

Transcript: Field Hearing On The State Of The Municipal Securities Market Panel III, IV, & V

Panel III Speakers: Lynnette Hotchkiss, Executive Director of the Municipal Securities Rulemaking Board (MSRB); Thomas Selman, Executive Vice President, Regulator Policy at FINRA; Benjamin Asher, Managing Director of Public Resources Advisory Group; Leslie Norwood Managing Director and Associate General Counsel of SIFMA

Panel IV Speakers: David Bean, Director Of Research and Technical Activities, Government Accounting Standards Board; Timothy Firestine, Chief Administrator Officer, Montgomery County, Maryland, Chair Of The Budget Finance Committee, D.C. Water and Sewer Authority; David Jones, National Managing Partner for Public Sector Assurance Services, Deloitte and Touche

Panel V Speakers: Nancy Kopp, State Treasurer, Maryland; John Cross, Associate Tax Legislative Counsel, Treasury Department; Bartley Hildreth, Professor of Public Management and Policy, Georgia State University; Derek Wolff, Vice President and Senior Research Analyst, Navina Asset Management

This transcript has not been edited for content.

Elisse Walter: I'll start again. We're going to get started, we're here with our panel on self regulation, and once again, I'm going to turn the floor over to Martha Haines.

Martha Haines: Panel three of today's field hearing will focus on self regulation in the municipal securities market. Among a host of other changes affecting the financial markets, market participants and regulatory structures, the Dodd Frank Wall Street Reform and Consumer Protection Act subjects municipal advisors to registration with the Commission and rule making with the MSRB. These new MSRB rules yet to be written mostly, will be enforced by the SEC while the rules applicable to broker dealers engaged in municipal securities transactions are enforced by the SEC, FINRA and the appropriate bank regulators. Of course, the SEC, FINRA and bank regulators are also engaged in the inspection of regulated entities under our jurisdictions. In light of the expanded responsibilities of municipal regulators in many areas provided by the Dodd Frank Act, it's more important than ever for organizations responsible for protecting the municipal market to work together efficiently.

We are very pleased to have with us today Lynnette Hotchkiss, the executive director of the MSRB; Thomas Selman, the executive director of regulatory policy of FINRA; Benjamin Asher, who's the senior managing director of public resources advisory group, a large municipal advisor organization; and Leslie Norwood, the managing director and associate general counsel of SIFMA. We're very interested in their insights on how regulators can best work together to allocate responsibilities in this new world.

I want to remind you we're going to hold you to a five-ish minute limit for your initial remarks and then come back with questions. And if you want to answer a question, one of the ways you can indicate that is by putting your nametag on end like that. It's very noticeable.

Elisse Walter: I'll point out that nobody did that all morning.

[laughter]

Waving seems to work too.

Martha Haines: Yeah, it did. Lynette, would you like to begin?

Lynette Hotchkiss: Sure. Thanks very much. Good afternoon, I am very proud to be here today to speak with you about the municipal securities rulemaking board and the important work that we do. As you know, we were created by congress in 1975 to protect investors and to promote a fair and efficient municipal securities market. The Dodd Frank Act expanded that mission to include the protection of municipal entities, which includes state and local government issuers, conduit borrowers, and state and local government pension plans. To our knowledge, this is the first time a securities regulator has been charged with protecting the issuer of securities.

So, we accomplish this mission in a variety of ways. We create a robust rulebook regulating dealer and now municipal advisor activity; we collect trade data, interest rate resets, and other market data, as well as disclosure documents and material event notices; and then we disseminate this information for free on our EMMA [spelled phonetically] website.

We maintain a strong partnership with fellow regulators to ensure the vigorous enforcement of MSRB rules. We maintain a focus on education and outreach efforts to ensure that regulated entities participate in the development of our rules through the public comment process, and also to ensure that other market participants understand and are aware of our activities. And finally, the board exercises market leadership by addressing issues outside of its jurisdiction but which impact the municipal market.

