

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79978; File No. SR-MSRB-2017-01)

February 6, 2017

Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of a 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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Exchange Act” or “Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 24, 2017 the Municipal Securities Rulemaking Board (the “MSRB” or “Board”) filed with the Securities and Exchange Commission (the “SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The MSRB filed with the Commission a 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, in MSRB Rule G-15, on confirmation, clearance, settlement and other uniform practice requirements with respect to transactions with customers, to rescind paragraph (f), on minimum denominations (the “proposed rule change”). The MSRB requests that the proposed rule change be approved, with an effective date to be announced by the MSRB in a regulatory notice published no later than 60 days following the Commission’s approval, which effective date shall be no sooner than six months following the Commission’s approval.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

The text of the proposed rule change is available on the MSRB's website at www.msrb.org/Rules-and-Interpretations/SEC-Filings/2017-Filings.aspx, at the MSRB's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the MSRB included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The MSRB has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Minimum Denomination Requirements

The minimum denomination of an issue of municipal securities is the minimum amount that may be sold or otherwise transferred, and is determined by the issuer at issuance. Existing MSRB Rule G-15(f) generally prohibits a broker, dealer or a municipal securities dealer ("dealer") from effecting a customer transaction in a municipal security in an amount lower than the minimum denomination of the issue (the "prohibition"), and provides two exceptions to the prohibition. The policy underlying the prohibition is to protect investors from holding positions that are smaller than the limits established by the issuer.³

³ See Securities Exchange Act Release No. 45338 (January 25, 2002), 67 FR 6960 (February 14, 2002) (SR-MSRB-2001-07).

The exceptions to the prohibition are provided to help preserve the liquidity of customers' below-minimum denomination positions, without creating an additional number of below-minimum denomination positions where there once was one.⁴ Under the first exception, Rule G-15(f)(ii), a dealer is not prohibited from purchasing from a customer a municipal security in an amount below the minimum denomination of the issue, 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 in such issue. Under the second exception, Rule G-15(f)(iii), a dealer is not prohibited from selling to a customer a municipal security in an amount below the minimum denomination of the issue if the dealer determines that the position being sold is the result of a customer -- either the dealer's customer or the customer of another dealer -- fully liquidating its position in such issue that was below the minimum denomination of the issue. In such sales of a below-minimum denomination position to a customer, the dealer must provide written disclosure to the customer that the quantity of securities being sold is below the minimum denomination of the issue of municipal securities, 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 "minimum denomination sale disclosure").⁵

Proposed Rule G-49, Transactions Below the Minimum Denomination of an Issue

⁴ Id.

⁵ The exceptions in the rule do not purport to displace contractual restrictions as to minimum denominations set forth in a bond indenture of an issue. In addition, the rule does not resolve whether transfers of securities positions that are below the minimum denomination pursuant to the exceptions to the prohibition are legal or contractually binding under the indenture or other bond documents, or comply with any applicable state or other laws or regulation. In this regard, the MSRB's description of a transaction as permitted or allowed in the proposed rule change is limited to mean those transactions that are not prohibited under existing Rule G-15(f) or proposed Rule G-49.

The MSRB proposes to transfer the prohibition regarding below-minimum denomination transactions with customers, without substantive amendment, and the two exceptions to the prohibition and the minimum denomination sale disclosure, with certain amendments, from Rule G-15(f) to proposed new Rule G-49. A third exception would be included in the proposed rule, which would permit a dealer to sell a below-minimum denomination position to one or more customers that have a position in the issue and any remainder to a maximum of one customer that does not have a position in the issue. Proposed Rule G-49 also would significantly amend, in the existing exception regarding dealer sales to customers, the requirement that a dealer determine, by receipt of a written statement provided by the party from which the dealer purchases the below-minimum denomination securities position, that the position acquired from such dealer and being sold to a customer is the result of a customer's liquidation of its entire below-minimum denomination position (the "liquidation statement"). Regarding the liberalization of that requirement, proposed Rule G-49 would apply restrictions to inter-dealer transactions in below-minimum denomination positions. Proposed Rule G-49 would also eliminate, for a narrowly defined group of below-minimum denomination transactions, a dealer's obligation to provide the minimum denomination sale disclosure to its customer. Based on the organization of these related provisions in proposed Rule G-49, the existing minimum denomination provisions in Rule G-15(f) would be rescinded.

The Prohibition

The MSRB proposes to relocate the prohibition applicable to dealer-customer transactions below the minimum denomination of an issue of municipal securities from Rule G-15(f)(i) to proposed Rule G-49(a), subject only to technical changes, including amending the cross-referenced provisions to reflect the renumbering of such provisions in proposed Rule G-49.

Exceptions to the Prohibition

The MSRB proposes to transfer the two existing exceptions to the prohibition from existing Rule G-15(f) to proposed Rule G-49, establish an additional exception permitting certain additional dealer sales to customers consistent with the policies underlying the existing rule, and eliminate an informational requirement, the liquidation statement, applicable to dealers regarding another dealer's customer, which would liberalize the existing exception applicable to dealer sales to customers.

