Remarks Of

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Washington, D.C.

Perspectives on Municipal Disclosure

The National Association of Bond Lawyers

February 7, 1991

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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners or the staff.

U.S. Securities and Exchange Commission
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NATIONAL ASSOCIATION OF BOND LAWYERS

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I. INTRODUCTION

The National Association of Bond Lawyers ("NABL"), now some 2,800 strong, should be proud of its accomplishments. I am aware of the tremendous service that NABL provides to the municipal industry, not only through its efforts to educate its members, at conferences like this, but also through its hard work in presenting your views to legislators, regulators, and other participants in the industry. NABL has come a long way since 1979 when it was formed to provide educational programs as alternatives to the PLI seminars and to the activities of the American Bar Association.

As I prepared to speak here today, I was reminded of Calvin Coolidge's warning that "one sure way to make enemies is to suggest change." With his advice in mind, I will charge into the breach by discussing my views on some of the issues facing the municipal market and by offering some constructive criticism. I am not going to suggest that there should be taxation of interest on municipal securities, however. In fact, I believe, as many of you may guess, that the tax issues and the federal securities law issues should be divorced entirely.

II. TODAY'S BOND MARKET

Before discussing areas in which, in my judgment, improvements are needed, I would like to talk for a few minutes about what you do right. James Lebenthal's speech, which appeared in NABL's last quarterly newsletter, contained the refrain:

> Love your hospital, love your hospital 7 1/8's.
> Love your sewer system, love your sewer system 7 1/8's.1/

His comments underscore the important work that everyone in this audience performs in bringing bonds to market and financing the needs of state and local governments. The importance of the market for municipal securities is reflected in its growth over the last twenty years. Over $800 billion in municipal securities were outstanding in 1990. More than 2,700 dealers are registered with the Municipal Securities Rulemaking Board ("MSRB") - almost one for every NABL member. Moreover, in 1990, $161 billion in new issues of securities were brought to market.

1/ Quoted from a speech delivered by James A. Lebenthal on September 16, 1990 in Tacoma Washington, _reprinted in_, _The Quarterly Newsletter of the National Association of Bond Lawyers_ (November 1, 1990), at 38.

The ability of thousands of municipal issuers to enter the market and service the needs of their communities depends upon the strength of the partnership that has been forged with investors. The relationship between issuers, dealers, and investors is constructed on a foundation of trust that has resulted from the long history of governmental securities as "safe" investments. In fact, this is a market that, by and large, survives on investor confidence.

Increasingly, the continued confidence of individual investors will be important in assuring that governments can finance their operations in a cost effective fashion. While commercial banks, property and casualty insurers, and other institutional investors steadily have been reducing the amount of municipal debt they own, individual investors, including mutual funds and money market funds, have steadily been increasing their level of investment. About two-thirds of all municipal bonds currently are either held directly or indirectly by individual investors.2/ Moreover, with increasing tax rates, individual investors now have additional incentives to continue to invest heavily in tax exempt securities.

2/ Source: Public Securities Association.

III. HEADLINES

I am concerned, however, that the reputation of the industry is being tarnished. Among sophisticated investors, there is growing dissatisfaction with the lack of secondary market information. In addition, individual investors are confronted daily with headlines in newspapers and magazines that decry the demise of credit quality in the municipal markets and ask whether municipal securities will be the junk bonds of the 90's.3/

We know that traditionally municipal defaults have significantly lagged corporate defaults. However, partly as a result of the explosive growth in the high yield debt markets in the 1980's and the current recession, default levels in both the corporate and municipal markets are approaching record highs. In 1990, the Bond Investors Association reports that total defaults in the municipal markets will be at their

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3/ See e.g., Christopher Farrell, "Once Upon A Time, A Muni Was a Muni, Was a Muni..." Business Week, p. 120 (January 7, 1991); Janet Day and Judith Graham, "Will Muni's be 'Junk' of the '90s?" The Denver Post Section G at p. 1 (November 4, 1990); Jonathan R. Lang, "The New Junk?", Barron's, p. 10 (October 24, 1990); Ben Weberman, "A Better Break for Investors?" Forbes, p. 273 (September 3, 1990).

highest level since the unprecedented default of the Washington Public Power Supply System's Project 4 and 5 bonds in 1983.

