

**WRITTEN TESTIMONY OF ANDY GILL  
SENIOR VICE PRESIDENT, FIXED INCOME  
CHARLES SCHWAB & CO., INC**

**SEC FIELD HEARING  
“THE STATE OF THE MUNICIPAL SECURITIES MARKET”  
SAN FRANCISCO, CALIFORNIA  
SEPTEMBER 21, 2010**

Commissioner Walter and Commission staff, my name is Andy Gill, and I am the Senior Vice President of Fixed Income at Charles Schwab and Company. It is a privilege to be here to testify today and offer an investor’s perspective on the state of the municipal securities market. Thank you for holding this series of field hearings on an issue of critical importance to investors.

Charles Schwab is a dually-registered investment adviser and broker-dealer, with whom our customers have entrusted more than \$1.4 trillion in assets. Because our business model focuses on serving retail customers directly as well as the independent RIAs who serve them, I believe Schwab has a unique perspective to offer today. Our customers have an important stake in the issues relevant to the Commission’s inquiry regarding the municipal securities market.

Let me begin by addressing the question asked by the title of today’s hearing – what is the “state of the municipal securities market?” For our retail clients, the state is very much mixed. On the one hand, municipal securities are an important and valuable component of the fixed income allocation in an investment portfolio, offering diversification, tax advantages, and the opportunity to invest in community and infrastructure building locally and across the nation. On the other hand, municipal security investors often must accept a heightened degree of risk as a result of the uncertainty that comes with incomplete issuer reporting and less-than-transparent pricing.

There are three topics I’d like to cover today, but first, let me draw a more complete picture of the municipal bond investors we serve at Schwab.

**MUNICIPAL BOND INVESTORS AT SCHWAB**

Customers maintain about 9.4 million accounts at Schwab. About 84% of these accounts are either in our “Investor Services” unit, which serves retail customers directly, or our “Adviser Services” unit, which serves retail customers through independent RIAs. Our Investor Services unit serves directly about 2.5 million households. Of these households, 117,000 of them, representing nearly \$90 billion in total assets, have at least one account enrolled in a fee-based advisory program. These programs include a non-discretionary advice program that we call “Schwab Private Client.” Fixed income advice, including recommendations on municipal securities, plays an important role in helping our retail clients in this program construct an overall balanced investment portfolio.

At Schwab, any client, regardless of the size of their account, can speak to a Schwab representative and receive education or advice about investing in municipal securities. The reality, however, is that the vast majority of municipal trades placed through Schwab are unsolicited. Our clients are by and large self-directed. As such, they want as much issuer and market transparency as possible to help them make informed decisions. One Schwab client provided the following comment in research we sponsored internally: “I want to be able to go online, just like you can do for stocks, and see all the bonds available that meet my criteria for coupon, yield, grade, CUSIP, and at what cost. The brokers have the ability to see this, so give us the visibility!”

Most of the self-directed trades in municipal securities are placed online, via schwab.com, through Schwab BondSource®, an electronic inventory and trading platform that allows our clients to search for fixed income securities, including municipal bond offerings, that match their preferences and needs. Schwab clients can typically access more than 25,000 bonds available through the network of Alternative Trading Systems, which most dealers, including Schwab, leverage to shop the over-the-counter market. The data available to our clients through Schwab BondSource includes the bond’s current offer price and yield; maturity; ratings; insurer status; terms, such as whether the bond is callable; and information on material events. Our representatives use the same system, and have access to the same information, when assisting a customer.

The three topics I would like to cover today are based on the needs we hear from our clients:

1. Trading as Principal to Obtain Best Price
2. Issuer Financial Transparency
3. Pricing Transparency

## **TRADING AS PRINCIPAL TO OBTAIN BEST PRICE**

In terms of the municipal bond market for new issues, Schwab’s participation out of necessity is as a principal. Municipal bond investors often seek new issues, motivated by the benefits of expanded availability over what is available in the secondary market, plus the straightforward pricing, and clear tax and accrued interest status. Whether they are purchased from an underwriter, a syndicate member, or a selling group, new issue bonds are sold in this market through a broker-dealer acting as principal.

By engaging in this market as principal, Schwab is able to expand the selection of bonds beyond what is available through other dealers, and to match or better the best price reasonably available in the market. Although trading as principal has historically been considered a conflict of interest with one’s client, the fact is that trading solely as agent would decrease access and, in many cases, increase the cost to retail investors. For example, last week Schwab sought bids for one of our clients to sell 25 general obligation bonds issued by a municipality in Iowa. Of the three quotes we obtained from other dealers, the best bid was 106.466, while Schwab quoted 106.766. If we had not been able to act as principal, our client would have been disadvantaged by \$75. In a recent 45-day period, Schwab provided the best price on 19% of our clients’ muni bond purchases and 54% of their muni bond sales.