Dealer Purchase from a Customer. The MSRB proposes to relocate, without substantive amendment, the exception under which a dealer may purchase a below-minimum denomination position from a customer, if the dealer determines that the customer's position in the issue already is below the minimum denomination and the customer's entire position will be liquidated by the transaction. The existing exception in Rule G-15(f)(ii) would be renumbered as proposed Rule G-49(b)(i) (the "dealer purchase exception"). In connection with the dealer purchase exception, existing Rule G-15(f)(ii) requires the dealer to determine that the customer is liquidating its entire below-minimum denomination position based upon the customer account information in the dealer's possession or a written statement by the customer of the customer's position in the issue. This requirement would be retained and transferred to proposed Rule G-49(b)(iii), a separate paragraph that would contain requirements of general applicability regarding dealer purchases from, and, as discussed below, dealer sales to, customers of below-minimum denomination positions in municipal securities.

Dealer Sales to Customers

Dealer Sale Solely to One Customer. The MSRB also proposes to relocate the exception that permits a dealer to sell an entire below-minimum denomination position solely to one

customer from existing Rule G-15(f)(iii) to proposed Rule G-49(b)(ii)(A) (a “dealer sale exception”). In connection with this dealer sale exception, existing Rule G-15(f)(iii) requires the dealer to make a determination that the below-minimum denomination position to be sold is the result of a customer fully liquidating a below-minimum denomination position, as described in existing Rule G-15(f)(ii), and in making this determination the dealer may rely upon customer account records in the dealer’s possession or a liquidation statement that is provided by the party from which the securities were purchased. The MSRB proposes to retain the requirement that a dealer determine that the customer that sold the below-minimum denomination position fully liquidated its position, but only in those cases where the dealer buys a below-minimum denomination position from one of its own customers. Conversely, the MSRB does not propose to retain in proposed Rule G-49(b)(ii)(A) as reorganized, the existing requirement in Rule G-15(f) that a dealer determine that a customer of another dealer fully liquidated its position, in those cases where a dealer obtains the below-minimum denomination position from another dealer, as discussed below. (See, infra, “Elimination of Liquidation Statement/Inter-Dealer Transactions”).

Also, the existing exception for dealer sales, Rule G-15(f)(iii), requires a dealer to provide its customer, at or before the completion of the transaction, the minimum denomination sale disclosure. This disclosure requirement would be retained in proposed Rule G-49, but would be set forth in a separate paragraph that would be applicable to dealer sales to customers effected using either the dealer sale exception (i.e., the exception permitting a sale of a below-minimum denomination position to a single customer, which is renumbered as proposed G-49(b)(ii)(A)) or the additional dealer sale exception, in proposed Rule G-49(b)(ii)(B), discussed below.

Dealer Sale to One or More Customers. The MSRB also proposes to establish an additional exception to the prohibition, which would permit a dealer to sell a below-minimum denomination position to one or more customers. The additional dealer sale provision, proposed Rule G-49(b)(ii)(B), would not prohibit a dealer from selling an entire below-minimum denomination position to one or more customers that have a position in the issue, and selling any remainder of such position to a maximum of one customer that does not have a position in the municipal securities issue, even if the transaction(s) would not result in a customer increasing its position to an amount at or above the minimum denomination of the issue. The additional proposed dealer sale exception is intended to provide dealers and customers additional flexibility to effect customer transactions involving below-minimum denomination positions in municipal securities, consistent with the policies underlying the existing rule. As similarly required in the existing dealer sale exception (renumbered as proposed Rule G-49(b)(ii)(A)), in those cases where a dealer intends to use the additional dealer sale exception set forth as proposed Rule G-49(b)(ii)(B), and buys a below-minimum denomination position from one of its own customers, the dealer would be required to determine that the selling customer fully liquidated its below-minimum denomination position. Also consistent with the existing dealer sale exception, the additional proposed dealer sale exception would not include the liquidation statement requirement, as discussed in greater detail below. (See, *infra*, “Elimination of Liquidation Statement/Inter-Dealer Transactions”).

Elimination of Liquidation Statement/Inter-Dealer Transactions

The existing dealer sale exception in Rule G-15(f)(iii) requires a dealer to determine that the securities position to be sold to a customer is the result of another customer fully liquidating a below-minimum denomination position. As noted above, in cases where the dealer acquires the

below-minimum denomination position from another dealer, the acquiring dealer that desires to sell the position to its customer is required to obtain a written statement from the other dealer, referred to herein as a liquidation statement, verifying that the securities position to be sold is the result of another customer fully liquidating its below-minimum denomination position. This requirement, and, when a dealer buys securities from a customer, a similar requirement that the dealer determine that the customer fully liquidated its below-minimum denomination position in such sale, are designed to permit trading in such positions for the protection of investors that own below-minimum denomination positions without creating additional below-minimum denomination positions where there once was one. Without such limiting conditions, a single below-minimum denomination position may, as traded, be restructured as two or many more below-minimum denomination positions.

