



June 4, 2009

The Honorable Barney Frank  
Chairman  
House Financial Services Committee  
2252 Rayburn House Office Building  
Washington, D.C. 20515

The Honorable Spencer Bachus  
Ranking Minority Member  
House Financial Services Committee  
2246 Rayburn House Office Building  
Washington, D.C. 20515

The Honorable Mary L. Schapiro  
Chairman  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

The Honorable Christopher Dodd  
Chairman  
Senate Banking, Housing,  
and Urban Affairs Committee  
448 Russell Senate Office Building  
Washington, D.C. 20510

The Honorable Richard C. Shelby  
Ranking Minority Member  
Senate Banking, Housing and Urban  
Affairs Committee  
304 Russell Senate Office Building  
Washington, D.C. 20510

**RE: NFMA Comments on Municipal Regulations**

Dear Senators, Representatives, and Chairman Schapiro:

Given the unprecedented events taking place in securities markets, the National Federation of Municipal Analysts (NFMA) would like to give you our perspective regarding municipal bond market regulations and disclosure standards.

As Congress and federal regulatory agencies deliberate new oversight and regulatory change, NFMA is concerned that the depth and diversity of this market may not be fully considered when considering new legislation and/or regulation.

As an example, Congressional discussions are mostly focused on general governments and their general obligation, unlimited tax securities. However, governments and government authorities sell many other types of securities, including bonds payable from hospital revenues, student tuition and fees, toll road revenues, sales taxes, general appropriations, and residential mortgages.

In addition, the market's diversity is often a reflection of state law. Some states require competitive bidding in which financial advisors are the key contact for issuers and bidders. In other states, negotiated underwriting and broker/dealers dominate. However,

individuals and institutional investors purchase and trade securities in all states without regard to the structure of the original underwriting.

These factors indicate that a "one size fits all" approach will not substantially achieve the goal of improved oversight. NFMA's sector-based approach, discussed in a subsequent section, may help to illustrate the wider variety of credit issues that confront our market.

### *The Current Status of Disclosure in the Municipal Bond Market*

Due to existing federal law, the SEC has had to approach disclosure through the broker/dealer community and Rule 15c2-12. However, as a recent report from DPC Data\* indicates, compliance with this rule is inconsistent. Short of a fraud investigation, there is no enforcement mechanism available that is similar to remedies imposed for publicly traded corporate securities. With no one regulatory authority overseeing the municipal bond market, there are also no formal disclosure standards or definitions of material information to be provided, and disclosure quality varies significantly.

Viewed from the perspective of a corporate investor, it is unlikely that one would consider buying shares in a company whose filings are two years old, nor consider investing without complete and open disclosure of all material facts about a company. Yet this lack of disclosure has been tolerated and excused in the municipal market for a range of reasons. ("It is too much trouble/cost/burden for small, infrequent issuers"; "Municipalities have low default rates, so what difference does it make?" etc.)

NFMA views the launch of the Municipal Securities Rulemaking Board's (MSRB) new Electronic Municipal Market Access (EMMA) disclosure system as a step in the right direction, and we look forward to continued development of this system. Although EMMA has improved the delivery of information, it does not improve the quality of that information for new issue offerings or for annual 15c2-12 reports. Complete and accurate disclosure for investors should focus not only on financial results but on all material information. Operating data, competitor information, projections, and the terms and counterparties of contingent activities such as swaps, other derivatives, guarantees, and liquidity agreements are often material. In many cases, these items are routinely missing from today's disclosure. Especially with the scarcity of "AAA" credit enhancement and the absence of underlying credit ratings, analysts are working as quickly as possible to evaluate the securities in their portfolios. If detailed disclosure about the underlying credits were more robust and easily available, this process would be far more effective, allowing more efficient market decisions. Further, we might be able to avoid perpetuating some of our current problems as highlighted below.

### *Recent Issues – Auction Rate Securities and Swaps*

The municipal market, along with the capital markets in general, has suffered significant dislocation since 2007. There are numerous examples of borrowers paying up to 20%

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\* *Estimating Municipal Securities Continuing Disclosure Compliance*, <http://www.dpcdata.com/html/about-researchpapers.html>

interest on auction rate securities when that market became illiquid last year. While the market has corrected for many of these high profile issuers, some borrowers, particularly health care and smaller issuers, continue to pay elevated rates.

Since the summer of 2007, when the short term markets seized up, our members and other market participants have struggled to unravel the details of each transaction.

- For interest rate swaps and similar instruments, simply being able to track exposure to troubled counterparties is a time-consuming, frustrating, and often fruitless effort. The structure of a swap, the counterparties involved, and in particular a transaction's terms and triggers are often not disclosed to investors. For example, it was not readily clear which borrowers had interest rate caps on auction rate bonds.
- Determining rating downgrade triggers for replacement of counterparties and consequences for non-compliance were not obvious.
- For borrowers who had purchased guaranteed investment contracts from failed institutions, the collateral triggers, replacement of counterparties, or cash funding requirements were not always known.
- For bank-supported variable rate obligations, bank letter of credit agreements and terms of reimbursement have typically not been disclosed.
- Similarly, how much money a municipality gets up front in a "swaption" is not typically revealed, nor is the size of the termination payment to unwind a swap.