It is impossible to ignore the problems facing thousands of unsophisticated investors that purchased special assessment district bonds, nursing home bonds, and housing bonds that now are in default. More troublesome, yet, are reports in the press concerning the problems of large governmental issuers that are apparently looming on the horizon. The fact that municipal securities generally are safer than corporate bonds will be little solace to many of the small investors in municipal securities that have lost their life savings.

I do not mean to suggest that the general economic problems experienced by municipal issuers today are the result of fraud or have any general correlation with the quality of disclosure provided to investors. The problems in most cases are a reflection of difficulties facing all segments of our economy, including the financial institutions that provided credit support for municipal bonds. Nevertheless, one cannot overlook the fact that these economic problems will place stress on the financial markets. They highlight the need for accurate disclosure, so that important financial information is available to investors at the time that they buy or sell securities in the secondary market. Furthermore, I am convinced that the post mortem that generally follows the default of an issuer will reveal that a number of issuers did not provide adequate primary market disclosure and that many investors were asked to purchase municipal securities without being fully informed of the risks. At the margin, courts will determine that some issuers engaged in fraud, and, had the underwriters and lawyers properly performed their roles, some of the offerings would never have gone forward.

Notwithstanding the significant improvements the municipal industry has made in primary offering disclosure over the last decade, and the overall high credit quality of governmental issuers, we all have to be concerned that the problems being reported in the press do not cast a cloud over the entire market. Although many of us would like to think that everyone who purchases a bond will pay close attention to the disclosures provided in those painstakingly prepared official statements - that simply is not the case.

Many individual investors purchase bonds on the strength of this market's reputation. They do not analyze the financial statements or make fine distinctions between types of municipal securities. Moreover, for those investors that do have the ability and desire to analyze the credit risk of an issuer, the information may not be available to them in secondary market transactions.

Because there are many other investment opportunities available today, this industry cannot afford to let the problems appearing in the press undermine the confidence of individual investors in the entire market. This is a time that calls for the industry to be proactive - to assure that the individual investor does not retreat from the market.

With this concern in mind, I would like to talk today about a three-fold approach designed to address some of the weaknesses of our current disclosure system. This approach would build upon the good work that members of the industry already have accomplished. It would provide for: (1) a cooperative effort by the Commission, state governments, and industry groups to improve the quality of disclosure provided by certain "non-governmental" issuers that have accounted for a disproportionate amount of the losses experienced by investors; (2) additional Commission enforcement of the general antifraud provisions of the federal securities laws in the municipal markets; and (3) increased emphasis in the voluntary efforts of the industry to encourage secondary market disclosure.

IV. FOCUS ON CONDUIT ISSUERS

Despite the huge amount of municipal securities offered to investors each year, there are significant differences in the regulation of the municipal and corporate securities markets. Fifty-eight years ago, Congress created a regulatory system for offerings of securities that was designed to provide for full and fair disclosure to investors. The primary mechanism chosen by Congress to attain this goal was through the registration of securities and the creation of express rights of action that allowed investors to redress disclosure violations.

For a variety of reasons, however, certain types of securities, and certain types of transactions, were excluded from the registration system. Securities of banks and savings and loan associations, for example, were required to be registered with their appropriate banking regulators, rather than the Commission. Similarly, certificates issued by receivers or trustees in bankruptcy, with court approval, are exempt. Intrastate offerings, because of their local nature and the presence of state regulation, are not required to be registered. Private offerings also can be sold to sophisticated investors without registration, because these investors can protect their interests by commanding additional disclosure where they believe it is necessary.

Municipal securities were not subjected to the registration requirements in 1933 because there was a lack of demonstrated abuses, the markets were largely local, and they were dominated by financial institutions. In addition, Congress was ever mindful in the 1930's of the same Constitutional concerns about abridging legitimate state interests in light of the governmental immunities doctrine that, of course, has been reflected in federal tax laws since 1913.