Several commenters raised concerns regarding the adverse impact that the existing liquidation statement requirement has on dealers' willingness to provide liquidity for below-minimum denomination positions held by customers, and the difficulty of complying with the liquidation statement requirement in positioning such securities for sale using an alternative trading system ("ATS") or through a brokers-broker. These and other comments are discussed in greater detail below. In response to such concerns, the MSRB proposes to eliminate the requirement to obtain the liquidation statement from the existing dealer sale exception (renumbered as proposed Rule G-49(b)(ii)(A)), and would not apply the requirement as a condition of the additional dealer sale exception set forth in proposed Rule G-49(b)(ii)(B).

Prior to determining that proposed Rule G-49 would be so modified, however, the MSRB carefully considered the ramifications and benefits of such action. Without the restraint imposed by the requirement to obtain a liquidation statement, the MSRB is concerned that dealers, in

inter-dealer transactions in below-minimum denomination positions, may create additional below-minimum denomination positions. Moreover, the MSRB is concerned that such positions may then be sold to customers. This result would be contrary to the policy underlying the existing rule, which is to protect investors from holding positions that are smaller than the limits established by the issuer, and to provide liquidity for investors holding such positions, without creating additional below- minimum denomination positions where there once was one. To deter the creation of additional and potentially smaller and less liquid below-minimum denomination positions in municipal securities for the protection of investors, the MSRB believes that the proposed elimination of the liquidation statement should be coupled with proposed Rule G-49(c). Proposed Rule G-49(c) would prohibit a dealer, in an inter-dealer transaction, from selling less than all of a below-minimum denomination position that such dealer acquired either from a customer making a total liquidation or from another dealer, and would provide an additional safeguard to counter the possible impact of the proposed elimination of the liquidation statement. Although some commenters that sought the elimination of the liquidation statement did not favor the inclusion of the inter-dealer limitation on trading, the MSRB believes that the proposed inter-dealer limitation on trading is necessary and appropriate for the protection of investors considering the proposed elimination of the liquidation statement. Although the proposed limitation on inter-dealer transactions may affect some transactions in below-minimum denomination positions in municipal securities, based on the commenters' views, the proposed elimination of the liquidation statement should result in significantly greater liquidity for such positions.

Disclosure

The existing disclosure provision in Rule G-15(f) requires a dealer in every transaction in which the dealer sells a below-minimum denomination position to a customer to provide the customer a minimum denomination sale disclosure (i.e., a written statement that the sale is of a below-minimum denomination position and this may adversely affect the liquidity of the position unless the customer has other securities from the issue that could be combined to reach the minimum denomination). The minimum denomination sale disclosure must be made at or before the completion of the transaction, and may be included on the customer's confirmation or may be provided on a separate document.

The MSRB proposes to relocate, with one amendment, the requirements in existing Rule G-15(f) regarding disclosure to proposed Rule G-49(b)(iii), a paragraph that would contain requirements of general applicability regarding dealer purchases from, and sales to, customers of below-minimum denomination positions in municipal securities. The proposed amendment would narrow the scope of the provision, eliminating the requirement that a dealer make the minimum denomination sale disclosure in cases where the dealer would effect a sale of securities that would result in the customer having a position at or above the minimum denomination. The amendment would not adversely impact investor protection because the disclosure would be of limited relevance to customers holding such positions.

2. Statutory Basis

Section 15B(b)(2) of the Exchange Act⁶ provides that

[t]he Board shall propose and adopt rules to effect the purposes of this title with respect to transactions in municipal securities effected by brokers, dealers, and municipal securities dealers and advice provided to or on behalf of municipal entities or obligated persons by brokers, dealers, municipal securities dealers, and municipal advisors with respect to municipal financial products, the issuance of municipal securities, and

⁶ 15 U.S.C. 78o-4(b)(2).

solicitations of municipal entities or obligated persons undertaken by brokers, dealers, municipal securities dealers, and municipal advisors.

Section 15B(b)(2)(C) of the Exchange Act⁷ provides that the MSRB's rules shall

be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in municipal securities and municipal financial products, to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and, in general, to protect investors, municipal entities, obligated persons, and the public interest.

The MSRB believes that the proposed rule change is consistent with the Act in that proposed new Rule G-49, regarding transactions below the minimum denomination of an issue, like its predecessor, Rule G-15(f),⁸ is designed to protect investors and issuers of municipal securities, with respect to transactions in municipal securities effected by dealers, from fraudulent and manipulative acts and practices and to promote just and equitable principles of trade. Proposed Rule G-49 is intended to deter the creation of positions in issues of municipal securities that are inconsistent with the issuer's determination of the appropriate minimum denomination of such issue to be held by investors, and, in doing so, will aid in the prevention of fraudulent and manipulative acts and practices and transactions effected by dealers that are not consistent with the minimum denomination requirements of an issue of municipal securities. In addition, proposed Rule G-49 will facilitate just and equitable principles of trade, generally prohibiting dealers from effecting transactions involving below-minimum denomination positions with customers that may not fully understand that the position is below the minimum denomination or that such attribute may make the position less liquid if the customer

⁷ 15 U.S.C. 78o-4(b)(2)(C).

