

**Remarks of Lynnette Kelly, Executive Director  
and Arthur Miller, Vice Chair, Board of Directors**

**at the**

**Securities Exchange Board of India Meeting**

**New York, NY**

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## Introduction

*Lynnette Kelly:*

- Good morning and thank you to the United States Department of the Treasury for the invitation to meet with representatives from the Securities and Exchange Board of India.
- I'm Lynnette Kelly, Executive Director of the Municipal Securities Rulemaking Board.
- I'm joined by Arthur Miller, Vice Chair of the MSRB Board of Directors.
- It's my great pleasure to speak with international audiences about the history and features of the United States municipal bond market.
- Our market is a uniquely American invention grounded in the concept of federalism.
- The United States reserves those powers not expressly granted to the federal government to the states.
- It is our philosophy that state and local governments are best positioned to make decisions about which public projects to pursue and how to finance them.
- So under our Constitution, state and local governments are sovereign entities and are considered to have the legal autonomy to make such decisions.
- We don't have specific enabling legislation permitting municipalities to access the capital markets like your July 2015 regulations.
- And we certainly have a long history of American municipalities raising capital from investors.
- If you ever have an opportunity to visit the MSRB's offices in DC, you will find a Massachusetts Bay bearer bond dating back to 1777 that promises 6 percent interest each year until 1781.
- For nearly 200 years, the US municipal bond market operated without regulatory oversight.
- Municipal securities were largely exempted from the federal securities laws that emerged in 1933 and 1934 as a result of the Great Depression.

- Only the antifraud provisions (Rule 10b-5) of the Securities Exchange Act apply to the issuance of municipal bonds.
- Part of the rationale for exempting municipal bonds had to do with the investor base.
- Early municipal bond customers were primarily banks, insurance companies and other large institutional investors with the sophistication to look out for their own interests.
- Let me invite Arthur to tell you more about how this view changed in the 1970s.
- Let me also say feel free to interrupt us at any time with questions.

### **Creation of the MSRB**

*Arthur Miller:*

- Thanks, Lynnette, and thank you for the opportunity to speak with you today.
- We are in New York City, the place that really ignited national interest in regulating the “wild west” of the American bond market in the 1970s.
- It was in the ‘70s that federal tax reforms made the municipal market more attractive for retail investors.
- Retail investors were sold millions of dollars of New York City debt, which the City was certainly not in a financial position to repay.
- You may have seen the famous October 30, 1975 Daily News headline, “Ford to City: Drop Dead.”
- Then-President Ford was reluctant, to put it mildly, to have the federal government “nationalize” municipal debt and bail out local officials who got into financial trouble.
- It’s a debate our country continues to have as Puerto Rico begins testing a new law allowing it to restructure its \$70 billion debt.
- But flashing back to 1975, New York’s fiscal crisis was a wake-up call for market participants around the country – and for lawmakers in Washington, DC.
- In June 1975, Congress amended the federal securities laws – that is, Securities Exchange Act Section 15B – to create the Municipal Securities Rulemaking Board.

- The MSRB is Congressionally chartered self-regulatory organization, not a federal agency.
- The statute laid out the MSRB's mission in detail.
- The MSRB is charged with promoting a fair and efficient municipal securities market.
- When the MSRB was first created, it was authorized to make rules with respect to municipal brokers, dealers and municipal securities dealers.
- These rules were to, in the words of the statute, "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, and] to remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products..."
- It is important to note that the MSRB has no jurisdiction to regulate issuers of municipal securities.
- Their rights to access the capital markets without registering or furnishing documents are protected by a provision known as the Tower Amendment.
- The MSRB's original mission was to protect investors and the public interest.
- But in 2008, the global recession prompted a fresh look at the regulatory framework for the US municipal market.
- Lynnette will talk more about recent reforms.

### **Dodd-Frank and the Mission of the MSRB**

*Lynnette Kelly:*

- In 2010, Congress adopted the Wall Street Reform and Consumer Protection Act, a wide-ranging law that sought to address some of the systemic risks and unfair practices that contributed to the recession.
- While much of the law targeted banks and the equities markets, the municipal market was not overlooked.

