



August 10, 2016

The Honorable Mary Jo White, Chair  
Securities and Exchange Commission  
100 F Street NE  
Washington, D.C. 20549

*Via Electronic Mail*

**RE: NFMA Comments on Primary and Secondary Market Disclosure in the Municipal Market**

Dear Chair White:

The National Federation of Municipal Analysts (NFMA) is a not-for-profit association with nearly 1,400 members in the United States, and is primarily a volunteer-run organization. The NFMA's goals are to promote professionalism in municipal credit analysis, to conduct educational programs for its members and other interested parties, to promote better disclosure by issuers, and to advocate for best practices in the municipal marketplace. The NFMA seeks to educate its members, and by extension, the municipal bond market at large, about municipal bonds through our Recommended Best Practices in Disclosure and White Papers, which are available on our website, [www.nfma.org](http://www.nfma.org). We also open our annual conferences to non-members and the media.

The NFMA would like to express its concern about the content and exclusion of material information in primary offering documents and the quality and timeliness of secondary market disclosures. Inadequate disclosure in the primary and secondary markets remains a significant problem in the municipal bond industry. This lack of information can negatively impact the accuracy of pricing and liquidity, especially in the secondary market.

Since the Security and Exchange Commission's (SEC) amendments to Rule 15c2-12 in 1994, the municipal bond market has undergone major transformations in product development, investor technology and its investor base. We believe that the SEC's recent Municipal Continuing Disclosure Cooperation (MCDC) initiative has exposed major shortcomings in the municipal secondary market disclosure regime, and is a good starting point for more comprehensive efforts to address these issues.

The SEC, in its [2012 Municipal Securities Market Report](#) (2012 Report), identified many of the municipal bond market's shortcomings, both in terms of pricing transparency and the timing and adequacy of secondary market disclosure. We are pleased that both the SEC and the Municipal Securities Rulemaking Board (MSRB) are addressing many of the

recommendations regarding market structure, pricing and transparency. However, we believe that regulatory and industry efforts to address the problems related to disclosure have lagged.

On February 13, 2015, then-Commissioner Luis Aguilar made a number of proposals to address disclosure-related challenges. Two of his [recommendations](#) fall within the powers of the SEC, namely amending Rule 15c2-12 and providing interpretative guidance to municipal market participants. The recommendations for amending Rule 15c2-12 contained several common-sense ideas including expanding disclosure to include bank loans and other debt instruments, and the development of an enforcement mechanism to address compliance lapses. He also called for the SEC to update its interpretative guidance to reflect changes in the municipal market since 1994, when interpretive guidance on disclosure obligations was last provided. The NFMA strongly supports these recommendations.

Amending Rule 15c2-12 would be an efficient method to address the current secondary market disclosure shortcomings in the municipal market. In recent years, the amount of information disclosed annually by issuers has not kept pace with the complexity, heterogeneity and credit conditions of the market. Generally speaking, it is not uncommon for disclosure to consist of only an annual audit, Comprehensive Annual Financial Report (CAFR) or annual report. Smaller, less frequent issuers tend to produce audited financial reports lacking Management Discussion and Analysis sections, and with limited financial statement notes and supplemental information. Timeliness of disclosures continues to be a concern, with issuers often disclosing information six to nine months after the end of the prior fiscal year, or even longer in many cases. Compliance with the required Material Events disclosures has also been problematic, as was discovered in the SEC's MCDC initiative.

For purposes of this letter, we have grouped our recommendations into the following categories: a) improving the current state of disclosure filings to EMMA; b) expanding the list of Material Events notices to reflect the changing needs of municipal market participants; c) facilitating improved municipal market disclosure through written interpretative guidance by the SEC; d) addressing primary disclosure concerns; and, e) providing new legislative authority, as recommended in the SEC's 2012 Municipal Securities Market Report.

### **Improving the Current State of Continuing Disclosure on EMMA**

Rule 15c2-12 provides that annual financial information and operating statistics be uploaded to the MSRB's EMMA website. However, the timeliness and inclusiveness of this information remains a concern among our membership. We believe that the following areas should be examined should the SEC undertake a review of Rule 15c2-12:

1. Review current disclosure practices with a goal of establishing more standardization in terms of the form, content and timing of the information to be disclosed under Rule 15c2-12. The information currently provided varies widely by sector, and broad discretion is often exercised over the importance of information and whether it will be included in the post-sale annual continuing disclosure filings. Often events and/or circumstances that are material are omitted

from reporting under Continuing Disclosure Agreements (CDAs), such as the incurrence of additional long and short-term debt, early swap terminations, swap collateral postings and defaults under other contractual agreements. The lack of such disclosure—or the delay in providing such information—impairs secondary market pricing and liquidity and can affect bond ratings.