So, I'd like to take a minute to just illustrate the different kind of initiatives that we undertake with the following examples. The MSRB created the first ever rule seeking to prohibit pay-to-play practices within the industry, and we will soon propose a similar rule for municipal advisors. This rule has been the model for similar rules both at the state and federal level. The MSRB instituted the first real time trade reporting system, and makes that trade data available to the market in real time. Last year, the MSRB launched a new transparency program which collects interest rate information and other details about auction rate and other short term securities. Further enhancements for this system are planned for spring of 2011.

Earlier this year, the MSRB launched RegWeb which is a secure, electronic interface that enables enforcement agencies to directly access our information systems to run queries on dealer activities, to investigate suspicious trading patterns, and to otherwise ensure compliance with MSRB rules.

In July of 2009, the expanded potential of EMMA was achieved with the SEC requiring that all mandated disclosures by municipal issuers be filed to the EMMA website. At this time, a user of EMMA can access real time trade data, interest rate reset information for short term securities, primary market disclosure documents, mandated annual operating and financial disclosures, material event notices, and voluntary disclosures by municipal issuers who want to go above and beyond the minimum requirements set by SEC rule 15C212. And, further enhancements to EMMA are planned for 2011, and the full potential of EMMA has yet to be realized.

And, as Commissioner Walter said this morning at its meeting last week, the MSRB board decided to undertake a study on municipal market structure and trading. So, cornerstone of the MSRB's mission is to promote a fair and efficient municipal securities market; and this study on pricing and liquidity is clearly consistent with that mission. Once the study is completed, we'll be able to determine whether pre trade information would promote additional pre trade information would provide additional benefits to market participants.

And finally, I'd like to close with our views on self regulation. As you know, the SRO model was conceived by Congress as a way to enhance the work of government regulators that have limited resources, and it provides the opportunity for the private sector to support and further the government's interests. An SRO brings particular strengths and characteristics to bear on the work of regulating the capital markets, and among these are industry expertise, a singular focus, a self-funded structure, corporate governance that is free of undo industry influence, a transparent rule making process, and of course, accountability to the Commission and to the market. As an SRO, the MSRB has 92 incredibly talented staff members with specialized knowledge and the singular focus required to effectively regulate the municipal market. The SEC has and continues to leverage this expertise in accomplishing our shared goals. Each and every one of the numerous initiatives and achieved by the MSRB are wholly dependent on the constructive and healthy working relationship between the SEC and the MSRB. We certainly appreciate the opportunity to be here, and we look forward to reviewing your assessments and conclusions at the end of these field hearings and working with you to address issues in the market.

Tom Selman: As Martha said, I'm Tom Selman, I am executive vice president for regulatory policy at the Financial Industry Regulatory Authority, and I'm pleased to be here to discuss FINRA's role in the municipal securities market. FINRA regulates all U.S. broker dealers that deal with the public. We license firms and individuals to work in the industry and sanction those who violate the law. We adopt and enforce rules to protect investors in the financial markets, we conduct examinations of broker dealers, we inform and educate investors, we maintain regulatory utilities, and we administer the largest dispute resolution form for investors and registered firms. As a National Securities Association FINRA operates subject to the exacting requirements set forth in section 15A and section 19 of the Securities Exchange Act of 1934.

These standards insure that FIRNA is publically accountable, its rule making and regulatory activities are transparent and its governance and regulatory programs protect the public investor. Under these standards the Commission conducts continuous stringent oversight. FINRA has a robust program to examine broker dealers for compliance with FINRA rules and federal law. Fifty-five percent of broker dealers are examined each year by the Commission and FINRA. In 2009, we conducted approximately 2,500 routine examinations and over 8,000 targeted examinations in response to events such as customer complaints, terminations for cause and regulatory tips. In 2009, FINRA took 9,093 disciplinary actions baring 383 individuals and suspending, expelling many others. We levied fines against firms and individuals totaling nearly \$50 million. FINRA's governance is designed to ensure that its board of governors and its staff act independently and in the public interest. Our board of governors must at all times have more public governors than industry governors. Our staff is autonomous subject to the supervision of senior FINRA management and the board of governors. FINRA staff has sole discretion to decide which matters to investigate and prosecute. The initiation of proposed enforcement actions are not subject to board of governors' approval. And all FINRA rules are subject to SEC approval after the public has an opportunity to comment.

