November 3, 2016

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. 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 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 building on its strong regulatory foundation for protecting investors, with a focus on improving price transparency and disclosure practices in the municipal securities market.

As described below, the MSRB has identified four areas of particular concern given their potential adverse effect on retail investors. These are: 1) Disclosure practices; 2) Price fairness and transparency; 3) Types of ownership; and 4) Senior investor protection.

Disclosure Practices

Issuer disclosure practices have been a topic of concern and focus for the MSRB primarily because a key way the MSRB protects investors in the municipal market is by promoting the transparency and availability of market information. First, the MSRB continues to emphasize the importance of voluntary disclosure by issuers of bank loan and other alternative financing information through the EMMA system. In addition to market advisories and guidance on bank loans in 2012, 2015 and 2016, the MSRB wrote to the SEC in 2015 requesting that the SEC review Rule 15c2-12 to identify ways to enhance disclosures with respect to bank loans and direct-purchase debt. In March 2016, the MSRB requested comment on a concept proposal to require municipal advisors to disclose information about their clients' bank loans. Commenters generally disagreed with the proposal, and believed that an SEC review of Rule 15c2-12 would be a better approach to address the issue of bank loan disclosure. The MSRB has recently enhanced EMMA with features to facilitate the voluntary disclosure of bank loans and other alternative financings, and will consider how to further build on these efforts in the coming year.

The MSRB is also targeting its efforts to address the timeliness of continuing disclosures submitted to EMMA by issuers. In a recent analysis of submitted continuing disclosures, the MSRB determined that the average time to disclosure of audited financial statements or Comprehensive Annual Financial Reports (CAFRs) is 201 days after the close of the issuer's fiscal year. While the average time to disclosure has stayed constant over the past several years, the MSRB believes that issuers should be working to incorporate best practices and policies to shorten the time it takes to communicate valuable information to investors, for example through the submission of intermediate or unaudited financials.

Also related to issuer disclosure practices, the MSRB is concerned about selective disclosure practices by issuers in which certain classes of investors may have access to disclosure information that other investors do not. The MSRB encourages issuers to implement disclosure practices to ensure that all investors and stakeholders have equal access to the same information in a timely manner.

Lastly, certain high-profile municipal bankruptcies and restructurings have raised concerns by municipal market stakeholders on the clarity of the general obligation pledge. The MSRB has noted recent rulings by bankruptcy courts that take a view on creditor priorities that settle the payment of obligations in a manner that is more advantageous to pensioners than bondholders[1]. The MSRB believes it is important that issuer disclosure documents clearly detail the priority of creditor payments, including the presence of any statutory liens or other contractual obligations.

Price Fairness and Transparency

The MSRB has made many recent enhancements in the area of price fairness and transparency in the municipal market and believes additional improvements are warranted. In March 2016, the MSRB implemented a best-execution rule for transactions in the municipal market. The new requirement aims to improve pricing for retail investors by ensuring dealers use reasonable diligence to execute the trade in a venue that achieves a price that is as favorable as possible under prevailing market conditions. The MSRB also recently added additional post-trade data on EMMA that expand the application of existing list offering price and takedown indicators as well as new indicators to identify trades involving non-transaction-based compensation agreements and trades that occurred on an alternative trading system (ATS).

While we are pleased with these efforts, we believe that more needs to be done to support price fairness and transparency in the municipal market. To help investors better understand the cost of buying or selling a municipal bond, the MSRB is developing a proposal, which has been filed with the SEC, to provide retail investors with information on dealer compensation. Under the proposed rule, dealers would be required to disclose any mark-ups or mark-downs from the prevailing market price for the security on the retail customer confirmation in certain principal transactions. The MSRB also filed associated regulatory guidance with the SEC on how dealers determine the prevailing market price of bonds from which their mark-ups and mark-downs are calculated. Additionally, based on feedback received from regulators and a wide variety of industry participants, the MSRB in the coming year will be conducting a holistic review of its rules regarding primary offering practices with a view to enhancing existing protections under MSRB rules. We will also continue to provide new resources and tools on EMMA to support pre-trade price transparency in the municipal market, including the possible display of industry yield curves, publication of a new issue calendar and pricing scales, as well as continuing our analysis of whether certain bid/offer data should be made publicly available.

Types of Ownership

Given changes in the ownership profile of municipal securities, including the significant drop in the number of dealers and shrinking dealer inventories of municipal securities, the MSRB sees the potential for risk in a rising interest rate environment. Six years ago, dealer inventories of municipal bonds stood at $40 billion while municipal fund holdings were valued at $955 billion, according to the Board of Governors of the Federal Reserve System's September 2016 Statistical Release. By June 2016, dealer inventories had dropped to $20 billion while mutual fund holdings of municipal securities were valued at $978 billion. An increase in interest rates followed by likely redemptions by individual investors of their mutual funds shares and the sale of municipal bonds by mutual funds could 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. Though not nearly as pronounced, similar trends can be seen with separately managed accounts and municipal bond exchange traded funds, whose holdings of municipal securities increased from $7.6 billion in 2010 to $23.1 billion as of June 2016.

The number of dealer firms in the municipal market continues to decline, which contributes to shrinking inventories. Since October 2012, the number of MSRB-registered dealers is down by 19 percent. This decrease is a result of both the exit of registered dealers from the market, as well as mergers and acquisitions and other consolidation of dealer firms. The combination of a reduction in the dealer population, a decrease in dealer holdings and increasing municipal bond mutual fund balances could lead to reduced liquidity in the municipal market. This type of market dislocation could have a significant impact on mutual fund net asset value (NAV) and the overall value of investors' municipal bond positions.

Senior Investor Protection

The MSRB is closely tracking industry efforts to protect senior and other vulnerable investors, and is focusing efforts on bringing awareness to rules and regulations in place to protect these and other vulnerable investors. Given that the average age of the municipal bond investor is estimated to be 61 years old[1] and with a rapidly aging general U.S. population, the MSRB believes that the protection of senior and vulnerable investors is an issue of increasing importance over the coming years. The MSRB is focused on opportunities for partnership with fellow regulators and trade associations to assist senior investors in understanding the rules and resources in place to protect them, and to help financial professionals better understand the needs and risks surrounding these investors.

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,

Lynnette Kelly

Lynnette Kelly
Executive Director

[1] Bergstresser, Daniel B. and Randolph B. Cohen, 2015, "Changing Patterns in Household Ownership of Municipal Debt: Evidence from the 1989-2013 Surveys of Consumer Finances."