As many of you are aware, in the mid-1980s the Commission revisited the vitality of the general exemption from registration for municipal securities. The Commission concluded that although the markets for governmental bonds have changed significantly since the early 1930's, in terms of their scope, complexity, and investor base, the overall credit quality of the governmental segment of the municipal market remains high and there is little evidence of abuse.

Voluntary efforts of groups like the Government Finance Officers Association ("GFOA"), and others, including NABL, have had a significant effect on improving the disclosure that is available to investors. In the absence of a Regulation S-K or S-X, and without guidance from the Commission or Congress, the industry has developed its own disclosure standards. Based largely on the improvements achieved by the industry, the Commission determined that the exemption for governmental issuers continued to be justified. The major problems in the primary market for municipal securities were not in the quality of disclosure, but in getting the disclosure documents to investors. In 1989, the Commission adopted Rule 15c2-12 to address this problem.

The Commission consistently has been careful to note, however, that whatever accolades are deserved by the municipal market as a whole, are not merited by each of its components. Over the past five years, for example, industrial revenue bonds, housing bonds, and nursing home and hospital bonds yearly have accounted for roughly three quarters or more of the total dollar amount of payment defaults of all municipal securities.4/ Moreover, frequently the defaulted issues were unrated, sold to unsophisticated investors, and subject to limited

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4/ Source: Bond Investors Association.

governmental controls, if any.

Although they account for only a portion of the total municipal volume, conduit offerings have produced a disproportionate amount of the problems attributable to the municipal markets as a whole in recent years. The one factor they share in common with the securities issued by governmental issuers is that in most cases interest on the bonds is not subject to taxation. Frequently, though, the issuers are subject to the same vagaries of the business and housing cycle as their taxable corporate counterparts whose securities are registered with the Commission. Investors in these tax exempt securities, however, are denied the full measure of protection offered by the federal securities laws.

In the 1960's and 70's, governmental issuer groups resisted all forms of federal encroachment in the municipal securities market. There were concerns that extending the federal securities registration requirements to even a limited portion of the tax exempt securities markets was an unacceptable burden on states' rights. Increasingly, however, I sense a recognition within the industry that federal tax policy and the application of the federal securities laws need not be linked.

That the current registration exemption for certain issuers pays too much homage to the needs of the individual communities at the expense of both governmental issuers and individual investors:

While I applaud the willingness of the GFOA to address conduit offerings in its recent revisions to the Disclosure Guidelines, and the efforts of the National Federation of Municipal Analysts to develop segment-by-segment guides that encompass many of these issuers, I am not convinced that the efforts of these, or other, industry groups alone will be sufficient to resolve the problems.

Collectively, we need to revisit the application of the federal securities laws to limited portions of the municipal market and determine if the level of protection offered investors in the 1990's is adequate. Whether or not registration or some other cost efficient alternative is appropriate, I believe that investors in municipal securities are entitled to the full measure of protection afforded by the federal securities laws. Moreover, regardless of what steps we may take in the future, investors in these markets deserve the protection of an active Commission enforcement program today.

V. INCREASED ENFORCEMENT

Although my comments so far have been directed to a limited segment of the municipal market, I believe that the Commission must play a more vigorous role in all areas of this market. In the past, the Commission has taken action against issuers and underwriters where there have been widespread violations of the federal securities laws. Nevertheless, its enforcement role in the municipal markets has been more circumscribed than in the corporate markets. As a result, some issuers, dealers and their counsel have not had a full appreciation of their responsibilities under the law.

When the Commission adopted Rule 15c2-12 and published its interpretation of the responsibilities of underwriters under the federal securities laws, it put the industry on notice that it is serious about improving municipal disclosure. Despite the efforts of NABL and other groups to educate members of this industry about their responsibilities under the federal securities laws, I have seen recent official statements in which underwriters disclaim any responsibility for the issuer's disclosure. In addition, I have heard disturbing reports that some dealers have not been complying fully with the requirements of Rule

15c2-12 or the MSRB's new Rule G-36.