When Congress established the MSRB in 1975, it granted the organization broad rule making authority. Examination with compliance with MSRB rules and enforcement is, however, vested with FINRA for municipal security firms that are broker dealers. Of course, we have no authority over issuers of municipal securities. About 1,853 of the 4,700 broker dealers who are subject to

FINRA oversight also conduct a municipal securities business. Indeed, the vast majority of municipal securities dealers are FINRA regulated firms. In a typical month, FINRA regulated firms affect about 99 percent of all municipal transactions reported to the MSRB. In accordance with MSRB rule G16, FINRA examines each municipal security dealer under its jurisdiction at least once every two years for compliance with MSRB rules. We maintain regular contact with the MSRB to ensure that the allocation of responsibilities between the two organizations is carried out efficiently, and in the public interest. The MSRB staff assists in training our examiners as needed regarding MSRB rules and requirements. FINRA and MSRB work together on industry outreach programs to provide regulatory and examination updates. And, our examination and enforcement activities related to compliance with MSRB rules, FINRA uses municipal bond transaction data reported to the MSRB to create an audit trail of market activity. Our market surveillance systems use this data to detect potential problems. Examiners review data that is available through FINRA and MSRB systems and assess a firm's books and records. Examiners also check whether a firm's records support their regulatory filings and trade reports. From January 1, 2009 through November 30 of this year, FINRA has settled 129 formal disciplinary actions involving violations of MSRB rules by firms and individuals. During this same period we collected approximately \$6.8 million in fines related to violations of MSRB rules. Some of the most common violations in these actions involved failure to deal fairly with customers, supervisory lapses, pricing violations, and failures to disclose in connection with new issues. FINRA also administers a qualifications examination for municipal securities dealers. We have developed these examinations in conjunctions with the MSRB. All of these examinations test the applicant's familiarity with applicable regulations and in the case of the principal's examinations with the supervisory requirements imposed by MSRB rules and federal law.

In June 2009, in light of increasing retail investment and mutual securities and dislocation in the fixed income markets beginning in 2008, FINRA announced an initiative to protect muni bond investors. In 2009 we undertook three sweep examinations of municipal securities activities, the findings of which we are still developing.

In addition, FINRA and MSRB issued an investor alert called "Municipal Bonds: Staying on the Safe Side of the Street in Rough Times," as well as an online muni-bond check list which provides a step-by-step guide to help investors avoid pitfalls in municipal and bond investing. Two recent FINRA notices addressed municipal securities transactions. A June 2009 notice reminded firms of their obligations to disclose material information to customers as well as their obligations regarding the suitability of recommendations and supervision of municipal securities activities. FINRA and MSRB jointly issued a notice in September 2010 regarding dealer disclosure obligations and secondary market transactions at municipal securities. We held a September 2010 webinar to educate the industry about a dealer's responsibility for fairly pricing municipal securities.

Thank you again for the opportunity to appear here today. I'd be pleased to answer any questions you have.

Ben Asher: Again, I'm Ben Asher from Public Resources Advisor Group. I want to thank the Securities and Exchange Commission including the office of municipal securities, the division of trading and markets, and Commissioner Walter for inviting me to participate on this panel today and for holding a series of field hearings on an issue of critical importance to both issuers and investors. It is a privilege to be here today to offer an independent financial advisors perspective on the state of municipal securities market with regard to self regulation.

