November 12, 2019

Rick A. Fleming
Investor Advocate
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Response to Investor Advocate Request Highlighting Municipal Market Practices

Dear Mr. Fleming,

The Municipal Securities Rulemaking Board (MSRB) is submitting this letter in response to the SEC Office of the Investor Advocate's annual request for the MSRB to share its perspective on products and practices that may have adversely impacted municipal market retail investors over the past year. As the self-regulatory organization that oversees the municipal market, the MSRB believes strongly in its investor protection responsibility, and continues to utilize the complementary tools of rulemaking, education and outreach, and transparency solutions to educate and protect investors in the $3.9 trillion municipal market.

This year, the MSRB has identified a number of risks to retail investors under the broader topics of (1) the macroeconomic environment; (2) disclosure practices; and (3) market practices. A detailed description of each follows.

Macroeconomic Environment

As the global financial marketplace prepares for the cessation of the London Interbank Offered Rate (Libor), the MSRB is monitoring the potential impact of the transition away from Libor on both issuers of municipal securities and their investors. The phase-out of Libor has the potential to affect numerous types of municipal market transactions, including floating rate notes, bank loans, and interest rate swaps tied to municipal bonds. The MSRB is supportive of the work of the Alternative Reference Rates Committee (ARRC) to facilitate the transition from Libor and is aware of the diligent work by state and local governments to transition to alternative rates such as the Secured Overnight Financing Rate (SOFR) or other qualified rates. Likewise, municipal market industry associations continue to educate and assist municipalities in the transition effort. However, the MSRB understands that some municipal issuers continue to enter into new trades that reference Libor, particularly in the swaps market. Should issuers of municipal securities not adequately prepare for the cessation of Libor, retail holders of those Libor-linked securities may be at risk of holding illiquid or dislocated securities come 2021. This risk may be more pronounced for small and infrequent issuers that may not have access to ongoing support from municipal market professionals. The MSRB continues to monitor developments surrounding the global Libor transition and its potential effect on the municipal market.

In the MSRB's 2018 Letter to the Investor Advocate, the MSRB contemplated the potential effect of rising interest rates on an investor's municipal securities portfolio. However, over the past year, the market has observed sustained historically low interest rates, with no foreseeable increases expected in the near-term. The persistent low interest rate environment, while beneficial to municipal market issuers who are able to raise capital for important projects at a low cost and refinance outstanding debt, may also present risk factors of which investors should be aware.

Retail investors continue to shift to ownership of municipal bonds through mutual funds, as opposed to through brokerage accounts. According to the Investment Company Institute (ICI), the market has experienced 43 straight weeks of inflows into tax-exempt mutual funds.[1] Municipal bond ownership through mutual funds may have appeal in a persistent low interest rate environment by providing diversification through investment in a larger portfolio of securities, which may include high-yield bonds. Investors may want to consider reviewing their portfolio holdings with their financial professionals to ensure they have the appropriate credit exposure and maturity range in their municipal bond holdings. Investors with exposure to municipal bonds through mutual funds should be aware that a future increase in interest rates may cause a mutual fund's net asset value (NAV) to decline, impacting the overall value of investors' mutual fund holdings. Declining NAVs could lead to redemptions by individual investors of their mutual fund shares and the sale of municipal bonds by mutual funds could, in turn, lead to market dislocation as the liquidity needs of mutual funds could exceed the willingness or ability of dealers to increase their municipal securities holdings. The MSRB continues to publish educational materials for investors on the changing nature of municipal bond ownership and the impact of interest rate movement on municipal bond prices and yields.[2]

In addition to interest rate movements and the transition from Libor, the MSRB is closely tracking the issue of cyberattacks on municipalities and trend in disclosure practices of climate risk factors in bond offering documents. In the past year, a number of state and local governments experienced ransomware attacks that impacted computer systems and, in some cases, resulted in costly payments to the attackers. Likewise, as climate risk factors become more closely evaluated by investors, issuers, especially those in locations more vulnerable to the effects of weather events, may want to consider how those risks are being communicated to market participants. The MSRB does not believe cyberattacks or climate factors to be a systemic market issue at this time but will continue to track the issue, including how municipalities disclose those risks to current bondholders and prospective investors.