2. Consider amending the CDA undertaking to include a statement regarding the issuer's established policies and procedures to ensure compliance with the CDA in the future. Confirmation that policies and procedures exist would reasonably improve the likelihood of compliance.
3. Encourage the dissemination of interim financial information to the market on a timelier basis, including the use of dedicated investor websites. Interim information includes: approved budgets; budget amendments; financial reports submitted to legislative bodies, governing boards and regulatory entities; changes in economic and revenue assumptions; tax receipts; cash flows and other unaudited information. The SEC's support of providing such information without fear of penalty, absent fraud or material misrepresentation, would remove a current impediment to issuer distribution of such information.
4. Actively cite relevant recommended best practices published by groups such as the NFMA, Government Finance Officers Association (GFOA), National Association of Bond Lawyers (NABL) and National Association of State Comptrollers and Treasurers (NASACT). These papers provide a good representation of the various views of market participants on the content and timeliness of disclosure.

### **Expanding the List of Material Event Disclosures**

The current list of Material Events under Rule 15c2-12 reflects important events that must be reported immediately (within 10 business days) to EMMA, given their potential impact on the credit quality of an issuer. The material event list has evolved over time and should be revisited periodically by the SEC to address new concerns that have arisen in the municipal bond market. Ideally, the enumerated material events would be presented and emphasized as a non-exclusive list. In many instances, the lack of disclosure of a non-enumerated event (such as the incurrence of a bank loan) is a material omission of critical information that negatively impacts credit quality and secondary market pricing and liquidity. The following are suggested additions to the enumerated material event disclosures:

1. Reporting Other Long-Term Debt Obligations – The use of bank loans and direct purchases of municipal bonds as an alternative to a public bond issues have increased significantly in recent years. These instruments can have a material impact on outstanding publicly issued debt by: a) increasing the amount of debt outstanding; b) allowing a new lender to exercise remedies ahead of existing bondholders; c) diverting of specific resources (originally part of general resources) to secure the new obligation; d) adding covenants that, when triggered,

could result in cross-defaults; and, e) compromising liquidity if the principal payment is structured as a balloon payment or has extraordinary call provisions.

The NFMA has previously recommended the disclosure of such debt obligations by making loan documents publicly available, with redactions as necessary, or providing a summary of the terms of such debt obligations. Greater detail regarding the NFMA's position on the disclosure of bank loans is included in Recommended Best Practices for Direct Purchase Bonds, Bank Loans and Other Bank Borrower Agreements, dated June 2015. While our focus has been on these instruments because of the product's significant growth, the reporting of the incurrence of other long-term debt obligations, including capital leases, should also be required.

2. **Disclosing Other Events** – There are numerous other events that can impact an issuer or obligor's credit quality, liquidity and bond pricing and that are not currently enumerated as reportable material events. Disclosure of these events is clearly material to an investor's ability to assess credit quality and pricing for a security. Examples of such events include: a) changes in the composition of debt service reserve funds, particularly the substitution of cash reserves with a surety bond, which introduce a surety bond provider's risk as counterparty into a transaction; b) early swap terminations and swap collateral postings, which can impact the liquidity and credit quality of an issuer; c) defaults under other contractual agreements, which can trigger actions that may negatively impact investors in an issuer's other debt obligations; and, d) ongoing investigations by the SEC which may impact pricing and liquidity of an issuer's obligations and alter investors' views on whether to buy, sell or hold a security.
3. **Requiring Follow-Up Reporting for all Material Events Notices** – It is essential that issuers provide market participants with information when reported material events have been resolved. This applies to a broad range of issues, such as rate covenant violations, technical and payment defaults, debt service reserve fund draws, and similar occurrences. Disclosing updated, current information is critical for the proper analysis of the bond's credit quality and its secondary market liquidity and pricing.

