



Municipal Securities Rulemaking Board

November 8, 2021

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

Re: Response to Investor Advocate Request Highlighting Municipal Market Practices

Dear Mr. Fleming,

The Municipal Securities Rulemaking Board (MSRB) appreciates the opportunity to respond to the SEC Office of the Investor Advocate’s request for information on products and practices that may pose risks to individual investors. As the self-regulatory organization that oversees the \$4 trillion municipal securities market, our highest priority is to fulfill the MSRB’s congressional mandate to protect investors, issuers and the public interest by promoting a fair and efficient market. We have adopted a long-term strategic plan to enhance protections for investors by modernizing market regulation, providing transparency through technology, fostering innovation through data, and upholding the public’s trust in this market that enables investment in the nation’s public infrastructure.

The MSRB believes that the following issues raise potential investor protection concerns: (1) evolving Environmental, Social and Governance (ESG) considerations; (2) the information gap between individual investors and institutional investors; and (3) market dependence on mutual fund flows.

ESG Considerations

Increasing investor appetite for “sustainable investing” or “impact investing” strategies has drawn attention to the environmental, social and governance practices of the issuers of municipal securities, which gives rise to several risks for these types of investors. First, at the present time, there are no industry standards for disclosure of ESG-related information, which makes it difficult for investors to compare the practices of one issuer to those of another. Second, while issuers are generally required to disclose any ESG-related information with material credit implications, many investors also are seeking non-credit related information about the ESG practices of issuers. Industry associations like the Government Finance Officers Association (GFOA) have published voluntary best practices to aid issuers in disclosing ESG-related information. But adherence to these best practices is optional, and the regulatory framework governing the municipal securities market presents challenges for the SEC and MSRB to more directly address these risks.

A distinct but related risk is the evolving practice of issuers to self-label or market certain bond issuances as green, social or sustainable. Presumably, investors in these securities are

interested in the use of proceeds and the advancement of certain ESG-related objectives. Investor demand for these types of investment products continues to grow as evidenced by the launch of the first sustainable municipal bond exchange-traded fund (ETF) earlier this year. The lack of consistent and comparable information to evaluate the marketing of these securities raises investor protection concerns.

The MSRB is actively engaging with its stakeholders in exploring ways to strengthen investor protections and market transparency with respect to ESG considerations. For example, the MSRB recently added an indicator to the new issue calendar on the free Electronic Municipal Market Access (EMMA[®]) website to help investors and other market participants identify bonds coming to market that are labeled by the issuer as green, social or sustainable, or that carry a second-party ESG opinion. In addition, the MSRB will be publishing a request for information to gather input from diverse market participants to inform its understanding of this emerging trend and how the MSRB should approach ESG in the context of its regulatory mission to protect investors, municipal issuers and the public interest.

Information Gap Between Individual Investors and Institutional Investors

The MSRB has long worked to leverage technology to close the information gap between individual and institutional investors. With the advent of “Big Data” and powerful technology solutions such as artificial intelligence, machine learning and natural language processing, individual investors are at risk of falling behind the pace of innovation available in the marketplace to gain unique insights in the municipal securities market.

The MSRB is enhancing the EMMA website to provide equal access to timely and relevant information for all investors, individual and institutional alike. Our migration of the EMMA website to the cloud has enabled us to prototype an advanced search tool leveraging these same technologies to empower individual investors to perform sophisticated searches across the hundreds of thousands of unstructured PDF disclosure documents describing key features – and risks – of municipal bonds.

Our goal is to unlock greater insights from the municipal securities data and disclosures we collect and make those insights readily available to the investing public. We have already shared some of the fruits of this prototype with the general public in response to the pandemic, leveraging the search tool to provide critical information to the market in real-time on the impact of the pandemic on states, municipalities, health care systems and other entities on the front lines of the crisis. We will continue to invest in technology to level the playing field and better equip all investors to make informed decisions.

Mutual Fund Flows

The dependence of the tax-exempt municipal securities market on mutual fund flows continues to pose a risk for individual investors. Mutual funds provide a critical source of liquidity for the market and have helped it to manage large supplies of new bond issuances over the past few years. However, the significant increase in mutual fund inflows has made the market more

reliant on this source of capital, especially for long-dated securities, and more susceptible to significant upward pressure on yields if investors in those funds were to suddenly redeem large numbers of shares, thereby triggering large outflows and causing the funds to sell bonds to meet redemptions.

According to Investment Company Institute (ICI), prior to March 2020, tax-exempt municipal bond mutual funds had inflows every week since January 2019, and 2019 saw total inflows of almost \$94 billion. Over three weeks in March 2020, funds saw outflows of more than \$42 billion with two consecutive weeks of outflows of \$19 billion. These unprecedented outflows forced funds to sell, which overwhelmed the market and pushed rates up dramatically in that two-week period. Individual investors, who are the dominant investors in these funds, saw their Net Asset Value (NAV) plummet as yields rose and dollar prices dropped significantly. Investors who redeemed fund shares at or near the highs in interest rates may have realized significant losses. Even holders of individual bonds saw reduced liquidity and a significant reduction in dollar prices while interest rates rose due to a significant increase in institutional selling in the secondary market.

The municipal securities market proved resilient and by August 2020 the benchmarks rates recovered and reached record or near-record low yields in the short-end of the market. Despite the record outflows in March, tax-exempt municipal bond mutual funds experienced inflows of \$39 billion in 2020. In 2021, year-to-date inflows are \$77 billion. The MSRB is updating an investor education publication highlighting the various investment products (individual bonds, mutual funds, ETFs, etc.) investors can buy to access the municipal securities market, including key risks associated with each product. We believe it is important for investors to understand the differences in these investment products in order to help them make the best investment decision to meet their financial objectives.

The MSRB appreciates the opportunity to provide its perspective on risks to individual investors in the municipal securities market. We look forward to working with the Office of the Investor Advocate to increase awareness and understanding of these risks through education and research. Please do not hesitate to contact me or Leah Szarek, Chief External Relations Officer, at (202) 838-1393 or lszarek@msrb.org, if we can be of any further assistance.

Sincerely,



Mark Kim
Chief Executive Officer