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[1] https://www.ici.org/research/stats/flows/ltflows/flows_11_06_19

[2] http://www.msrb.org/msrb1/pdfs/Interest-Rate-Movement.pdf

Disclosure Practices
Since 2008, the MSRB has elevated the level of municipal market transparency through its Electronic Municipal Market Access (EMMA®) website. The EMMA website has always been, and remains, free to retail investors and the public. The MSRB does not charge retail investors to access real time trade data, download disclosure documents, or access any of the market tools and resources provided by the MSRB.

The MSRB recognizes that the volume and organization of information on EMMA can be challenging for retail investors. Last year, based on user feedback, the MSRB implemented navigational improvements, including predictive search functionality, to help investors more easily find information on EMMA. This year, the MSRB enhanced the disclosure submission process for issuers, obligated persons and their agents to support improved categorization and descriptions about disclosure documents, which should help investors more easily locate and understand the content of disclosures they can access at no cost on EMMA.

The MSRB also continues to evaluate the timing of disclosure on EMMA of annual or audited financial information by municipal securities issuers. In response to concerns raised by SEC Chairman Jay Clayton and other policymakers about the age of financial disclosures in the municipal securities market, the MSRB plans to propose new features for the EMMA website to help investors more easily identify the number of days from an issuer's or obligated person's fiscal period end to the date of posting of annual or audited financial disclosures to EMMA.

Market Practices
The MSRB is evaluating the potential regulatory impact of the SEC's recent proposed Exemptive Order, which would provide municipal advisors registered with the SEC a conditional exemption from the requirement to register as a broker when engaging in certain limited activities in connection with the direct placement of municipal securities.[3] The MSRB is considering whether, if approved, the Exemptive Order would, as commenters suggest, result in regulatory disparities and potential impact to market transparency.

Next, in our 2017 and 2018 Letters to the Investor Advocate, the MSRB highlighted the practice of "pennying."[4] The MSRB believes that widespread pennying could, over time, be harmful to retail investors by disincentivizing participation of other dealers in the bid-wanted process. The MSRB is also concerned that pennying may harm municipal market liquidity by discouraging

[3] https://www.sec.gov/rules/exorders/2019/34-87204.pdf

[4] Pennying occurs when a dealer purchases bonds for its own account, following the dissemination of a bid-wanted (through either an alternative trading system or a broker's broker) for a customer who is seeking to sell a municipal security. The dealer, after reviewing bid information received, either matches the high bid received in response to the bid-wanted or purchases the bonds at a price that is nominally higher than the high bid.

quotations by market participants. The MSRB has been working to further understand the prevalence of the practice and the potential harm it presents to retail investors in the municipal market. Following the MSRB's 2018 request for comment on pennying[5], and at the request of the SEC's Fixed Income Market Structure Advisory Committee (FIMSAC), the MSRB will coordinate with FINRA regarding next steps on how to potentially address the practice of pennying.

Finally, the MSRB is mindful that as the market prepares for Regulation Best Interest (BI), investors will begin to receive new information about the obligations of the financial professionals they choose to engage. In order to promote regulatory harmonization and clarity around the responsibilities of brokers, dealers, and municipal securities dealers, the MSRB is conducting a review of its rules to evaluate the changes that may be necessary or appropriate to align with the requirements of Regulation BI. The MSRB will continue to coordinate closely with the SEC and FINRA as it considers these issues.

Conclusion
The MSRB appreciates the opportunity to provide perspective on products and practices within the municipal securities market that may have an adverse impact on retail investors. We look forward to working with the Office of the Investor Advocate to take meaningful steps toward increasing awareness and addressing the areas mentioned above for the benefit of retail investors. If we can provide additional information, please do not hesitate to contact me.

Sincerely,

Nanette D. Lawson

Nanette D. Lawson
Interim Chief Executive Officer and Chief Financial Officer

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[5] MSRB Notice 2018-22, Request for Comment on Draft Interpretive Guidance on Pennying and Draft Amendments to Existing Guidance on Best Execution (September 7, 2018).