⁸ See Securities Exchange Act Release No. 45338 (January 25, 2002), 67 FR 6960 (February 14, 2002) (SR-MSRB-2001-07).

subsequently desires to sell the position. Also, the exceptions, as amended, and an additional proposed exception, are designed to provide greater liquidity than under existing Rule G-15(f) for such positions if held by customers, for the protection of the public, with limitations on such exceptions and related limitations on inter-dealer transactions, that are necessary and appropriate to protect investors from the creation by dealers and acquisition by customers of additional below-minimum denomination positions that may be difficult to liquidate subsequently and are contrary to requirements established by issuers.

B. Self-Regulatory Organization’s Statement on Burden on Competition

Section 15B(b)(2)(C) of the Exchange Act⁹ requires that MSRB rules not be designed to impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The MSRB has considered the economic impact associated with this proposed rule change, including in comparison to reasonable alternative regulatory approaches, relative to the baseline. As part of this process, in two notices requesting comment, the MSRB solicited comment on any potential burden on competition posed by the proposed rule change.¹⁰

The MSRB believes that the proposed rule has potential benefits including reducing the number of investor positions below minimum denominations, increasing the ability of investors currently holding positions below minimum denominations to exit those positions and/or reducing the burden on dealers associated with implementing the minimum denomination

⁹ 15 U.S.C. 78o-4(b)(2)(C).

¹⁰ [Request for Comment on Draft Amendments to MSRB Rule G-15\(f\) on Minimum Denominations](#), MSRB Notice 2016-13, dated April 7, 2016 (“First Request for Comment”). [Second Request for Comment on Draft Provisions on Minimum Denominations](#), MSRB Notice 2016-23, dated September 27, 2016 (“Second Request for Comment”). The notices incorporated the MSRB’s preliminary economic analysis. The comments and the MSRB’s responses thereto are discussed in the next section of the proposed rule change.

regulatory provisions in existing Rule G-15(f), renumbered as proposed Rule G-49. The MSRB recognizes that some dealers may incur costs should they utilize the 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 exceptions *per se* would necessarily result in any new costs for dealers.

The proposed rule does not impact the choices available to issuers in determining minimum denominations as part of the offering documents. Issuers would continue to select the denomination level that they believe to be optimal for purposes of suitability or for purposes of enhancing secondary market liquidity of traded issues. Therefore, the MSRB believes that competition in the primary issuer market would not be affected by the adoption of this proposed rule.

The MSRB believes that larger dealers with larger inventories and larger numbers of customers may be better positioned to exercise the exceptions offered under the proposed rule, but does not believe that this significantly improves their competitive position or overly burdens those dealers that are less able to exercise the exceptions. Therefore, the MSRB does not believe that the proposed rule change will impose any additional burdens on competition in the dealer market, relative to the baseline, that are not necessary or appropriate in furtherance of the purposes of the Act.

The MSRB does not believe that the proposed rule is likely to result in a net increase in the number of positions below the minimum-denomination amounts. The MSRB also has no reason to believe that any new positions below minimum-denomination amounts associated with the proposed rule would be held by a significantly different or less sophisticated group of investors than the group currently holding such positions. Therefore, the MSRB does not believe

that there are any additional costs for investors and the proposed rule may, as discussed above, reduce costs for investors holding such below-minimum denomination positions by generally improving liquidity for those investors.

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

In 2016, the MSRB twice sought comment on proposed amendments to provisions relating to below-minimum denomination customer transactions, first as proposed amendments to Rule G-15(f) (the “initial draft rule”) and subsequently as draft Rule G-49.¹¹ The MSRB received 10 comment letters in response to the First Request for Comment,¹² and seven comment letters in response to the Second Request for Comment.¹³ The comment letters are summarized below by topic and the MSRB’s responses are provided.

¹¹ See n.10, supra.

¹² The ten comment letters received in response to the First Request for Comment were from the following: American Municipal Securities, Inc. (“AMS”): Letter from Michael Petagna, President, dated May 25, 2016; Breena LLC (“Breena”): Email from G. Letti, dated April 19, 2016; Bond Dealers of America (“BDA”): Letter from Mike Nicholas, Chief Executive Officer, dated May 25, 2016; Center for Municipal Finance (“CMF”): Letter from Marc D. Joffe, President, dated April 7, 2016; Email from Thomas Kiernan (“Kiernan”), dated April 7, 2016; Neighborly.com (“Neighborly”): Email from Jase Wilson, dated May 25, 2016; Regional Brokers, Inc. (“Regional Brokers”): Letter from H. Deane Armstrong, CCO, not dated; Securities Industry and Financial Markets Association (“SIFMA”): Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated May 25, 2016; Vista Securities (“Vista”): Email from Rick DeLong, dated May 9, 2016; and Wells Fargo Advisors, LLC (“Wells Fargo”): Letter from Robert J. McCarthy, Director of Regulatory Policy, dated May 25, 2016.