Because Rule 15c2-12 is designed to assure that underwriters have an opportunity to comply with their responsibilities under the general antifraud provisions of the federal securities laws, and that investors receive disclosure documents in a timely fashion, I will urge the Commission's staff to aggressively enforce compliance with this rule. Both the NASD's and the Commission's examiners will be looking closely for compliance when they visit your dealer clients. As many of you are aware, we now have the authority to impose substantial fines against firms that demonstrate an unwillingness to comply with our regulations.

VI. IMPROVEMENTS IN THE SECONDARY MARKET.

Finally, I would like to say a few words about secondary market disclosure. It should be obvious to everyone that the industry needs to work together to make sure that the partnership between investors and the issuer continues into the secondary market.

Cost effective secondary market disclosure is an idea whose time has come. Many municipal issuers have recognized the value of secondary market disclosure and voluntarily provide information to the market. In addition, some municipal issuers must make available annual reports to satisfy state law requirements, and more limited periodic information may be required by rating agencies.

We must recognize, however, that the preparation and dissemination of secondary market information entails costs. While these costs may be prohibitive for some small issuers, the marginal expense associated with collecting and disseminating information already available to a great number of issuers should not be significant. Nevertheless, the willingness of an issuer to provide information to the secondary market should produce value in terms of liquidity and accurate pricing at the time of resale that can be factored into the return demanded by investors.

Although I believe that a decision to provide secondary market information should be intuitive, a great deal of effort already has been devoted to creating awareness among issuers of the need for secondary market disclosure. The efforts of the GFOA, the American Bankers Association's Corporate Trust Committee, the National Federation of Municipal Analysts, and NABL, to name a few, will be the catalysts for improvement in secondary market disclosure.

We also should be sensitive to the fact that more disclosure is not necessarily better disclosure. The information that is provided to the secondary market should be both reliable and relevant. Consequently, I believe that it is important to get beyond the apparent discord about where the information should be sent, or who should send it, and to redouble cooperative efforts to develop relevant disclosure guidelines for the secondary market.

In this regard, I want to emphasize that concerns about the legal liabilities of issuers disclosing information into the secondary market are not a legitimate reason for slowing the progress that already is underway. Each day, both corporate and municipal issuers talk to analysts, issue press releases, make speeches, and engage in other activities that reasonably can be expected to reach investors. The one requirement imposed by the general antifraud provisions of the federal securities laws is that when issuers speak, they speak accurately and completely.

Lawyers have an important role to play in any industry efforts to develop disclosure guidelines. Moreover, they should impress upon clients their responsibilities under the federal securities laws.

Nevertheless, I do not view the voluntary, organized presentation of information to the secondary market as a source of greater liability for issuers than they already encounter. If there are liability issues that need to be addressed, we should make sure that they are placed in their proper perspective and do not become an impediment to improving voluntary disclosure efforts.

A more significant concern to all of us should be in developing an efficient secondary market. There is a growing sentiment among sophisticated investors that good secondary market disclosure should be the norm. At the very outset of an offering, issuers, lawyers, underwriters and trustees should agree on what kind of support will be provided to the secondary market and who will provide it. Instead of an issuer asking what interest discount will I receive for offering secondary market disclosure, the appropriate question should become: what premium will the market require if I do not offer what is necessary?

VII. CONCLUSION

In closing, I note that no one appreciates constructive criticism as much as the one giving it. You have kindly given me a soap box on which to express my views today. Although I have focused on areas in which improvement is needed, the overwhelming story is positive.

As I proceed into my term with the Commission, and as we prepare for the likely Congressional hearings that will take place this Spring, I would invite everyone in this audience to let me know your views - not only on the issues that I have touched upon today, but also on other areas in which you believe the Commission can play a greater role in improving the municipal markets.

I would also like your help in protecting investors. By virtue of your day-to-day involvement in the industry, you are in a far better position to detect serious problems <u>before</u> investors are injured. I urge each of you to speak out about practices that deserve our attention. Our common goal should be to assure that the municipal markets operate effectively for both issuers and investors.