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Study Finds EMMA has Reduced Price Volatility, Price Differentials.

WASHINGTON – The Municipal Securities Rulemaking Board's introduction of EMMA and its subsequent requirements for dealers to disclose near-real time information on the system has narrowed measures of market inefficiencies like price volatility and price differentials but has not eliminated the advantage institutional investors have over retail investors, according to a study from Komla Dzigbede.

The paper was one of several chosen to be presented as part of the Brookings Institute's annual Municipal Finance Caucus here. Dzigbede, an assistant professor at Binghamton University, was invited to present the paper during one of the conference's sessions.

The study, published this month, explores secondary market trade data on California state general obligation bonds issued between 2005 and 2014. That period of time was chosen to cover the span before EMMA was launched in March 2008 as well as the time after the MSRB's 2009 introduction of requirements for dealers to report information to the new system. The requirements touched on, among other things, auction rate securities disclosure and all-electronic official statement dissemination standards. They also included mandatory disclosure of trade information on a near real time basis to EMMA.

EMMA and the establishment of the subsequent disclosure requirements to the system have helped investors by giving those in the market more information to use as they carry out transactions, Dzigbede said.

Regulators "must respond more effectively to counteract disparities in information flow and rent-seeking behavior, which creates unequal opportunities for the retail investor segment of the market," said Komla Dzigbede, assistant professor at Binghamton University.

Average daily trade prices rose in the post-regulatory period while trade price differentials decreased by an average of $0.18. Dzigbede said that the trade price rise may be attributable to investors' gradually demanding increased yields as more information on bonds became available because of the increased disclosures. That increase in information may also be the underlying cause of the trade price differential decline as investors were more able to assess the value of bonds, he said.

Trade volatility, which Dzigbede said is generally associated with an inefficient market, declined by 0.26% in the post-EMMA regulation period, according to the data. While that is good news and shows the regulations were effective, Dzigbede said that the data shows that institutional investors benefited more from the changes, seeing a higher margin of decline for volatility than retail investors.

He said that finding confirms "evidence on the inequities in trade pricing that tend to favor large investors over small investors in municipal securities secondary markets."

So while the regulation was generally good for the market and “should give renewed impetus” to such regulatory efforts, there is still work to be done to lessen the advantage institutional investors have, Dzigbede said.

He added that regulators “must respond more effectively to counteract disparities in information flow and rent-seeking behavior, which creates unequal opportunities for the retail investor segment of the market.” One way to do that, according to Dzigbede, is to identify spaces within the market that are attractive to retail investor trades and target protective regulatory schemes there.

He also said it is important for the MSRB and Securities and Exchange Commission to help educate investors, especially small ones, about things like complex, sophisticated debt instruments and the mechanics of trading portfolios and the risks associated with them.

Karol Denniston, a partner with Squire Patton Boggs in San Francisco who specializes in bankruptcy matters who was chosen to comment on Dzigbede’s paper, said that the market is “never going to be an even playing field” between institutional and retail investors.

Institutional investors have “more information, bigger purchases, and better access to the market,” Denniston said. “I’m not sure if we’re ever going to see a level of disclosure that is going to balance out” retail and institutional investors.

She agreed with Dzigbede that regulators need to focus more on promoting and ensuring strong disclosure in the municipal market but said the enforcement of the disclosure provisions is particularly important right now as states like California deal with funding pensions and other post employment benefits.

“The premise of the paper is good, disclosure will make the market more efficient,” Denniston said.

“[But] there needs to be some mechanism to enforce [disclosure regulations] so people take it seriously. We need some teeth.”

Her comments are drawn from experiences she has had while working with troubled entities. She said that she sees some issuers having financial troubles that are reluctant to report them because they want to try to keep up appearances. That lack of disclosure is especially problematic as states and municipalities confront a variety of fiscal challenges like pensions, she said.

The Bond Buyer

By Jack Casey

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