¹³ The seven comment letters received in response to the Second Request for Comment were from the following: BDA: Letter from Mike Nicholas, Chief Executive Officer, dated October 18, 2016; Financial Services Institute (“FSI”): Letter from David T. Bellaire, Executive Vice President and General Counsel, dated October 11, 2016; Georgetown University McDonough School of Business (“Georgetown”): Letter from James J. Angel (“Angel”), Associate Professor of Finance, dated October 22, 2016; Email from G. Letti (“Letti”), dated September 27, 2016; National Association of Bond Lawyers (“NABL”): Letter from Clifford M. Gerber, President, dated December 23, 2016; Romano Brothers & Co. (“Romano”): Letter from Eric Bederman, Chief Operating

General Comments

Several commenters, including BDA, SIFMA and Wells Fargo, responding to the initial draft rule in the First Request for Comment, expressed general support for the MSRB's proposal to create additional exceptions to the prohibition that would be consistent with the existing rule's original intent to protect investors that own below-minimum denomination positions in municipal securities without creating an additional number of below-minimum denomination positions. Commenters generally noted that providing additional options for dealers to sell such securities to customers may increase liquidity and improve pricing. At the same time, commenters, including AMS, BDA, Vista and SIFMA, stated that the regulation of, and regulatory uncertainty regarding below-minimum denomination positions adversely affects the liquidity and value of these positions in the secondary market in that dealers are not willing to actively bid securities in amounts below the minimum denomination, and that legitimately created, high-credit quality but nonconforming customer positions are artificially devalued, leaving customers unable to liquidate at a reasonable bid.

In response to the Second Request for Comment, three commenters, FSI, Letti, and Romano, indicated general support and approval of draft Rule G-49. Two of the three commenters, FSI and Romano, commented that the draft provisions would improve liquidity and make it easier for a customer holding a below-minimum denomination position to sell the securities. FSI stated that the stand-alone rule would make the provisions clearer and more accessible. In FSI's view, draft Rule G-49 would strike the appropriate balance between enhancing liquidity and restricting creation of additional below-minimum denomination

& Compliance Officer, dated October 18, 2016; and SIFMA: Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, dated October 18, 2016.

positions, and the draft rule, with the liquidation statement eliminated, should be adopted. Letti commented that draft Rule G-49 was simple, well-written and easy to understand.

Two commenters, SIFMA and BDA, expressed appreciation that revisions to the minimum denomination provisions were being considered to provide greater flexibility for dealers and investors, noting that some of the changes would improve the rule. These commenters also requested the MSRB to make additional significant amendments to draft Rule G-49. In SIFMA's view, the proposed exceptions would not appropriately balance the interests of issuers, customers, dealers and the market, and some would create additional challenges for dealers and less liquidity for customers. BDA expressed concerns that the rule was extraordinarily complex, predicting that dealers would be confused, and differ over interpretations of permissible transactions under the rule, which would leave customers holding positions that they would not be able to trade, or would be able to trade but only at inferior prices.

One commenter, Angel, did not support any aspect of draft Rule G-49, stating that existing Rule G-15(f) should be rescinded instead of amended.

Existing and Additional Exceptions

In response to the First Request for Comment, several commenters requested that additional exceptions to the prohibition be incorporated. BDA, AMS, Vista, SIFMA and Wells Fargo generally commented that, in their view, the circumstances of the creation of a below-minimum denomination account (e.g., by allocations of an investment advisor, the settlement of an estate or the division of marital assets, or call provisions that permit calls in amounts inconsistent with the minimum denomination) should be considered in the changes being considered, and in some cases, as a basis for an exception (without providing a specific structure

for such exception), so that investors would not be penalized.¹⁴ BDA and Wells Fargo also suggested an exception to permit a customer to liquidate some but not all of its below-minimum denomination position. Kiernan requested that the MSRB consider adding an exception for refunded bonds subject to a high minimum denomination, because, in his view, the repayment risk is mitigated.

In response to the Second Request for Comment, two commenters, BDA and SIFMA, stated that dealers should not be constrained in their transactions involving below-minimum denomination positions with customers under the additional dealer sale exception, proposed Rule G-49(b)(ii)(B), and the exception should be liberalized to allow a dealer selling a portion of a below-minimum denomination position to a customer also to sell a portion of the position to one or more dealers. SIFMA commented that such sales (i.e., sales of a portion of a below-minimum denomination position to one or more dealers) should be allowed at the same time as the sales to customers or thereafter. In SIFMA's view, this approach would not increase the number of below-minimum denomination positions, and if not adopted, liquidity would be hampered unnecessarily.

The MSRB has carefully reviewed the changes suggested by the commenters. Some of the additional exceptions, or amendments to existing exceptions, suggested by commenters would not provide sufficient additional flexibility to benefit customers. In addition, such changes could result in the creation of additional below-minimum denomination positions, which likely

¹⁴ For example, SIFMA suggested that an exception should apply when the customer's position is a result of an allocation to the managed account by the customer's investment adviser. BDA requested a provision be included that would grant a dealer additional flexibility when such customer positions are created in circumstances beyond a dealer's control. In response to the Second Request for Comment, SIFMA repeated its concern for investors holding below-minimum denomination positions due to such circumstances or actions over which they have no control.

would be transferred ultimately to customers. The creation of additional minimum denomination positions would be contrary to the original policies of existing Rule G-15(f) to protect investors that own below-minimum denomination positions but, at the same time, not allow or facilitate the creation of additional below-minimum denomination positions. The MSRB believes that the existing exceptions and the additional proposed exception are structured to provide customer protection and, at the same time, avoid increasing the number of below-minimum denomination positions held by customers, and the changes suggested above should not be incorporated in proposed Rule G-49.