- It was clear that reforms were necessary to address changes in the capital markets, such as the creation of new financial products and the emergence of firms providing advice regarding these products.
- The municipal securities marketplace had evolved from one in which states and municipalities offered traditional, fixed rate bonds to finance specific projects into a market that involves the use of complex derivative products and intricate investment strategies.
- At the time, federal law did not permit the MSRB to regulate non-dealer municipal market participants, such “independent” financial advisors that provide advice to issuers regarding bond offerings or investment advisers that assist issuers with investing bond proceeds.
- Congress agreed that the MSRB was in the best position to regulate these professionals.
- The Dodd-Frank Act expanded the MSRB’s jurisdiction to include the regulation of municipal advisors.
- Further, the Act extended the MSRB’s mandate to include protection of issuers of municipal securities, including state and local governments, obligated persons such as hospitals and universities, state-operated 529 college savings plans marketed by broker-dealers, public pension plans and other municipal entities.
- To our knowledge, we are the only regulator charged with protecting not just the investors in securities, but the issuers of those securities as well.
- The MSRB fulfills its mission in three key ways:
  - 1) Writing rules for municipal securities dealers and municipal advisors,
  - 2) Operating market transparency systems, namely our Electronic Municipal Market Access, or EMMA, website, and
  - 3) Providing education, outreach and market leadership.
- The MSRB’s activities are subject to oversight by the Securities and Exchange Commission.
- We will speak more about the MSRB’s relationships with other national and state regulatory bodies shortly.

- I'd like to turn now to the MSRB's governance structure as a self-regulatory organization.
- We are led by a 21-member Board of Directors, the majority of whom are representative of the public, such as state treasurers, city chief financial officers, investors and academics.
- A minority of Board members are from regulated dealer and municipal advisor firms – that's the "self" element of "self-regulation."
- Arthur is a prime example of the benefit of having experienced industry practitioners on the Board.
- He's had a long and impressive career at Goldman Sachs, where he is Managing Director of the Public Sector & Infrastructure Group in the Investment Banking Division.
- Let me ask Arthur to briefly describe the MSRB's SRO model.

### **Self-Regulatory Organization Model**

*Arthur Miller:*

- SROs play a complementary role alongside federal and state securities regulators in the United States.
- As the MSRB's oversight authority, the SEC reviews and determines whether to approve MSRB rule proposals.
- Once approved by the SEC, MSRB rules have the force and effect of federal law.
- Unlike some financial industry SROs in this country like the stock exchanges, the MSRB does not operate a market nor is it shareholder-owned, so we have no profit motive.
- We receive no federal funding either; rather, MSRB revenue comes primarily from underwriting, transaction, registration and technology fees on registered firms.
- These MSRB-regulated dealers and municipal advisors are not "members" in the way entities at FINRA are members – the MSRB has no membership elections to the Board of Directors.

- A Nominating and Governance Committee of the Board selects slates of candidates for election by the full Board.
- There are several benefits to the MSRB's SRO model.
- As Lynnette said, our Board brings together specific industry knowledge and expertise from a diverse range of market participants who are representative of the parties affected by MSRB rulemaking.
- Our narrow focus allows us to appropriately tailor rules to the unique nature of the municipal market.
- Rules that work in the corporate and equity markets may not fit well in the municipal space.
- The MSRB operates a transparent and highly participatory rulemaking process with multiple opportunities for public and industry comment.
- Also, given that states are co-sovereign entities with the federal government, it is more appropriate to have an SRO, rather than a pure federal entity, serve as an intermediary in the municipal disclosure regime.
- State and local government issuers are more comfortable reporting their disclosures to the MSRB's EMMA system than they might be filing them with a federal government entity like the SEC.
- Speaking of EMMA, another advantage of the MSRB's governance structure is that we are free to consider creative solutions to market challenges beyond rulemaking.
- Sometimes a technical enhancement to EMMA can bring about greater market transparency and efficiency than a rule change.
- Additionally, rules are only as good as the extent to which they are followed.
- The MSRB has a robust education and outreach program to help regulated entities comply with the rules, and to help investors and issuers know what to expect from their financial professionals.
- That's not to say there are no challenges with the SRO model, as Lynnette can attest.

