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Submitted Electronically

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-025

RE: Proposed Rule Change to Add New MSRB Rule G-49, on Transactions Below the Minimum Denomination of an Issue, to the Rules of the MSRB, and to Rescind Paragraph (f), on Minimum Denominations, from MSRB Rule G-15 (SR-MSRB-2017-01)

Dear Mr. Errett:

On behalf of the Bond Dealers of America ("BDA"), I am pleased to submit this letter in response to the Municipal Securities Rulemaking Board's ("MSRB") proposal to add new MSRB Rule G-49 (the "Proposed Rule"). The BDA is opposed to the Proposed Rule. BDA urges the SEC to disapprove the Proposed Rule and to direct the MSRB to draft an interpretative release to Rule G-19 to appropriately regulate the policy concern at the heart of the Proposed Rule.

BDA believes that the MSRB should abandon the Proposed Rule and fashion an interpretative release to Rule G-19.

The policy focus of the Proposed Rule is investor suitability and that is a matter covered by Rule G-19. The real regulatory need here is that dealers need to be required to honor an issuer's determination of investor suitability in transactions where the authorized denominations are $100,000 or above ("Higher Minimum Denominations"). The Proposed Rule demonstrates how there are life circumstances where the issuer's suitability determinations are not impacted and trading below authorized denominations does in fact make sense.

For example, a retail investor can be left with a $50,000 position in a bond with a Higher Minimum Denomination by virtue of inheritance or divorce, and selling that bond to a large institutional investor does not dishonor the issuer's concerns regarding investor suitability. But instead of fashioning a rule with a complex labyrinth of exceptions, the

MSRB should draft an interpretative release to Rule G-19 that obligates dealers to develop policies and procedures that will ensure that they honor Higher Minimum Denominations and lay out the policies and procedures for transactions with which exceptions may be made.

Using an interpretative release to Rule G-19 will allow dealers to consider the factors reasonable and relevant in their transactions (which can vary substantially from dealer to dealer) that may justify an acceptable trade below a Higher Minimum Denomination. This will prevent the one-size-fits all approach set forth in the Proposed Rule which leads to an awkward industry-wide implementation of a highly complex set of exceptions. An interpretative release to Rule G-19 is the far simpler and therefore more effective way to address the core policy concern of the Proposed Rule.

BDA believes the current minimum denomination framework in MSRB Rule G-15 is the primary source of investor harm.

BDA agrees that investors are being harmed. However, we believe the greatest impediment to a fair market and the greatest source of investor harm is the G-15 minimum denomination regulatory framework itself.

The origin of the Proposed Rule is the MSRB's determination that the current rules relating to minimum denominations in MSRB Rule G-15 do not sufficiently protect investors in a fair and meaningful way. In the view of the MSRB, this is because the rule does not adequately prevent the creation of below-minimum denomination positions and, therefore, it does not prevent liquidity problems for retail investors.

MSRB has failed to appreciate the real problem is that the current minimum denomination provisions in MSRB Rule G-15 regulate two very different fact patterns. The first fact pattern is representative of the vast majority of transactions involving bonds that have authorized denominations typically of $5,000 (and integral multiples thereof) purely as a consequence of historical practice that originated in the days of bearer bonds and clipping physical coupons. The second, which represents a clear minority of transactions, involves bonds that have Higher Minimum Denominations. In this second fact pattern, the issuer established the Higher Minimum Denomination as a matter of investor protection to help ensure that the bonds are sold to investors who are more likely to be financially sophisticated and able to better handle certain risks; or in order to meet the exemption in SEC rule 15c2-12(d)(1). That is, the second of these concerns at its core is more of a suitability issue.

The Proposed Rule is flawed because it imposes a single set of complicated rules to these two very different fact patterns. The MSRB's current minimum denomination rules have led to unnecessary liquidity problems for retail investors who end up with

positions in bonds below the minimum denomination (or above the minimum denomination, but not in authorized increments above the minimum denomination) due to various circumstances (such as marital settlements, inheritances, corporate actions, i.e., bond calls and others). But, instead of re-evaluating whether investors are being protected by the current minimum denomination regulatory structure or if it is creating liquidity issues for investors, the MSRB has assumed that the policy behind the current rule is sound and has proposed additional layers of exceptions to the rule. In fact, the problem is the current rule itself—not the lack of exceptions to it.

BDA believes that because securities are issued and traded in book-entry form the MSRB's regulatory efforts are only necessary for issuances with Higher Minimum Denominations.

