



Municipal Securities Rulemaking Board

October 30, 2015

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

Re: Response to SEC Request Highlighting Municipal Market Practices

Dear Mr. Fleming:

The Municipal Securities Rulemaking Board (MSRB) is submitting this letter in response to the Office of Investor Advocate's request for the MSRB to identify products and practices within the municipal securities market that may have an adverse impact on retail investors.^{1,2} As the self-regulatory organization for the municipal securities market whose mission is to protect investors, municipal entities, and the public interest, and as the sponsor and operator of the Electronic Municipal Market Access (EMMA[®]) system, the official repository for disclosure and transaction information on municipal securities, the MSRB is committed to improving price transparency and disclosure practices in the municipal securities market. The MSRB continues to build on its strong regulatory foundation for protecting investors.

As described below, the MSRB has identified three areas of particular concern given their potential adverse effect on retail investors. These are: 1) timeliness of continuing disclosures; 2) lack of bank loan disclosures; and 3) trades below the minimum denomination. Also, two additional areas are highlighted, time of trade disclosures and price transparency, that the MSRB continues to monitor for potential risks to retail investors.

Timeliness of Continuing Disclosures

The availability of information about municipal securities issuers and their disclosure obligation is essential to the fairness and integrity of the municipal securities market and the protection of investors. The MSRB's May 2015 report, *Timing of Annual Financial Disclosures*

¹ The age profile of municipal retail investors has been remarkably stable, with median ages around 60 years. Of note, approximately 42 percent of municipal debt is held by the wealthiest 0.5 percent of households and their average age being approximately 85 years old. *See* Bergstresser and Cohen, [Changing Patterns in Household Ownership of Municipal Debt: Evidence from the 1989-2013](#), (Current draft June 2015). The MSRB strongly supports the efforts of our fellow regulators to address the financial exploitation of seniors and other vulnerable adults.

² Retail investor direct holdings account for more than 40 percent of municipal securities market and less than 10 percent of the treasury, agency and corporate markets. *See* Federal Reserve Financial Accounts of the United States, (September 2015).

by *Issuers of Municipal Securities*, highlighted the length of time after the end of a fiscal year that investors and the general public must wait to gain access to valuable information contained within an issuer's audited financial statements. According to the report, excluding catch-up disclosures, the timing of audited financial statement submissions to the EMMA system in 2014 averaged 200 calendar days after the end of the applicable fiscal year. This figure is virtually unchanged from the previous four years, when the timing of submissions averaged between 199 days and 203 days. This same lag is seen in the submission of annual financial information. These documents were submitted on average 188 calendar days after the end of the applicable fiscal year, nearly identical to the length of time observed in the four previous years, which ranged from 186 days to 189 days. The applicable contractual deadline for these disclosures was not taken into account.³

In an effort to assist issuers in understanding their disclosure obligations and in using tools and resources developed by the MSRB to promote more timely disclosure, beginning in August 2013, the MSRB engaged in a multi-year outreach effort, "Putting EMMA to Work." Also, to support issuer compliance with continuing disclosure obligations, the MSRB published a *Market Transparency Advisory – Suggested Practices in Submitting of Financial Disclosures to EMMA*⁴ and created a free automated email reminder service to assist issuers with filing timely periodic financial disclosures on the EMMA system. Approximately 7,500 municipal entities have taken advantage of the free email reminder service. The MSRB remains committed to improving disclosure practices in the municipal securities market for the benefit of all market participants including retail investors.

Lack of Bank Loan Disclosures

The MSRB is aware of the increasing use of bank loans, direct-purchase debt, and privately placed debt as a financing alternative to a public debt offering. According to the Federal Deposit Insurance Corporation (FDIC), *Call and Thrift Financial Report*, the issuance of bank loans to state and local governments increased from \$96.7 billion outstanding in fourth quarter of 2012 to \$192.3 billion in fourth quarter of 2014 for FDIC-regulated banks.⁵ Despite the effort by municipal market participants to encourage bank loan disclosures and develop related best practices and guidance for state and local governments, bank loan executions have

³ Generally, within the official statement the issuer specifies the contractual time period by which annual financial information will be completed.

⁴ See MSRB Notice 2013-18, *Market Transparency Advisory – Suggested Practices in Submitting of Financial Disclosures to EMMA*, (August 12, 2013).

⁵ See Federal Deposit Insurance Corporation, *Call and Thrift Financial Report Data* https://www5.fdic.gov/call_tfr_rpts/ (Oct. 21, 2015). The Federal Deposit Insurance Corporation (FDIC) is the primary regulator of banks that are chartered by the states that do not join the Federal Reserve System. Financial data for individual FDIC-insured commercial banks, FDIC-supervised savings banks, and OCC-supervised noninsured trust companies is filed by quarter for publication of Call Report data.

far exceeded bank loan disclosures.⁶ Currently, bank loans, direct-purchase debt, and privately placed debt, unless determined to be a municipal security, do not trigger disclosure obligations set forth under Rule 15c2-12 of the Securities Exchange Act of 1934. An issuer's existing bondholders, as well as potential investors and other market participants, may not become aware of such bank loans, direct-purchase debt, and privately placed debt including the impact of the loans on the seniority status of existing bondholders and on the issuer's outstanding debt, until the issuer's next public debt offering or the release of an issuer's audited financial statements.⁷ Delayed or undisclosed debt-like obligations could result in an investor's inability to assess in a timely manner the loan's impact on an issuer's credit profile and could inadvertently distort valuation of an issuer's bonds in both the primary and secondary markets.