I am currently a senior managing director at Public Resource Advisory Group, or PRAG, as we are generally known. The firm is a leading independent financial advisory firm headquartered in New York serving state and local governments in their agencies and authorities, not-for-profits and other entities that raise funds in the municipal capital market.

The firm was founded in 1985, I joined in 1991. Since the firm's inception, we've advised issuers on over \$600 billion of financings. PRAG's only business is providing independent financial investment and derivative advisory services to municipal clients. The independent nature of our firm differentiates its approach to advisory duties and responsibilities from those of an investment banking firm that also provides financial advisory services. We also do not engage in any form of underwriting, trading, or marketing in securities. This eliminates the possibility that a conflict can ever exist within our organization between marketing and advisory services. I am supportive of these new efforts to regulate the municipal advisors. These new rules provide a measure of protection to both issuers and investors, and importantly, will now require all municipal advisors to follow the same rules, particularly, with regard to pay-to-play.

Indeed, our firm adopted a voluntary internal policy in 1993 that adheres to the principles of rule G37. Subsequent to this internal policy, our firm, along with several other independent financial advisors, signed in 1999 the SEC statement of initiatives regarding political contributions to state and local candidates which was an agreement to a voluntary ban on pay-to-play practices in the municipal securities markets. It is our view that political contributions create a conflict of interest, and we simply do not believe that they are appropriate. The firm considers conflict of interest questions very seriously and has always acted to avoid both the fact and appearance of such conflicts.

I'm also pleased about the new regulation requiring municipal advisors to act as fiduciaries to clients. As an independent financial advisor, we always strive to meet a fiduciary responsibility by having a constituency of one, our client, the municipal issuer. We accomplish this by providing clients, particularly policy makers, with the information, analyses and tools to make informed policy decisions with regard to their depth and capital programs.

With regard to the requirement for the MSRB to propose and adopt new rules for municipal advisors to ensure that we meet professional standards and to ensure that our conduct is consistent with this new fiduciary duty, it's going to be important for the MSRB to fully understand the business practices of the many types of municipal advisors it now regulates. Because the definition of municipal advisors is broad, and municipal advisory firms vary considerably in size, when many firms focus on just one or few areas now covered by these new rules, the MSRB must consider carefully whether one size fits all with regard to continued education requirements, compliance, and the development of professional standards. Additionally, the MSRB will need to be cognizant of the initial and ongoing time effort and cost for municipal advisors to comply with these new rules.

Finally, I look forward to providing any additional comments to the SEC and the MSRB on MSRB's expanded mission as it transitions from a self-regulating entity that regulates security firms to a self-regulatory body that will now also regulate municipal advisors to ensure that the rules are fair, and its expanded mission is achieved. Thank you and I look forward to trying to respond to your questions.

Leslie Norwood: Good afternoon. My name is Leslie Norwood, and I am co head of municipal securities at SIFMA. Thank you for the opportunity to participate in this panel on self-regulation; to represent the broker dealer community's views on this important topic. In creating the MSRB in 1975, Congress recognized the unique nature of the municipal securities markets and acknowledged the value of having rules developed by self regulator with direct expertise and experience in the municipal securities market. As a result, Congress originally required two thirds of the MSRB to be broker dealer or bank representatives involved in the municipal securities business. This form of regulation was a system predicated upon a philosophy of supervised self-regulation. It assured that the regulation of this unique business was informed by the experience and expertise of its participants. Market participants have an incentive to police themselves. Because participants trust in confidence and a market is critical to a market sufficient operation. Market participants are also incentivized by knowledge of general and