## SRO Challenges

*Lynnette Kelly:*

- Yes, we certainly have our challenges.
- For the past several years, we have not had the opportunity to be as “self-directed” as you might expect from a self-regulatory organization.
- Our agenda was largely driven by external priorities set by Congress with the Dodd-Frank Act and the SEC in its 2012 report on the municipal securities market.
- The SEC also imposed significant compliance burdens on the MSRB with the adoption of Regulation SCI, a rule aiming to enhance the integrity and security of technological systems that are integral to the capital markets.
- The MSRB’s EMMA system fell under that rubric, and our IT team has had to ensure our disaster recovery and testing procedures align with the regulation’s standards.
- Then there is the perennial concern about inefficiencies with multiple regulators writing rules.
- The MSRB is very cognizant of the benefits of efficiency and makes every attempt to harmonize our rules with those of other regulators where appropriate.
- I am proud to say the MSRB fosters a culture of corporate transparency.
- We publicize the topics under consideration by our Board and publish a summary of Board decisions.
- As Arthur said, our rulemaking process is very transparent and relies on input from market participants.
- But there are those who would criticize SROs for having closed Board meetings and being exempt from responding to Freedom of Information Act (FOIA) requests that ensure public access to government records.
- A challenge specific to the MSRB is that we have no enforcement authority.
- The SEC, FINRA and the bank regulators examine for compliance with our rules and bring enforcement actions.

## Regulatory Relationships

*Lynnette Kelly:*

- That brings me to the MSRB's relationships with fellow regulators.
- The MSRB has statutory relationships with several federal regulatory agencies and with FINRA in support of this enforcement relationship.
- The Dodd-Frank Act formalized relationships between the MSRB and agencies responsible for enforcing MSRB rules, including the SEC, FINRA and bank regulators.
- The MSRB provides assistance and guidance to enforcement agencies.
- The MSRB makes market information available to the public on EMMA and provides additional information to other municipal securities regulators privately through a system called RegWeb.
- The MSRB and enforcement agencies have periodic meetings to share information on rulemaking, examinations and enforcement.
- Dodd-Frank established fine-sharing arrangements with the SEC and FINRA when they bring an action based on MSRB rules.
- The MSRB has non-statutory relationships with state regulators and other federal agencies like the IRS.
- The MSRB provides the IRS with municipal market information to assist in its enforcement of federal tax laws related to the municipal market.
- Communicating regularly and often with our fellow regulators is an important day-to-day responsibility of the staff at the MSRB.
- The MSRB is the nation's deepest source of knowledge on the municipal securities market.
- We share that objective expertise and data with our fellow regulators and policymakers.

- Often we are needed to clarify the important differences between municipal securities and other markets, right Arthur?

## **Market Differences**

*Arthur Miller:*

- That's right, Lynnette.
- Perhaps the most important distinguishing feature of municipal bonds is that they are typically issued for a public good.
- We are talking about hospitals, roads, water and sewers, schools, colleges, airports, public transportation, etc.
- The structure of the municipal bond market requires state and local government issuers not only be accountable to taxpayers and elected officials, but also to face market scrutiny.
- That is, projects only get financed if the market "approves."
- Another reality that sets this market apart is that the United States municipal market is more fragmented than other fixed income markets.
- This is a \$3.8 trillion market with approximately 1 million outstanding securities and 50,000 issuers.
- The municipal market's 50,000 issuers have a wide range of sophistication, from small municipalities that issue bonds once every 10 years to large and frequent issuers that go to the market many times a year and raise billions of dollars.
- In contrast, the American corporate bond market is larger at \$8.5 trillion par outstanding, but only has about 30,000 securities and 10,000 issuers.
- There is a low ability to hedge, but a significantly lower risk of default in the municipal market.
- Municipal bonds are not a uniform, commoditized product so liquidity is sometimes a challenge.

