternatives identified above represent a comprehensive set of reasonable regulatory alternatives or are there alternative methods the MSRB should consider regarding permissible transactions below the minimum denomination of an issue that would be more effective and/or less burdensome?
9. To what extent have MSRB registrants found it difficult or costly to comply with the existing rule? If possible, please quantify the impact of these challenges.
10. What is the, per firm, annual cost of compliance with existing Rule G-15(f)?
11. Are there other relevant baselines the MSRB should consider when evaluating the economic impact of the proposal?
12. Are commenters aware of any studies assessing the impact of investors holding below-denomination positions?

April 7, 2016

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Text of Draft Amendments*

Rule G-15: Confirmation, Clearance, Settlement and Other Uniform Practice Requirements with Respect to Transactions with Customers

(a) - (e) No change.

(f) Minimum Denominations.

* Underlining indicates new language; strikethrough denotes deletions.

(i) Except as provided in this section (f), a broker, dealer or municipal securities dealer shall not effect a customer transaction in municipal securities issued after June 1, 2002 in an amount lower than the minimum denomination of the issue.

(ii) The prohibition in subsection (f)(i) of this rule shall not apply to the purchase of securities from a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the customer's position in the issue already is below the minimum denomination and that the entire position would be liquidated by the transaction. ~~In determining whether this is the case, a broker, dealer or municipal securities dealer may rely either upon customer account information in its possession or upon a written statement by the customer as to its position in an issue.~~

(iii) The prohibition in subsection (f)(i) of this rule shall not apply to the sale of securities to a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer determines that the securities position being sold is the result of a customer liquidating a position below the minimum denomination, as described in subsection (f)(ii) of this rule. ~~In determining whether this is the case, a broker, dealer or municipal securities dealer may rely upon customer account records in its possession or upon a written statement provided by the party from which the securities are purchased. A broker, dealer or municipal securities dealer effecting a sale to a customer under this subsection (iii) shall at or before the completion of the transaction, give or send to the customer a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. Such written statement may be included on the customer's confirmation or may be provided on a document separate from the confirmation. In effecting a sale with a customer in an amount below the minimum denomination, the broker, dealer or municipal securities dealer may:~~

(A) Sell the entire below-minimum position to one customer; or

(B) Sell a portion of the below-minimum position to one or more customers that have a position in the issue and the remainder of the below-minimum position to a maximum of one customer that does not have a position in the issue, even if the transaction(s) do not result in a customer increasing its position to an amount at or above the minimum denomination, provided that the increment(s) being sold to the customer(s) is consistent with any restrictions in the issuer's authorizing documents regarding incremental amounts.

(iv) The prohibition in subsection (f)(i) of this rule shall not prohibit a broker, dealer or municipal securities dealer from effecting a sale to a customer in an amount below the minimum denomination if the broker, dealer or municipal securities dealer is effecting a sale with a customer that has a position in the issue below the minimum denomination and the sale will result in that customer owning a position at or above the minimum denomination. Provided that no portion is sold to a customer that does not currently have a position in the issue, the broker, dealer or municipal securities dealer could then sell the remaining below-minimum position to one or more customers so long as the amount sold is consistent with any other restrictions in the issuer's authorizing documents regarding incremental amounts.

(v) A broker, dealer or municipal securities dealer effecting a purchase from or sale to a customer under subsection (ii), (iii) or (iv) shall determine a customer's position in the subject security based upon account records in the broker's, dealer's or municipal securities dealer's possession or upon a written statement provided by the party from which the securities are purchased or party to whom the securities are sold and, with respect to any sale in an amount below the minimum denomination, shall at or before the completion of the transaction, give or send to the customer a written statement informing the customer that the quantity of securities being sold is below the minimum denomination for the issue and that this may adversely affect the liquidity of the position unless the customer has other securities from the issue that can be combined to reach the minimum denomination. Such written statement may be included on the customer's confirmation or may be provided on a document separate from the confirmation.

(g) No change.