securities law liability, SEC rule 10B5 has been applicable before the creation of the MSRB. Congress believed the SEC oversight of self-regulatory activities would limit any negative consequences, of the potential conflicts of interest inherent in the system. The enactment of the Dodd Frank Act has dramatically altered this landscape for the MSRB, broadening its authority and scope to a greater degree than at any time since its inception. I dare say that the title of the panel today is a misnomer. I'm not the first to say this, but the "S" has been removed from the SRO. We are now in an environment in which every former self-regulatory organization now has a public board of directors and is now an independent regulatory organization or IRO. In this case, Dodd Frank mandates the MSRB board be composed of a public majority to include members not affiliated with broker dealers or bank representatives including issuers, investors and independent municipal advisors. The MSRB has complied with that mandate as of October 1 and the majority is now indeed public. Dodd Frank also requires that non broker dealer municipal advisors including swap advisors and gig brokers register with the SEC and MSRB, with the MSRB serving as the principal rule maker for municipal advisors.

There are a number of statutory changes designed to ensure that non dealer municipal advisors are regulated similarly to dealers including compliance examinations, testing and continuing education requirements amongst many others. SIFMA supported and strongly advocated for this change and is interested in participating in the rule making process that the SEC and MSRB have begun to undertake. For SIFMA, one of the important underlying reasons for regulating municipal advisors under Dodd Frank was to attempt to level the playing field for different types of entities. Dealer advisors, and the previously unregulated municipal advisors, that engage in the same types of business activities by bringing municipal advisors under regulation by the SEC and MSRB, Dodd Frank brought more fairness to all market participants. I think we can all agree that permitting regulatory arbitrage, or picking a business structure merely to avoid regulation for otherwise regulated activity is not helpful to fair and consistent application of the rules across the market; however, SIFMA continues to have concerns that broker dealers are still subject to an unlevel regulatory playing field. As we all know, FINRA enforces the MSRB's rules; however, FINRA can only enforce the rules against dealer members of FINRA. Under Dodd Frank, non dealer FAA's will not be subject to paying FINRA fees or undergoing FINRA enforcement exams, and will only face SEC enforcement exams; thus the playing field is still not level for the different market participants engaging in the same types of municipal advisory activities.

Another concern that SIFMA members have is that underwriters have historically paid for the vast majority of fees needed to support the MSRB's work. SIFMA strongly believes that with this new independent nature of the MSRB, as well as the additional regulated parties and the expanding of the board, that the burdens of the fees that support the MSRB should be shared among all market participants. While there is some variability of the MSRB's revenues based on issuance trading volume, the MSRB has the ability to adjust its required regulatory fees to closely match its budgeted expenses in a given year. As a result, there is no reason for the MSRB to assess the dealer community more than is necessary to cover the annual expenses simply to hold those funds in reserve for future initiatives without a more comprehensive discussion with the dealer community of how much those initiatives will cost to time tables and their projected benefits to the market. Dodd Frank recognized that coordination among agencies is vital for effective regulation and as such, new to the MSRB's per view is specific requirements that FINRA consult with the MSRB in the enforcement and examination of clients with MSRB rules. The MSRB, SEC, and FINRA are now required to meet at least twice a year to discuss market regulatory issues. FINRA is now also required to request guidance from the MSRB in interpreting rules and provide information back to the MSRB regarding enforcement actions with respect to those rules. SIFMA supports this effort.

Some SIFMA members have expressed frustration that FINRA examiners often lack expertise in the municipal securities industry and often broker dealers are put in the position of teaching FINRA examiners about the municipal securities market and its separate rule book as the examination unfolds. There are also frustrations about uneven application of the rules across the

country with varying penalties for the same violations. SIFMA supports the creation of the funding of the office of municipal securities by the SEC. Some broker dealers, however, have concerns about the number of regulators in this market and have suggested that consolidation might be beneficial. For instance, SIFMA is publically on the record advocating for the merger of the SEC and SFTC. We would hope that the new requirements of Dodd Frank would be a catalyst to strengthen the relationship between all regulators including the SEC, MSRB and FINRA to provide for even more insightful and even examinations as opposed to mere checklist reporting. SIFMA's members generally value the separation of rule making and enforcement in the regulators and believe this separation has served the industry as a whole quite well by managing regulatory conflicts of interest. SIFMA generally believes having a dedicated rule maker such as the MSRB whose focus can be specifically on writing clear rules that best govern the industry is integral to a well functioning and smartly regulated marketplace. SIFMA does encourage the MSRB to consider common sense in the cost benefit analysis when drafting new rules or amending current ones.