The MSRB believes that the timely disclosure by municipal bond issuers of additional debt and debt-like obligations is essential to foster market transparency and to ensure a fair and efficient municipal market. Since 2011, the MSRB has repeatedly called on market participants to encourage issuers to disclose bank loans and other debt-like obligations and suggested best practices for the disclosure of bank loans and similar debt on the MSRB's EMMA website.⁸ Only 130 bank loan disclosure documents have been submitted to the EMMA system since 2012. In a January 2015 letter to the SEC, the MSRB encouraged it to conduct a wholesale re-examination of Rule 15c2-12 and consider interpretive guidance that would foster improved disclosure framework practices, namely related to bank loan disclosure.⁹ The MSRB continues to encourage efforts to improve available disclosures.

Trades Below the Minimum Denomination

A minimum denomination represents the smallest amount of bonds to be sold by a dealer to an investor in a single transaction. During a municipal bond offering, issuers often prescribe the minimum denomination allowed which is then set forth in the official statement. Generally,

⁶ See Moody's Investors Service, *Growth in Bank Loans and Private Placements Increases Risk and Reduces Transparency in the Municipal Market*, (October 2014); See also Standard & Poor's, *Alternative Financing: Disclosure Critical to Credit Analysis in Public Finance*, (February 2014).

⁷ Governmental Accounting Standards Board Statements 34 and 38, and Governmental Accounting Standards Board Codification 2300.120, 1500.102 and 1500.121 require bank loan activity to be disclosed as appropriate in long-term liabilities, governmental fund financial statements, proprietary fund financial statements, notes disclosure about debt service requirements and significant violations of legal covenant provisions and long-term liabilities.

⁸ See MSRB Regulatory Notice 2015-03, Bank Loan Disclosure Market Advisory, (January 29, 2015); MSRB Regulatory Notice 2012-18, Notice Concerning Voluntary Disclosure of Bank Loans to EMMA, (April 3, 2012); MSRB Regulatory Notice 2011-52, Potential Applicability of MSRB Rules to Certain "Direct Purchases" and "Bank Loans," (September 12, 2011); MSRB Regulatory Notice 2011-37, Financial Advisors, Private Placements, and Bank Loans, (August 3, 2011).

⁹ See letter from Kym Arnone, Chair of the MSRB to U.S. Securities and Exchange Commission Acting Director/ Chief Information Officer dated January 20, 2015.

the minimum denomination is \$5,000. However, an issuer may structure certain securities with minimum denominations of \$100,000 or higher, thus making them unlikely to be purchased by retail investors in the primary market. MSRB Rule G-15 prohibits dealers from effecting a customer transaction in municipal securities in an amount below the minimum denomination of the issue, subject to limited exceptions. The minimum denomination standard seeks to ensure that bonds are not sold to retail investors for whom such bonds may not be suitable.

Time of Trade Disclosures

Another area that the MSRB continues to monitor is the failure of a dealer to disclose all material information about the security at or prior to the time of trade. It is unclear the extent to which dealers are not complying with this obligation, however the failure of a dealer to disclose material information at or prior to the time of trade could pose a significant risk to the retail investor resulting in the investor possibly acting on incomplete information and executing a transaction that is unsuitable. Also, when determining the price of the security, if a dealer fails to take into consideration all material information about a security, the investor may pay or be paid a price for a bond that is not fair or reasonable.

MSRB Rule G-47, on time of trade disclosure, requires that a dealer disclose to its customer at or prior to the time of the trade, all material information about the security known by the dealer, as well as material information about the security that is reasonably accessible to the market. This obligation applies to primary offerings and secondary market transactions, and to both solicited and unsolicited transactions.

In meeting suitability and pricing obligations under MSRB Rule G-19, on suitability, and MSRB Rule G-30, on fair pricing, dealer disclosures to investors include continuing disclosures that consist of information about a municipal security that arise after the initial issuance of the security and reflect the issuer's financial condition as it changes over time. These MSRB rules are fundamental to protecting investors.

Price Transparency

As the self-regulatory organization for the municipal securities market, the MSRB has a long-standing concern regarding investors' access to information necessary to make informed investment decisions. MSRB price transparency initiatives seek to ensure fair pricing and sufficient transparency in the municipal securities market in order to maintain the integrity of the market and protect the retail investor. Dealers are required to provide investors with fair and reasonable prices when transacting in municipal securities. The MSRB supports the SEC's vigorous enforcement of MSRB rules that seek to ensure a fair municipal securities market. To further protect investors, the MSRB continues to work to develop additional price transparency rulemaking initiatives that will benefit retail investors through the potential disclosure of additional information on customer confirmations. This work complements other MSRB price transparency rulemaking initiatives, including the recent creation of a best execution requirement and the availability of additional post-trade data on the EMMA system.

The MSRB's EMMA website provides retail investors real-time trade prices for nearly every municipal security bought and sold. EMMA's price discovery tool supports investors finding and comparing trade prices of municipal securities with similar characteristics. It also, easily generates a graphical summary of the daily high and low prices and yields of the selected securities over time. These price discovery tool features support retail investors making informed decisions.

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 investors. If we can provide additional information, please contact the MSRB.

Sincerely,

A handwritten signature in blue ink that reads "Lynnette Kelly". The signature is written in a cursive, flowing style.

Lynnette Kelly
Executive Director

cc: Stephen Luparello, Director
Division of Trading and Markets

Jessica Kane, Director
Office of Municipal Securities

Rebecca Olsen, Deputy Director
Office of Municipal Securities