Liquidation Statement and Inter-Dealer Limitation. In response to the initial draft rule in the First Request for Comment, several commenters, including SIFMA, BDA and Regional Brokers, stated that, in facilitating the sale to a customer of a below-minimum denomination position using the existing dealer sale exception (renumbered as proposed Rule G-49(b)(ii)(A)) or the proposed additional dealer sale exception (renumbered as proposed Rule G-49(b)(ii)(B)), in any inter-dealer trade occurring in connection with such sale, the dealer that is acquiring the securities from another dealer should not be required to obtain a liquidation statement. Vista commented that the liquidation statement requirement has merit for securities having a minimum denomination of \$100,000 (or more) to protect unsophisticated investors, but is unnecessary for securities not subject to such minimum denomination requirements. AMS suggested that the liquidation statement requirement should not apply to positions of less than \$5,000 to enhance their liquidity. SIFMA, BDA, Vista and Regional Brokers believed that the liquidation statement requirement discourages many traders from bidding on such positions and its elimination would improve liquidity. Commenters, including Vista and SIFMA, noted that below-minimum denomination positions often are transferred using alternative trading systems (“ATs”), or, in

some cases, brokers-brokers, and, in their view, requiring the liquidation statement in such venues creates an unnecessary impediment to trading such positions. Also, commenters, including BDA and SIFMA, noted that the liquidation statement requirement raises concerns because dealers bidding to buy a below-minimum denomination position do not immediately know the counter-party's customer, and the provision requires dealers to "look through" to ascertain the account-level information and identity of the customer of its counterparty. Commenters expressed concern that a dealer's compliance with any dealer sale exception requiring a liquidation statement is reliant upon the selling dealer and the ATS (or the brokers-broker) providing the appropriate written verification, and a dealer may be penalized if it cannot prove the complete customer liquidation occurred.

In response to the comments received, the draft rule published for comment in the Second Request for Comment eliminated the requirement that a dealer obtain a liquidation statement when a dealer obtains a below-minimum denomination position from another dealer. However, the elimination of the liquidation statement was coupled with a new requirement, draft Rule G-49(c), which would prohibit dealers from breaking up below-minimum denomination positions in sales to other dealers to deter the creation of additional below-minimum denomination positions.¹⁵

In response to the Second Request for Comment, although several commenters, including FSI, SIFMA and BDA, commented favorably on the proposed elimination of the liquidation statement in proposed Rule G-49, certain commenters, including SIFMA and BDA, commented

¹⁵ As noted, *supra*, the MSRB recognized that the two proposed amendments set forth in draft Rule G-49 should be considered together, in that without the restraint imposed by the liquidation statement, the MSRB was concerned that existing below-minimum denomination positions might fracture into additional below-minimum positions in inter-dealer trading, and come to rest with multiple customers.

unfavorably on proposed Rule G-49(c). SIFMA and BDA urged that proposed Rule G-49(c) be deleted, commenting that it would result in a loss of dealer flexibility and impair the liquidity of below-minimum denomination positions. SIFMA also commented that the proposed inter-dealer provision is unwarranted and inconsistent with the protection of customers, stating that dealers should be permitted to accumulate below-minimum denomination positions without limitation, and sell such positions to a customer to add to a customer's existing below-minimum denomination position.¹⁶ In SIFMA's view, the proposed inter-dealer provision bears no relationship to the MSRB's proposal to eliminate the liquidation statement requirement. Finally, SIFMA opposes proposed Rule G-49(c) because SIFMA believes that the sole purpose of the existing rule provisions is to prohibit dealers from effecting below-minimum denomination transactions with customers. The MSRB has considered the comments carefully and concludes that proposed Rule G-49(c) should not be eliminated, for the same reasons that the MSRB believes that the dealer purchase and dealer sale exceptions should not be broadened. The elimination of the liquidation statement requirement in the proposed dealer sale exceptions in proposed Rule G-49, if not coupled with the incorporation of proposed Rule G-49(c), would permit a dealer to sell other dealers additional below-minimum denomination positions, which would likely be eventually transferred to customers, and would be inconsistent with the policy goals underlying the rule. The MSRB believes that, with the inclusion of proposed Rule G-49(c)

¹⁶ BDA similarly commented that, at least regarding a transaction to be effected pursuant to the additional dealer sale exception in proposed Rule G-49(b)(ii)(B), a dealer should not be subject to the prohibition in proposed Rule G-49(c) if a dealer desired to sell a portion of a below-minimum denomination position to another dealer, or if a dealer desired to purchase such a partial position. However, in the discussion, supra, the MSRB indicated that it does not believe it is appropriate to amend the relevant dealer sale exception (for sales to customers) in proposed Rule G-49 to permit the type of inter-dealer sales or purchases suggested by BDA and SIFMA.

and the elimination of the liquidation statement, proposed Rule G-49 will accomplish the policies underlying the existing rule and intended in the proposed rule change.