While Dodd Frank granted the MSRB more authority, we would hope the MSRB would take its time with that authority and would not rush new regulations without first considering the implications, their possible unintended consequences. The MSRB should open its doors and books to be as transparent as possible given that more stakeholders have come under the MSRB's authority.

Another twist to the story is that Dodd Frank also broadened the MSRB's mission to include the protection of state and local government issuers of municipal bonds, in addition to investors in the public. This represents an unprecedented role for any regulator across the securities markets, while the MSRB has some existing rules to protect issuers, including rule G-17 on fair dealing, and G23 on the actions of broker advisors, SIFMA believes this new role may create an additional level of compliance for broker dealers, NFA's and certainly adds complexity for regulators. How the MSRB interprets the law and adopts new rules will become precedential. FINRA, for example, is clear on its mission to protect investors and regulates the market based solely on that duty. Robust capital markets require that market participants have confidence in the fairness and efficiency of the primary and secondary markets. Such confidence derives in part from the known allocation of responsibilities amongst market participants. Regulators have broad authority over securities dealers and this authority is exercised to require a high degree of responsibility and accountability on account of dealers. Dealers must adhere not only to the letter of the applicable law, but its spirit as well and a responsibility to act in accordance with just and equitable principles of trade.

However, regulation of dealers is too often used to achieve a desired result not because it is the most appropriate means, but because it is currently the most convenient lever available to policy makers given existing jurisdictional limitations. For the fixed-income markets to operate fairly and efficiently, all market participants, broker dealers, issuers and investors, must accept responsibility for creating and maintaining fair and efficient markets. Because the federal regulatory authorities are largely foreclosed under the tower amendment from regulating issuers directly, the municipal market is largely policed on the federal level by indirect regulation. Some SIFMA members have suggested that the dealer community bears a disproportionate amount of the regulatory burden with respect to issuer disclosure. In other types of securities, the issuer is primarily responsible for describing the securities being offered, the adequacy of the offering documentation, including the fair and complete representation of material facts about the issuer, and the circumstances surrounding the offering as well as continuing disclosure. However, in the municipal market, because of statutory limitations on the SEC's authority, disclosure rules are largely applied to issuers indirectly. The parties directly responsible for policing issuer disclosure practices are broker dealers. Under these requirements, firms that underwrite and transact in the secondary market for municipal securities are made to police issuers or risk being held accountable for the actions or omissions of issuers. While SIFMA's always supportive of disclosure that protects investors and issuers alike, we believe that in today's regulatory system,

in particular with the MSRB's new authority, we would greatly benefit from increased transparency, which in turn promotes accountability and increased investor confidence. SIFMA recognizes that congress and the SEC have focused their lens on improving discloser conditions and expanding the regulatory world to include more participants in the municipal securities industry. SIFMA members appreciate the large endeavors the SEC and MSRB have to undertake, and want to be and are dedicated to be an active participant in the regulatory process for municipal securities. SIFMA hopes to continue to work with the SEC and the MSRB on these issues to benefit all parties.

To reiterate, SIFMA believes the benefits of the MSRB are vast and having a dedicated regulator with the expertise and focus on the municipal securities industry's unique issues is valuable and had generally worked well since 1975 when the board was created. However, the MSRB has now shifted into an independent regulatory authority and it is critical to ensure not just the benefits, but also the costs and regulatory burdens are spread to its new constituents. Thank you again for this opportunity to put SIFMA's views into the record.

