

MEMO# 28811

March 11, 2015

SEC Commissioner Gallagher Gives Speech on Fixed Income Markets

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TO: MUNICIPAL SECURITIES ADVISORY COMMITTEE No. 6-15
FIXED-INCOME ADVISORY COMMITTEE No. 6-15
SEC RULES COMMITTEE No. 8-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 10-15 RE: SEC COMMISSIONER
GALLAGHER GIVES SPEECH ON FIXED INCOME MARKETS

Earlier this week, Securities and Exchange Commission (“SEC”) Commissioner Daniel M. Gallagher gave a speech regarding the need for reform in the fixed income markets. [*](#) His speech focuses on both the corporate fixed income and municipal securities markets, and raises concerns regarding liquidity, transparency, and disclosure. Some key points from the speech are summarized below.

Conditions in the Fixed Income Markets

Commissioner Gallagher notes that today’s fixed income markets are characterized by a record notional amount of outstanding corporate debt, decreased dealer capacity to commit capital and hold significant inventories, and lower secondary market liquidity. He is concerned that when interest rates rise, investors may rush to exit their positions, creating a liquidity crisis. The Commissioner highlights that insurance companies and mutual funds have increased their holdings of corporate and foreign debt, and questions how institutional asset managers and their clients will react when interest rates rise.

Increasing Liquidity in the Fixed Income Markets

Commissioner Gallagher believes that the SEC should be considering all options for facilitating electronic and on-exchange transactions of fixed income securities. This may include incentivizing standardized primary offerings to further facilitate secondary liquidity in these markets. He emphasizes that the status quo is not sufficient, and that the industry must get together and create private market solutions before the government imposes a solution on the industry.

Increasing Transparency in the Fixed Income Markets

Commissioner Gallagher believes that there is a lack of transparency in the fixed income

markets, an issue that disproportionately affects retail investors. With respect to municipal securities, he is particularly concerned that retail investors do not understand exactly what they pay in bond transactions. The Commissioner commends FINRA and the MSRB for their recent proposals that would require dealers in retail-sized fixed income transactions to disclose on trade confirmations the price of the dealer's same-day principal trades in the same security, along with certain other pricing information.

Disclosure Reform in the Fixed Income Markets

Commissioner Gallagher notes that there have been growing calls for reform to the fixed income disclosure regime, particularly with respect to municipal securities, but that the SEC's authority in that area is limited because of the Tower Amendment. The Commissioner highlights how the SEC has used its existing authority to improve municipal disclosure practices, as well as enforcement cases the SEC has brought against municipalities. Commissioner Gallagher then focuses on the importance of transparent accounting for municipal pension and other post-employment benefit ("OPEB") liabilities. He supports new GASB standards for accounting for pension liabilities, as well as a legislative fix mandating the use of GASB standards for municipal issuers (either a grant of authority to the SEC to recognize GASB standards or as a condition placed on the bonds' tax-exempt status).

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endnotes

*See A Watched Pot Never Boils: the Need for SEC Supervision of Fixed Income Liquidity, Market Structure, and Pension Accounting, Remarks of Commissioner Daniel M. Gallagher, U.S. Securities and Exchange Commission, New York, NY (March 10, 2015), available at <http://www.sec.gov/news/speech/031015-spch-cdmg.html#.VQBNAPnF884>

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