

**Remarks of Lynnette Kelly, Executive Director**

**at the**

**Securities and Exchange Commission**

**Investor Advisory Committee Public Meeting**

**Washington, DC**

**December 7, 2017**

- Good morning. My name is Lynnette Kelly, and I serve as the Executive Director of the Municipal Securities Rulemaking Board.
- Congress entrusted the MSRB more than 40 years ago with the important mission of protecting investors in the municipal securities market.
- Today, at least two-thirds of investors in the \$3.8 trillion municipal market are retail investors, either holding municipal securities directly or through funds.
- We often talk about the uniqueness of the municipal securities market. Let me just highlight why that is the case.
  1. No other capital market attracts such a large percentage of individual investors. At the MSRB, our rallying cry is how can we protect the Mom and Pop retail investors.
  2. And because many of these investors are seeking reliable, long-term income, most municipal securities are buy-and-hold investments. In fact, less than 1 percent of the 1 million outstanding municipal bonds trade in any given day.
  3. No other debt market comprises more issuers. The municipal securities market contains more than 50,000 issuers who represent the diversity of our country. Decisions on what to finance and how are made at the local level, and are a function of the highly specialized and unique needs of communities around the country.
  4. And no other capital market has the purely public purpose of municipal securities, which provide the foundation for financing the nation's infrastructure, and contribute to economic development and job creation on a highly local level. In fact, it has been estimated that over 2/3 of this country's infrastructure is financed through the issuance of municipal bonds.
- The municipal market's purpose, diversity of issuers, trading patterns and significant retail investor participation require a unique and specialized approach to regulatory oversight and underscore the need for strong investor protections.
- I'd like to briefly describe some of the existing investor protections and where we see opportunities to strengthen them.

## **RULES**

- First, we safeguard investors through rules of professional conduct for broker dealers and bank dealers, encompassing underwriting, sales and trading and uniform practices.
  1. For example, a broker must have a reasonable basis to believe that a recommended transaction or investment strategy involving a municipal security is suitable for the customer.
  2. MSRB rules require the disclosure of all material information known by the dealer or reasonably available in the market about a security at or prior to the time of trade.
  3. MSRB rules also protect investors by ensuring that brokers sell municipal bonds to investors at fair and reasonable prices.

The most important factor in determining a fair price is that the yield on a recommend bond should be comparable to the yield on other similar securities.

4. This fair pricing standard is enhanced by two other requirements for brokers.

The first one is a best execution standard which requires that brokers follow reasonable procedures to check multiple markets for a municipal bond to get the most favorable price for a customer's order based on market conditions.

The second one is mark-up disclosure, which has been approved by the SEC but is not yet effective, will require brokers to provide on an investor's trade confirmation, the amount of their compensation on the transaction.

This information will provide meaningful and useful pricing information to retail investors and, we think, may result in lower transaction costs over the longer term.

- Suitability, time of trade disclosures, fair pricing, best execution and the new mark-up disclosure rule are among the core standards of conduct that protect municipal bond investors.

## **TRANSPARENCY**

- Equally important for protecting investors is transparency.

- The MSRB operates market transparency systems that collect, store and display hundreds of thousands of municipal market disclosure documents and millions of pieces of transaction data.
- And we bring it all together for investors on our EMMA website.
- So, while a free website for investors doesn't sound like a big deal, in the municipal market it is. There are over one million individual securities outstanding so to provide information on each of these securities is a herculean task, and as with any IT system, is very expensive to develop and operate.
- I am very proud to be associated with an organization whose Board of Directors has repeatedly dedicated significant resources to support and enhance our EMMA system.
- EMMA marries disclosures with trade data and interest rate resets for short-term instruments, with additional information about the broader market including a price discovery tool, new issue calendar, market-wide statistics, and yield curves, to empower investors and issues to engage more equally with their financial professionals.
- On EMMA, investors can see, plotted on a graph, each individual trade in a particular bond within 15 minutes of the time of the trade.
- The detailed disclosure documents on EMMA shine a light on the financial health of the locality or state that issued a particular bond, both at the time of issuance and throughout the life of that bond.
- By making all this information publicly available, EMMA is fundamental to supporting market confidence and integrity.
- Sunlight, as they say, is the best disinfectant.
- The MSRB certainly agrees with this Committee that EMMA, while extremely valuable, can be challenging to navigate.
- That's why we convened a year-long series of focus groups to explore how we could enhance the usability and usefulness of the EMMA website.
- In the coming months, coinciding with the 10-year anniversary of the EMMA site, investors will see a completely reimagined homepage, as well as improved presentation of information about individual securities, and improvements to the search and navigation tools.

- Our goal is to simplify and enhance the user experience on EMMA for the retail investor.

## EDUCATION

- So, I've talked about how our rules and EMMA help safeguard investors.
- The third way the MSRB protects municipal bond investors is through education.
- We maintain a robust digital education center that provides free and objective information for investors about municipal bonds.
- The education center houses a deep well of information from preparing to invest, to buying and selling bonds, to monitoring those municipal bonds you already own.
- We also hope investors take advantage of the MSRB's free online course for investors through our MuniEdPro® educational platform to understand how the municipal bond market – and muni bonds themselves - work.
- Finally, let me turn now to several practices in the municipal securities market that may have an adverse impact on retail investors, and are issues that we are actively pursuing.
  1. The first is called "pennying," or "last-look," a practice that can affect the prices a retail investor receives during a sale of bonds.

In pennyning, rather than executing the trade with the highest bidder, the dealer will instead nominally exceed the high bid to the client and buy the bonds for the dealer's own trading account.

While a dealer's willingness to improve the highest bid, even nominally, is beneficial to the particular retail client in the short term, we are concerned that it can be harmful to investors over the long-term if the practice discourages broad market participation in the bidding process and renders the market less efficient.

2. We are also concerned about the practice of filtering, or screening, where a dealer may use automated tools available on an alternative trading system to screen out bids and offers received from certain dealers, or where a selling dealer may direct a broker's broker to limit the audience for a bid-wanted.

We recognize that certain credit, legal, regulatory and other legitimate concerns can justify filtering, however dealers should have policies and procedures in place to govern when and how to use, review and change such filters.

3. Additionally, we have examined the risk to retail investors of holding a position of municipal securities in an amount below the minimum denomination set by the issuer.

These positions are relatively illiquid, and if the investor can liquidate their position, it is generally at a relatively less favorable price.

It is our understanding that allocations by investment advisers are the common cause of below-minimum denomination positions and we have engaged the SEC staff on this issue.

4. Another area of ongoing concern for the MSRB is municipal market disclosure practices. We continue to be concerned about bank loans undertaken by issuers of municipal securities because retail investors may not have a full understanding of an issuer's debt profile when alternative financings are not immediately and fully disclosed to the market.

We have consistently encouraged issuers to make bank loan information available to the investing public, and support the Commission's efforts to enhance disclosures with respect to bank loans and direct-purchase debt.

5. The MSRB has also raised the concern about the selective disclosure that occurs when issuers provide certain investors access to information that is not broadly available to other classes of investors or the public.
- We published an advisory on this topic in September to increase awareness of selective disclosures, educate market participants on its potential negative impact and promote the development and use of best practices to avoid such disclosure.
  - The MSRB appreciates the invitation to participate in this public meeting, and thanks the SEC's Investor Advisory Committee for its dedication to protecting investors.
  - Investor protection is at the core of what we do at the MSRB, and I hope the Committee and the public will always consider us as a resource and a partner.
  - Thank you.