Elisse Walter: Thank you all. I'd like to start with a question, I guess primarily aimed at Tom and Lynne, which is that not only do we have the unique self regulatory system that is true through much of the federal securities laws with respect to the municipal securities markets, but we have a divide between rule making and enforcement. Short of combining the two entities, which is not a topic that we want to spend a lot of time on today, are there suggestions you have to enhance that bifurcated system?

Tom Selman: Well, it does -- the bifurcation does complicate things. I mean, to have one agency that's responsible for examining and another agency that's responsible for rule making obviously will complicate it, but I think we've -- I know we've done actually a very good job of working together meeting almost on a continuous basis to make sure that we examine in a way that's consistent with their interpretations and their rules, and vice versa, if they have changes or new technology that they consult with us. I really can't think of anything that could be done at a larger, at a higher level, say through some rule making. I think it really requires a constant effort by the staff that's dedicated on our side to the examination and interpretation of MSRB rules and on their side just to keep us informed of the changes they intend to make. I really think it's a staff effort.

Elisse Walter: Thanks Tom, Lynette.

Lynette Hotchkiss: Sure. I absolutely agree. We spend an incredible amount of effort coordinating with FINRA, with the bank regulators, with the SEC. We all sort of chuckled with Dodd Frank requiring that we meet twice a year, I think sometimes we meet twice a week or twice a day. It is a constant ongoing effort. And Tom's right; it is a staff effort, and we come to work every day with a regulator hat on. And we are only effective if our rules are rigorously enforced. We also try to coordinate very carefully to make sure that MSRB rules for municipals are consistent with the corporate rules where it makes sense. Gifts, gratuities, things like that so that there isn't a double burden on dealers to have to maintain, sort of, two sets of records. So again, I think it's a very good working relationship, very constructive, but it is an effort -- well, it's a goal really to make sure that that effort is sustained and is ongoing day in and day out.

Martha Haines: I wondered what your thoughts were on the changes to the exchange made by the Dodd Frank Act to the structure of the MSRB board, to a majority of public members now and the addition of three municipal advisor members. How do you anticipate that this may affect the board and its rule making and do you think there should be a different balance, should there be more or fewer municipal advisor members? Should there be more or fewer broker dealer members? Is the bare majority of independent members sufficient?

Lynnette Hotchkiss: Well, why don't I go ahead and start? With Dodd Frank we have a majority now of public members. It's important to know now that when we were created in 1975 the best thinking in the industry on corporate governance was that you would have a majority of regulated parties on your board, and now post Sarbanes-Oxley and Enron, and WorldCom and everything else, the best thinking in terms of good corporate governance requires that you have a majority of independent, public board members. We were not able to do that on our own because we were created by Congress. So in Dodd Frank Congress took the opportunity to mandate that we now have a majority of public board members. We seated that board on October 1; we've had two board meetings since that time. In my experience as a staff person, the -- I wouldn't say that it's -- you just have many more experiences and perspectives to bear on any particular issue. We have four issuers on the board, three investors, banks, broker dealers, municipal advisors, we have retired people from the industry, but every single person comes to the board meeting with the best possible interests of the industry at heart. So, it's really a great conversation. I think we get to the right answer. So, I think it's been quite effective. We do have an opportunity over a two year transition period whether a 21 member board is the right number for us, and we'll be working carefully with the board to look at that issue, but so far we're all very pleased with the way it's been working out.

Leslie Norwood: SIFMA is on record supporting the changes to the MSRB's board making the board independent. We do have concerns about the current size of the board at 21 members and that potentially being an unwieldy number compared to the former number of 15. And I think we'd like to see some discussion about potentially bringing the MSRB back to a board of 15 members. We also had significant concerns about the board going to an independent board and losing some of that historical expertise and experience, that the board has always had since 1975, but we think that the nominating committee of the MSRB has done an excellent job identifying people to serve on the board this round that have significant amount of expertise in the industry but also are independent.