- Maturities are more evenly distributed in municipal market and the average maturity is rather long.
- Individual investors are significantly more important in the municipal bond sector than in other asset classes.
- Individuals own more than 40% of municipal bonds directly and 20% through funds.
- Direct retail holdings account for less than 20 percent in other markets.
- Our market is what's called an "over the counter" market – bonds are not on an exchange; rather, trading occurs through an intermediary, the broker.
- It used to be quite common for bond issuers to use credit enhancement (2000-2007), but that practice has decreased since 2008 due to the effect of the financial crisis on banks and municipal bond insurers.
- In short, this market unique not only in comparison to international markets, but even when compared to its closest cousin, the US corporate bond market.
- Perhaps I am a bit biased, but I think what really sets this market apart from others is the EMMA website.

## **EMMA**

*Lynnette Kelly:*

- I couldn't agree more.
- Both Arthur and I were working in the municipal market long before the EMMA website existed.
- Before 2008, municipal market disclosures were mailed to one of several so-called NRMSIRs.
- The system of Nationally Recognized Municipal Securities Information Repositories was an inefficient and costly system that made it difficult for investors to locate official statements and continuing disclosures.
- Further, the general public had no access to the complete picture of real-time trade activity in the market.

- That changed with the launch of the EMMA website, which was formally designated the only official NRMSIR by the SEC in 2009.
- EMMA created transparency in the municipal market.
- Disclosures from bond issuers and underwriters, real-time trade data from dealers and market data from third-party vendors are all feeding into the EMMA website through several market transparency systems.
- The MSRB serves as a clearinghouse for a vast amount of information and makes it available to the public on the EMMA website.
- The existence of EMMA ensures that information about virtually all municipal bonds and their issuers is free, centralized and available to the public at no cost.
- While initially created with the investor in mind, the EMMA website has become an indispensable resource for all market participants.
- Under MSRB Rule G-32, underwriters are required to post official statements for new issues on EMMA.
- We receive about 1,000 official statements each month and have more than 350,000 primary offering documents on EMMA.
- Escrow documents for advance refundings are on EMMA too.
- Underwriters of 529 plans and ABLE programs must also submit the plan disclosure document to EMMA.
- Additionally, the MSRB makes available to the public information about regulated entities' political contributions to issuer officials and bond ballot campaigns filed to us quarterly under MSRB Rule G-37.
- This serves to improve transparency and address real or perceived pay-to-play activity in the municipal market.
- EMMA is the official repository for continuing disclosures, which provide updated information about the financial health of the state or government that issued the bonds.

- Governments also must post notices of credit rating changes, late payments, bankruptcy and other newsworthy financial events affecting their bonds.
- The required disclosures are enumerated in SEC Rule 15c2-12.
- More recently, the EMMA website includes information for municipal asset-backed securities pursuant to SEC Rule 15Ga-1.
- The disclosure documents housed on EMMA are just half the story.
- EMMA is also extraordinarily data-rich.
- There's a real-time feed of municipal market data coming into EMMA each day.
- Brokers buying and selling municipals securities are required to report trade prices and yields to EMMA within 15 minutes of a transaction under MSRB Rule G-14.
- The MSRB receives about 35,000 trade reports a day.
- Another set of data available on EMMA is variable rate securities data, such as interest rate resets and letter of credit documents.
- These variable rate data are required to be reported under MSRB Rule G-34.
- The MSRB has also developed partnerships with several third-party data providers to make important market data available on EMMA, such as current long-term credit ratings from Fitch, Kroll, Moody's and S&P.
- We recently added a new issue calendar on EMMA to list upcoming bond issuances integrated with final pricing scales for recently sold issues.
- An economic calendar on EMMA provides easy access to the timing of federal economic data releases.
- Together these calendar tools may inform state and local officials' decisions about when and how to issue municipal securities.
- EMMA also includes market-wide statistics for new issuance, trade activity and disclosure submissions.

- These statistics offer insight into broader trends and patterns in the municipal market, such as the volume of new issues and activity in certain sectors.
- The MSRB continues to explore ways to add more useful data and information to EMMA.
- The EMMA website and the data on it are freely available, 24-7.
- With that, let me stop and take more of your questions.
- Thank you again for your interest in the MSRB's role in the municipal securities market.
- I hope we can be a resource to you moving forward.