In the modern securities markets in which securities are traded in book-entry form, ensuring that all bond transactions are traded within their authorized denominations serves no public policy purpose (except when those minimum denominations were created to comply with SEC rule 15c2-12 or to otherwise restrict distribution of the bonds to more financially sophisticated investors). When bonds were held in physical form, issuers and trustees needed to ensure that there were reasonable limits on the number of physical certificates they would prepare, and the practice of authorized denominations did that. As bonds have for many years been traded overwhelmingly in book-entry form, there are no valid reasons to maintain authorized denominations in book-entry trading on <u>all</u> bond transactions. In fact, it is one of the areas where book-entry trading offers a practical advantage to physical certificate trading—no one cares how many positions are created. Further, if no one cares how many positions are created, the only ones who are harmed by such a rule are retail investors who can be harmed by not being able to liquidate below minimum denomination holdings—ironically the same investors whom the rule ostensibly protects.

For an example of this, consider the 1994 revisions to Article 8 of the Uniform Commercial Code. In those revisions, the drafters created two systems, a direct holding system (involving physical certificates) and an indirect holding system (involving book-entry positions). The drafters specifically opted for far fewer protections in the indirect holding system because they saw the need for the functionality of the book-entry system and understood the impracticality of imposing too many obligations on the ownership and transfer of book-entry positions.[1] Like other legal structures such as these revisions to Article 8, the MSRB should not carry into book-entry trading policies that do not further any tangible policy objective merely because they represent historical practice or legal custom. We believe that is what the Proposed Rule does.

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[1] *See* Russell A. Hakes, UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day, 35 Loy. L.A. L. Rev. 661, 664 (2002).

Issuers frequently establish Higher Minimum Denominations when they want to limit distribution to investors who are more likely to be financially sophisticated and therefore better positioned to purchase bonds with higher risks or more difficult risks to understand. With these suitability concerns, the MSRB serves a valuable role of ensuring that dealers honor the issuer's determination. In the absence of an MSRB rule, there is no legal structure that enforces these suitability concerns in a book-entry trading[2] environment. Thus, the BDA believes that the market needs the MSRB to fashion a clear restriction that ensures that issuer-driven suitability concerns for Higher Minimum Denomination bonds are enforced in the market, but do not extend to the lower minimum denomination bonds where minimum denominations exist as a matter of historical practice that has no bearing in today's book entry environment, and not out of a suitability concern.

BDA believes that the Proposed Rule is excessively complex and leads to unintended costs and consequences.

The Proposed Rule tackles a fairly straight-forward issue – trading below authorized denominations – and does so with breathtaking complexity. If approved, dealers will need to implement compliance systems to both ensure that prohibited trades are not effected and that permissive trades are allowed. In a market that has seen an increasing number of small- and medium-sized dealers fall away, the MSRB appears to have no appreciation that its rules impact the businesses of dealers. Complexity involves time and money and, therefore, complexity, as such, matters to the businesses of dealers, and therefore needs to matter to the MSRB since ultimately liquidity for retail investors will be adversely impacted if dealers choose not to execute below minimum denomination transactions due to an unnecessarily complex regulatory structure.

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[2] The BDA notes that some commentators have called into question whether a trade by a beneficial owner of a bond in violation of an authorized denomination constitutes a breach of contract. We do not believe this to be true. In our experience, the vast majority of indentures are drafted in a fashion such that the authorized denominations solely represent obligations of the issuer and the trustee and, thus, do not even purport to extend to beneficial owners. Further, even if an indenture were to so provide, we do not understand how a contract can restrict a person not a party to that contract and who is trading an indirect ownership interest that is not created by that contract. Further, Article 8 of the Uniform Commercial Code preempts common law (including contract law) (see UCC § 1-103(b)) in the areas in which it governs, including the duties and obligations of owners and transferors of investment securities. Article 8 goes out of its way to preempt common law so that trading in the book-entry system functions as effectively as possible. Regardless, we concur with the MSRB that, whether or not such trading constitutes a breach of contract, MSRB rules do not change any obligations under contract law, should they exist. Furthermore, in our experience, the only transactions that we have seen that do in fact purport to bind beneficial owners involve high authorized denominations such as limited offerings under Rule 15c2-12, which the BDA's proposal would not impact.

In conclusion, the BDA is opposed to the Proposed Rule. The BDA strongly urges the SEC to reject the Proposed Rule and to direct the MSRB to draft an interpretative release to Rule G-19 narrowly constructed to address suitability concerns for transactions in municipal securities having Higher Minimum Denominations.

Sincerely,

Mike Nicholas
Chief Executive Officer