MSRB
Municipal Securities Rulemaking Board

# Remarks of Lynnette Kelly, Executive Director

## at the

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## Introduction

Good morning and thank you to the World Bank and the China Ministry of Finance for the invitation to speak with you about the United States municipal securities market.

It's an honor to be in a country that has one of the oldest civilizations in the world. Compared to your 22 centuries of antiquity, the United States is just a blip when it comes to the history of your storied nation. But we do have some long-standing traditions in the US. Our cultural diversity, cowboy hats—and jeans—for example. But there is another tradition I am eager to tell you about today that is as woven into the fabric of the US as denim.

I'm Lynnette Kelly, Executive Director of the Municipal Securities Rulemaking Board. I am proud to be associated with an organization that in many ways is the guardian of our centuries-old municipal securities market. Our market is a uniquely American invention grounded in the division of powers between levels of government of equal status. Under this concept called federalism, authority not expressly granted to the federal government belongs to the states.

This authority extends to making decisions that affect local citizens. For example, we believe that state and local governments are best positioned to make decisions about which public projects to pursue and how to finance them. State and local governments have the legal autonomy to make such decisions. This autonomy extends back to our earliest days as a nation, in our office in Washington, we have images of bonds from the 18th century, including one issued in 1777 by Massachusetts Bay, the province that preceded the creation of state of Massachusetts. Perhaps not ironically, it's is also where the American Revolutionary War began when London tried to squelch the local self-government I just mentioned.

For many years the municipal bond market developed, along with other financial markets, unfettered. But with the Great Depression and the stock market crash of 1929 came regulation. When securities laws first emerged in the early 1930s to provide greater transparency in financial statements and to establish laws against misrepresentation and fraud, municipal securities were largely exempt.

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.

It was in the 1970s 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 not in a financial position to repay. You may have seen the famous October 30, 1975 Daily News headline, "Ford to City: Drop Dead," in which then-President Ford was refused 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 my organization, the Municipal Securities Rulemaking Board. Congress charged the MSRB, as we are known, with protecting municipal securities investor by writing rules of conduct and uniform practice for financial intermediaries.

In my presentation today, I will tell you more about the mission of the MSRB and how we are connected to other regulatory agencies at the federal and state level. Let me first describe some of the characteristics of the modern U.S. municipal market.

**Overview of the Municipal Securities Market**

- Perhaps the most important distinguishing feature of municipal bonds is that they are used by state and local governments to finance a public good.

- We are talking about hospitals, roads, water and sewers, schools, colleges, airports, public transportation, etc.

- This is a $3.8 trillion market with approximately 1 million outstanding securities.

- Each year, US municipalities raise approximately $400 billion in the bond market. That's more money than China plans to spend on renewable power sources over the next three years.

- 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, like the states of New York and California, that go to the market many times a year and raise billions of dollars.

**Key Component of U.S. Debt Markets**

- Municipal bonds are an important part of the U.S. debt markets, with $3.8 trillion worth of bonds owned by investors.

- 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.

**Investor Base**

- 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 U.S. corporate bond market.

**Framework of Federal and State Oversight**

- As I mentioned, the American system of government is grounded in federalism.

- States have a Constitutionally protected right to access the capital markets.

- State statutes permit political sub-divisions and local authorities to similarly access the market.

- The benefits for state and local governments of the ability to borrow are clear – it's a way to obtain financing for large-scale public projects, bond structures allow the government to spread the cost over the useful life of capital projects, and it helps steady uneven cash flow.

- The states enjoy a privilege to access the capital markets without registering or furnishing documents thanks to a provision known as the Tower Amendment.

- However, it is important to note that even though states and municipalities are free to access the capital markets, that does not mean there are no checks and balances.

- In fact, there is a strong overlapping system of oversight involving federal, state and self-regulatory bodies.

- At the federal level, the regulatory framework for disclosure is established under the Securities Exchange Act of 1934.

- The Exchange Act prohibits fraudulent, inaccurate or misleading information in disclosures to investors, as well as the omission of material information.

- Together with SEC Rule 10b-5, the provisions of the Exchange Act are designed to prevent fraud.

- SEC Rule 15c2-12 lists the financial, operational and event-based information that is expected to be provided to the market about a municipal bond issuer and its issues.

- Financial information can take the form of a CAFR, audited financial statements or other information.

- Events triggering disclosure include any sort of event that investors would need to be made aware of to make informed decisions.

- These disclosures must be made within 10 business days of the occurrence of the event.

- There are 14 specific events that automatically impose an obligation on the issuer to make an event notice filing to EMMA.

- Issuers also enter into Continuing Disclosure Agreements that establish contractual obligations for when and how disclosures are to be provided.

- Typical sections include required timing of annual financials, content that must be included in annual financials/reports, types of events that will warrant continuing disclosure and information related to prior compliance with SEC Rule 15c2-12.

- Violations of federal anti-fraud provisions can result in SEC charges against issuers and their financial professionals, ranging from fines to bans on doing municipal securities business.

- The SEC put the spotlight on disclosure compliance with its Municipalities Continuing Disclosure Compliance Initiative, or MCDC.

- In August 2016, the SEC announced settlements with 71 issuers in 45 states that sold municipal bonds using offering documents that contained materially false statements or omissions about their past compliance with continuing disclosure obligations.

- States and local political subdivisions may impose restrictions on this right by state statute or local ordinance, for example to set debt limits.

- Many states have implemented oversight systems to assess and track fiscal conditions at the local level through debt monitoring, periodic review of financial information and benchmarking tools.

- More than 20 states monitor the fiscal health of local governments by actively and regularly reviewing their financial disclosure documents.

- Complementing these federal and state methods of oversight is an "SRO," that is, self-regulatory organization.

- The MSRB is Congressionally charted self-regulatory organization, not a federal agency.

- We receive no federal funding; rather, MSRB revenue comes primarily from underwriting, transaction, registration and technology fees on registered firms.

**About the MSRB**

- Congress created the MSRB in 1975.

- 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…"

- The MSRB's activities are subject to oversight by the Securities and Exchange Commission.

- 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."

- 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 activities.

- 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.

- One of the MSRB’s signature contributions to the market is our Electronic Municipal Market Access, or EMMA, system.

- EMMA is the official repository for trade data and disclosure documents for the municipal market.

- 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.

- 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.

- 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.

- 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.

- For the past several years, the MSRB has been in an intense period of rulemaking driven by the Dodd-Frank Act and also a 2012 report from the SEC that spotlighted areas of concern for the municipal market.

- 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.
- 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.
- EMMA is the MSRB’s primary vehicle for market transparency.
- A bit of history: 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.

- The MSRB provides an extensive library of multimedia educational content about the market in our online Education Center.