The necessity and advantages of retail clients buying and selling municipal bonds from their broker-dealer acting as principal should be an important consideration as the Commission considers the staff announcement that the staff will not recommend to the Commission an extension of Temporary Rule 206(3)-3T under the Investment Advisers Act, and as it considers possible rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that could harmonize the standard of conduct for broker-dealers and investment advisers. The Temporary Rule currently allows dual-registrant broker-dealers and investment advisers, such as Schwab, to obtain client consent to principal trading in non-discretionary advisory programs in an efficient way to comply with the general prohibition against principal trading under Section 206(3) of the Act. The basis of the Temporary Rule is that broker-dealers, such as Schwab, acting in a dual capacity must provide best execution to their clients and the failure to do so would be a breach of duty if not fraudulent. The absence of the Temporary Rule, however, will encumber retail investors or lead to worse execution of their municipal bond orders, an outcome the Commission cannot intend.

Unless the Commission staff is willing to give timely and reasonable exemptions to individual firms, this will have a dramatically negative impact on retail investors in our Schwab Private Client program, who will effectively be precluded from the level of market access we provide to our self-directed clients. We urge the Commission to avoid this anomalous and unfortunate outcome.

## **ISSUER FINANCIAL TRANSPARENCY**

The municipal securities market is a huge and critically important market. It is estimated that the current amount of outstanding municipal securities is nearly \$3 trillion. About \$400 billion of new bonds and notes were issued in 2009. Individual investors hold more than two-thirds of the outstanding municipal securities either directly or through a mutual fund. Yet the municipal securities market lacks many of the basic investor protections that exist in most other sectors of our capital markets. It is time for this circumstance to change, beginning with an improved disclosure regime that will boost investor confidence and improve access to information about the municipal securities market.

Retail clients are increasingly self-reliant. They use online and other research resources to evaluate their current investments and consider potential purchases. They access the information available before making a decision. Complete and timely reporting has been required of equities and other registered securities for decades. Technological evolution has provided extremely efficient dissemination of information in these markets. Material events and other financial news are posted quickly and uniformly. But the municipal securities market remains frustratingly opaque to individual investors. Financial reporting by municipal issuers can take up to 270 days to reach an investor. This information lag is particularly worrisome because, for many investors, bond assets provide stability and income generation, the most critical portion of an individual investor's assets.

Important steps have been taken. Schwab strongly supports the Commission's recent changes to Rule 15c2-12, which enhanced material event disclosures for municipal securities. Schwab also

applauds the Commission's recent municipal enforcement initiatives that should serve to bring about more complete and timely disclosure by issuers of material financial information. Clients would benefit if broker-dealers could integrate a single source for material event disclosure into their platforms. We believe EMMA should be that single source in order to efficiently and completely provide these disclosures to clients in a cost effective way.

But more needs to be done. Clients need to be able to count on accurate, timely and complete information in making decisions on what to buy, what to hold and what to sell. Clients should be able to count on the same registration and disclosure standards to non-governmental conduit borrowers as apply if they issued their securities directly, without using municipal issuers as conduits. These conduit borrowing arrangements should be subject to the same level of disclosure as a corporate issuer directly obtaining financing in the public securities markets.

Moreover, clients would benefit if municipal issuers use generally accepted governmental accounting standards. Uniform accounting standards would make municipal issuer financial statements much easier to understand and compare, and would lead to better client outcomes.

Perhaps most importantly, clients need to be able to count on municipal issuers making available to investors offering documents, periodic reports, and other information, similar to the requirements of issuers in offerings of corporate securities. Schwab is not advocating that the disclosure programs for municipal securities and corporate securities be identical, but the information gap needs to be narrowed considerably.

## **PRICING TRANSPARENCY**

At Schwab, we strive to provide simple, straightforward pricing for every product we sell. Municipal trade reporting to the MSRB has been a great step forward, and we support continued efforts to make market information more transparent and more consistent to help investors evaluate municipal security decisions. Investors are accustomed to the depth and breadth of information available to them when analyzing stocks. From charts of historical prices, to quotes that show the depth of the market from multiple sources, to trading volumes over time, the richness and variety of information available to investors helps them understand the volatility and risk, and assess potential liquidity issues. The same should be true for investors in the more fragmented bond market. As new information resources emerge, more should be done to provide clearer, easily accessible and comparable information in the municipal securities market.

Thank you very much for inviting me to participate in today's hearing. I look forward to answering your questions.