Deletion of a Dealer Sale Exception. In response to the Second Request for Comment, SIFMA commented that the second additional dealer sale exception, then numbered as draft Rule G-49(b)(iii), was redundant and should be deleted.¹⁷ The MSRB agrees that most of the more common scenarios that arise would be covered by the dealer sale exceptions in proposed Rule G-49(b)(ii)(A) and (B). In response to the commenter's suggestion, the MSRB proposes to omit the second dealer sale exception referenced in draft Rule G-49. The omission also will clarify and simplify the rule, and thus, is responsive to a second commenter's concern regarding the complexity of the draft rule.

Other Comments

Contractual Requirements. In response to the Second Request for Comment, NABL stated that authorized denominations, including the minimum denomination, of an issue are determined by the issuer at issuance. Further, such requirements, which are typically included in the bond indenture, bond ordinance, or resolution, are part of the bond contract and may be modified only in accordance with the specific terms of the contract governing modifications. Noting that the MSRB is not a party to such contracts, the commenter stated that "whether the

¹⁷ The initial draft amendments included a third dealer sale exception (then numbered as initial draft Rule G-15(f)(iv)), which would have required a dealer that desired to sell a below-minimum denomination position to more than one customer: (i) to sell to one customer already having a position, the number of securities needed to bring the position of the customer up to or above the minimum denomination of the issue; and (ii) to sell, to one or more additional customers, each already having a position, the remaining portion of the below-minimum position. The draft third dealer sale exception, set forth in the Second Request for Comment as draft Rule G-49(b)(iii), did not require that one customer's position be brought up to or over the minimum denomination of the issue, and, with the elimination of that requirement, became substantially similar to the dealer sale exception set forth in draft Rule G-49(b)(ii)(B).

MSRB permits sales of municipal securities in less than the minimum denomination, or in anything other than an authorized denomination, is ineffective to determine whether such transfers are legal or contractually binding under the bond documents.” According to the commenter, such requirements are in the bond documents with the intent that sales and transfers of bonds will be made only in compliance with such requirements, including transfers effected by book entry in The Depository Trust Company.¹⁸ Although NABL appreciated the desire to improve liquidity for investors, the commenter also stated that any effort to do so should be consistent with issuer requirements set forth in bond documents, suggesting that in its deliberations of proposed Rule G-49, the MSRB should strive, in its rule, to decrease rather than hold steady (or increase) the number of below-minimum denomination positions; consider whether the MSRB rule should actively discourage or prevent sales of below-minimum denomination positions to investors not already having an existing position in the security; and consider whether more could be done to facilitate compliance with bond documents (e.g., improvements to trading platforms, transaction mechanics, including minimum denominations in the data reported under Rule G-32), and ensure that investors are not trading in below-minimum denomination positions.

The MSRB has carefully considered the issues raised by the commenter relating to the requirements in the bond documents as established by the issuer. For the protection of investors, the MSRB believes that proposed Rule G-49 would balance the need for liquidity in such positions for the protection of customers holding such positions, while continuing a general and broad prohibition against trading in such positions for the protection of issuers establishing such

¹⁸ According to the commenter, the book-entry system of registration, while facilitating securities transfers, also has removed the entities – the bond trustee and issuer’s paying agent – that police the denomination requirements in transfers.

requirements. In developing the proposed rule, the MSRB carefully crafted any exception to the prohibition so that the number of customers holding below-minimum denomination positions would not increase as a result of transactions effected using the rule. However, for purposes of protecting customers already holding such positions by providing additional liquidity for such customers, the proposed rule also would not require that a transaction effectively result in fewer persons holding such below-minimum denomination positions. The MSRB notes that it has not, in the past, nor in considering proposed Rule G-49, represented that transactions effected pursuant to the rule(s) would remedy any contractual or other legal issues or deficiencies regarding such below-minimum denomination transfers. The exceptions to general prohibition are precisely that – exceptions to the prohibition – and do not purport to impact any other legal rights or obligations. The MSRB also notes that certain issues and suggestions raised by the commenter exceed the jurisdiction of the MSRB (e.g., issues regarding book-entry transfers and the improvement of trading platforms). After considering all such issues, the MSRB continues to believe that proposed Rule G-49 represents the appropriate balance among the competing policies involved.

Threshold. In response to the Second Request for Comment, BDA commented that the prohibition against trading below a minimum denomination of an issue in draft Rule G-49 should be limited in application to transactions in municipal securities having higher minimum denominations, such as \$100,000 (or possibly \$20,000 or \$50,000) because, according to BDA, securities having higher minimum denominations are those that may raise heightened security concerns and the suggested change would focus the prohibition and the exceptions on such municipal securities. As previously discussed, the MSRB originally adopted the prohibition in existing Rule G-15(f) against trading with a customer in a below-minimum denomination

position in part to respond to issuer concerns regarding below-minimum denomination positions being sold to retail customers, noting that in some cases issuers explicitly stated that higher minimum denominations had been established in light of the risks the issuer attributed to a particular issue.¹⁹ However, an issuer should be free to set the minimum denomination of a particular issue of municipal securities as it deems appropriate, weighing many factors, include risks, and the MSRB declines to adopt the commenter's suggestion to create a minimum denomination threshold, below which proposed Rule G-49 would not apply.