### **Facilitating Better Disclosure Through Additional Written Guidance**

The SEC last issued Interpretative Guidance to the municipal bond market in 1994. Since that time, the market has undergone tremendous change yet there have been limited modifications to the disclosure regime. Significant advancements in information technology relating to the dissemination of data have not been fully realized because of concerns about voluntarily providing financial information or operating statistics that are unaudited. There also seems to be a misconception that providing information required under Rule 15c2-12 is the "gold standard" or "ceiling" and therefore, there is reluctance by some municipal issuers, underwriters, counsel and/or financial advisors to provide additional information, regardless of its significance. We expect that this could be remedied to some degree if the SEC were to

issue more comprehensive and clear guidance on the types, content and frequency of secondary market disclosure that is expected under Rule 15c2-12. Absent new constructive SEC guidance, the NFMA is concerned that many issuers and their representatives will continue to provide only what they believe is the minimum required, and that there could be further erosion in the timeliness of information.

### **Addressing Primary Market Disclosure Issues**

The evolution of the municipal market and the recent situations of issuer distress have highlighted a number of shortcomings in primary market disclosures that we think warrant action on, or guidance from, the SEC, including more detailed information on security structure and asymmetrical disclosure of information to market participants.

Evaluation of security structure has become critical in the wake of recent bankruptcy court actions. Because of the importance of these features in determining investor treatment relative to other securities in distress and in bankruptcy, it is vital that there is comprehensive disclosure about bond security in each primary offering document. Bond security disclosure should include: a) its authorization; b) voter approval requirement, if any; c) specific revenue pledges and tax raising abilities and processes; d) limitations on raising incremental or new revenues; and, e) whether a statutory lien is present.

Issuers routinely provide information to municipal bond rating agencies that may influence the agencies' ratings assigned to the bonds. Information that is material to the rating agencies in the context of its ratings is similarly material to investors and should be disclosed. But often, this information is not made publicly available, to the detriment of the ability of outstanding bondholders and prospective buyers to independently assess the credit quality of the bonds. This leaves investors at a disadvantage when assessing a fair price for the bonds, and has potentially harmful effects on secondary market liquidity. Eliminating this asymmetry in information disclosure supports the directives in the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring investors to perform their own independent research and not rely solely on the opinions of the rating agencies. We also note that similar issues exist regarding asymmetrical disclosure in which other market participants, such as banks and financial guarantors, receive information that is not provided to investors.

### **Providing New Legislative Authority**

While the previously outlined recommendations fall within the current municipal bond market regulatory structure, these alone may not be sufficient to provide the type of oversight that is necessary to ensure adequate transparency and fairness for municipal bond market participants. Several of the SEC's legislative proposals made in its 2012 Report warrant serious consideration:

1. Authorization for the SEC to require municipal issuers to prepare primary and continuing disclosure during the term of the securities. Such requirements could include time frames, frequency and minimum disclosure standards.

2. Permission for the SEC to require that financial statements be audited.
3. Ability to provide a mechanism to enforce issuer compliance with CDAs.

Thank you for your continued efforts to improve transparency and fairness in the municipal market. We appreciate your attention to our concerns and are willing to provide any additional information and/or assistance that would be helpful in addressing these issues. Should you or your staff have any questions, or wish to discuss this further, you can reach me via the NFMA offices, or directly at [lwashburn@mma-research.com](mailto:lwashburn@mma-research.com).

Sincerely,

/s/

Lisa Washburn  
NFMA Chair

cc: The Honorable Richard Shelby, Chairman, Senate Committee on Banking, Housing & Urban Affairs  
The Honorable Sherrod Brown, Ranking Member, Senate Committee on Banking, Housing & Urban Affairs  
The Honorable Orrin Hatch, Chairman, Committee on Finance  
The Honorable Ron Wyden, Ranking Member, Committee on Finance  
*United States Senate*

The Honorable Kevin Brady, Chairman, House Ways and Means Committee  
The Honorable Sander Levin, Ranking Member, House Ways and Means Committee  
The Honorable Jeb Hensarling, Chairman, House Committee of Financial Services  
The Honorable Maxine Waters, Ranking Member, House Committee of Financial Services  
*United States House of Representatives*

The Honorable Kara M. Stein, Commissioner  
The Honorable Michael S. Piwowar, Commissioner  
LeeAnn Gaunt, Chief, Municipal Securities and Public Pensions Unit  
Jessica Kane Director, Office of Municipal Securities  
Rebecca Olsen, Deputy Director, Office of Municipal Securities  
*Securities and Exchange Commission*

Lynnette Kelly, Executive Director  
*Municipal Securities Rulemaking Board*