Each of these events has material credit consequences for municipal borrowers and their investors. NFMA hopes these examples help market regulators to determine disclosure guidelines and improve transparency in the market.

### *The National Federation of Municipal Analysts*

NFMA was chartered in 1983 as a not-for-profit association with the goals of promoting professionalism in municipal credit analysis and furthering the skill level of our members. We do this through educational programs and industry communication, providing an informed perspective on legal and regulatory matters relating to the municipal finance industry, and by facilitating the flow of information between investors and issuing entities.

NFMA membership includes approximately 1,000 members who evaluate credit and other risks of municipal securities. Members represent institutional investors, insurance companies, broker/dealers, bond insurers, and rating agencies. Credit analysts are present at all stages of the municipal securities market, from a transaction's inception to structuring, insuring, rating, sale of the securities, investing and trading in the secondary market. While each analyst's company may have a different role in the marketplace, understanding and communicating credit risk is the analyst's unifying link.

To this end, one of the major initiatives of NFMA has been to provide disclosure guidelines and best practices in the major sectors of the municipal securities market. Since inception, NFMA has published and disseminated “White Papers” and “Recommended Best Practices” on relevant topics such as GASB 45, securities law, project finance, hospital debt, water and sewer bonds and toll roads. “White Papers” serve to explain a topic and offer NFMA’s views; “Recommended Best Practices” promote detailed disclosure guidelines for each particular sector. To produce these papers, NFMA forms a committee of experts from among our membership and other market participants. NFMA contributors will typically include representatives of buy-side, sell-side, credit enhancement, and rating agency firms. The papers are subject to extensive review and discussion by NFMA Board of Governors before publication, as well as a public comment period. These documents and others may be viewed on NFMA's web site, [www.nfma.org](http://www.nfma.org).

In addition to these initiatives, NFMA works actively with regulatory bodies and trade associations to promote effective disclosure, best practices, and education in the municipal securities market. Throughout its history, NFMA has provided a clear and consistent message that improved disclosure is a key component to the smooth functioning of a market that promotes the goals of investor protection, market integrity and efficiency.

### Recommendations

- First, NFMA believes that the result of any changes to regulation of the municipal market should move municipal disclosure closer to corporate disclosure standards with respect to timeliness, content and fairness. While much progress has been made, this standard has not yet been achieved. NFMA does not take a position as to which entity would be best suited to improve this process. We believe any regulator for the municipal market must be organized and governed so that it considers the needs of the public and all market participants. To the extent municipal markets remain under a self-regulated organization through the MSRB, all stakeholders, including NFMA, should have board level representation to promote market fairness. In this era of heightened credit risk, NFMA members provide a valuable cross section of perspectives on the market.
- Second, NFMA strongly advocates that any regulator have direct rulemaking authority over disclosure of key credit features of securities themselves, the borrowers, and ancillary deal participants such as swap counterparties, insurers, and other credit enhancers. NFMA supports removing barriers to change and would support legislation that would allow capital market regulators to work directly with all participants to implement and enforce robust and timely disclosure. This disclosure should be made available at no cost to all who seek it, in a timely and organized fashion as a condition for participation in publicly traded markets.
- Third, NFMA strongly recommends that any regulatory changes focus on improving the quality and depth of information that is provided. We submit that NFMA’s well-vetted Recommended Best Practices papers or similar sector based guidelines are an excellent starting point for that discussion.

- Fourth, NFMA would like to see the establishment of a municipal market advisory panel created from among the major trade organizations in our market to help develop and maintain the quality of a regulator and regulatory scheme. To date, invitations to comment have been *ad hoc*, a practice which risks missing important developments as they arise as well as often excluding key parties. There are models for this type of advisory panel at the IRS, FASB and GASB, as well as the Muni Council. Muni Council was a 20-organization coalition formed earlier this decade that included the MSRB, SEC, NFMA and other industry groups. It worked successfully to improve the timeliness of municipal disclosure, setting guidelines for the resulting system - DisclosureUSA - and the MSRB's EMMA system. We also note that the SEC itself convened an "advisory committee on improvements to financial reporting" when developing its XBRL rules. We recommend that any such committee meet regularly to advise a federal regulator on developments and concerns in the market. This is because changes in state and local finance may be less familiar to those serving in federal government than to state and local market participants, and the panel would be available to brief and educate regulators and federal representatives. The organizations will no doubt disagree on many points and perspectives; however we believe this approach would serve as an early warning signal of emerging and urgent issues in state and local government finance.
- Finally, NFMA recommends that existing technology can be put to better use to improve transparency in the municipal market. The corporate securities markets will soon be making filings using XBRL technology, a global standard that will permit retrieval of information to be easy, uniform, and robust. There is little reason not to take the next step in streamlining electronic information in the municipal market as well. In fact, limiting the number of "touches" on a single document will save money, paper and time.

In closing, we believe in the strength and positive benefits of the municipal market, which has for decades offered affordable access to the capital markets for municipal issuers. We believe there are improvements to make and hope that NFMA's viewpoint can be considered.

We welcome the opportunity to meet with you to discuss these or other related points further.

Sincerely,

Lisa Good  
Executive Director, NFMA