Rescission. In response to the Second Request for Comment, one commenter, Angel, stated that existing Rule G-15(f) should be rescinded. In the commenter's view, the rule is no longer necessary, considering the amount of information about the municipal securities market currently available to investors, who have information about issuers on EMMA and from other sources. Also, in the commenter's view, the complexity of the exceptions would mean customer below-minimum positions would remain illiquid. The commenter stated that suitability regulations, and regulations such as the new Department of Labor regulation applicable to retirement accounts provide appropriate protections for municipal securities investors. After considering the comment, the MSRB believes the general prohibition in effect for many years continues to serve a beneficial investor protection function, and is not proposing rescission.

Disclosure to SMMPs. In response to the First Request for Comment, BDA suggested that dealers should not be required to provide the minimum denomination sale disclosure to sophisticated municipal market professionals (SMMPs). BDA stated that SMMPs should not be protected by the rule, including the requirement to receive the minimum denomination sale disclosure, because in all transactions with SMMPs, a dealer must have a reasonable basis to

¹⁹ See Second Request for Comment.

believe that the SMMP can evaluate market risk and market value independently of the dealer. The MSRB believes that it would be appropriate to solicit specifically the comment of institutional investors before considering whether the disclosure should be eliminated and, therefore, at this time, does not believe it would be appropriate to eliminate the protection for such customers.

Compliance. In response to the Second Request for Comment, SIFMA commented that the annual cost of compliance for existing Rule G-15(f) cannot be accurately quantified, but based on anecdotes, firms may be spending significant resources to comply with the rule. SIFMA suggested that this is, in part, because regulatory scrutiny regarding below-minimum denomination transactions has increased, creating pressure on compliance. SIFMA believes that compliance costs are increasing and that this, coupled with regulatory scrutiny and enforcement, has decreased liquidity for below-minimum denomination positions. Although the MSRB does not believe it is appropriate to revise the proposed rule based on concerns that liquidity has been adversely impacted due to regulatory scrutiny and enforcement of the existing below-minimum denomination requirements, the MSRB notes that the proposed rule is intended to provide additional flexibility for dealers and their customers.

EMMA. SIFMA suggested in the response to the First and Second Requests for Comment that the MSRB include additional information on issuers' minimum denomination requirements on EMMA. In the future, the MSRB may consider various proposals to increase information on EMMA, including the minimum denomination of municipal securities, as part of its longer-term review of various issues arising regarding market transparency.

Trade Reporting; Rescission of Transactions. BDA suggested that firms be allowed to rescind and correct a transaction in a below-minimum denomination position within a reasonable

time frame. Romano suggested that RTRS be enhanced to include a “flag” denoting any below-minimum denomination transaction, which would allow dealers to review such trades on T + 1 and cancel and correct such trades if not effected pursuant to the appropriate exception. The changes suggested by BDA and Romano involve exceptions to MSRB’s trade reporting rules and are beyond the scope of the proposed provisions on which the MSRB requested comment. At this time, the MSRB does not propose to amend such rules to incorporate the commenters’ suggestions.

Comments not Related to Proposal. Finally, several comments were received in response to the First and Second Requests for Comment, that were generally beyond the scope of the MSRB’s jurisdiction (e.g., generally, issuers should change their practices to reduce or eliminate below-minimum denomination positions or positions not meeting an issuer’s increment requirements; issuers should be informed that there is no regulatory requirement to use \$5,000 as a minimum increment; and an “official” minimum increment of \$1,000 should be considered). As a result, the MSRB has not considered such comments in the proposed rule change.

Economic Analysis

Although commenters expressed general concerns regarding the cost of the regulation on below-minimum denomination transactions, no commenters in response to the First or Second Request for Comment provided data to support these concerns. Issuers set a minimum denomination, presumably, at a level that is consistent with receiving the best possible price, or desired yield, in the primary market. Thus, doing away with the minimum denomination entirely is not a reasonable regulatory alternative since this would lead to suboptimal minimum denominations from the perspective of the issuer.

From the perspective of dealers, proposed Rule G-49 does not require dealers to exercise the exceptions to transact in amounts below the minimum denomination. Therefore, the costs associated with complying with the requirements for transactions below minimum denominations are not forced upon dealers. Presumably, entities only incur these costs when they stand to reap benefits exceeding compliance costs. However, to the extent that compliance costs are incrementally higher because of the proposed rule, dealers can be expected to engage in fewer profitable transactions for positions below the minimum denomination.

Although commenters raised concern over the potential costs associated with the enforcement of minimum denominations, no commenter provided data or quantitative estimates in connection with the preliminary Economic Analysis outlined in the First and Second Requests for Comment. Nevertheless, to reduce uncertainty regarding the exceptions to this proposed rule, and in response to comments, the text of the proposed rule has been simplified while an additional exception was still incorporated.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period of up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning

the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-MSRB-2017-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-MSRB-2017-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the MSRB. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-MSRB-2017-

01 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, pursuant to delegated authority.²⁰

Robert W. Errett
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).