Martha Haines: Some critics have asserted that SROs by their nature have inherent conflicts of interest that can make it difficult for them to regulate the markets and enforce the securities laws. What are your thoughts in this regard? How might these inherent conflicts of interest be minimized? And, are there any particular areas in which you think these conflicts present either a real problem or a perception in the market of their being a problem?

Tom Selman: Well the SRO, or I like the IRO, the Independent Regulatory Organization model, has a lot of advantages. I think that two primary advantages are first of all that through this model we have an assurance that sufficient resources will be brought to the regulation of the industry that's subject to the model. There's no reliance on taxpayers, for example, or limited appropriations. There's an assurance that the resources will be got for the regulation that's necessary. That's one advantage. The other advantage is that it's able to ensure that its rule making and its interpretation of its rules will reflect a practical realities of the industry. There is a determined effort, certainly within FINRA, to make sure that our rules are tailored to the legitimate business practices of firms and that they reflect those firms in a way that'll best protect investors. Investors are really only protected when the rules that are imposed on firms are rules that reflect their business. And, that's the other primary advantage of an SRO or IRO model. But with that second advantage, there is a necessity to balance that need for understanding the business and that need for independence; and we've handled it at FINRA in a wide variety of ways, one of which is the board governance, which I mentioned, the requirement that most of the members our board of governors be non industry, the insistence that the staff be independent in all respects of the industry.

And I think at least as important as all that is simply our subjection to SEC oversight, which is critical. The structure of Section 15(a) I think is a model for any SRO model because it requires the SEC to ensure that the rulemaking that an SRO does reflects its independent judgment and it requires the SEC to constantly model -- monitor the question of whether that SRO is complying

with its regulatory mandate and statutory mandate. So I think the SEC oversight is probably the most important component.

Lynnette Hotchkiss: Well, it certainly echoed Tom's comments. I would also add that a market that has transparency, disclosure, you know, a robust rulebook to make sure that market participants are acting appropriately. That builds investor confidence in the market, and that ultimately inures to the benefit of all market participants. So I don't see, and I have not seen, sort of the self-interest or the conflict that you're suggesting, if the greater good is a more robust, healthy functioning market.

Elisse Walter: Lynette, is there any more detail you can provide us about the new study you've just authorized?

Lynnette Hotchkiss: Not really. No, it's big news. It's very exciting. You were -- have been talking a while about pre-trade transparency and whether or not that might be useful for investors, especially retail investors, in this market. The MSRB, as you know, in 2005 launched its real time trade reporting system for all types of municipal trades. And since that time, we have never commenced a study of the market and the effects of liquidity, price transparency, you know, all of the various issues, the cost of, you know, executing a transaction. And your comments, really, I think sort of moved that agenda issue to the top of our list.

And the board wholeheartedly endorsed, you know, the concept of, you know, undertaking a study before we get to the discussion or the question of what are the types of pre-trade transparency that products or indices or whatever that might be helpful, we actually need to study the market and the impact. And issues like trade size, cost of execution, all of the issues that came up in the first panel today. And when that study is commenced, we'll be able to look at that and then answer the questions that you've raised about are there additional types of pre-trade transparency that will be helpful.

Elisse Walter: Thank you. My colleagues, you have anything? Howard?

Male Speaker: Yeah, I'd like to ask about the -- some of the implications of the expanded jurisdiction of MSRB over muni advisors. A number of you have mentioned it in your remarks. And I'm just kind of curious, both from your perspective, Lynnette, how do you take into account the -- I know that you have the representation on the board -- but how will you go about the process of developing the rule set for this new entity you do not have jurisdiction over before? And maybe also, Mr. Asher, you could address a little bit from your perspective as one of these new entities, what advice you or comments you'd have for the MSRB and the SEC in reviewing MSRB rules about how we should be thinking about the expansion of these rules into this new area?

Lynnette Hotchkiss: Well that's a great question because one of the challenges we have is really understanding the types of municipal advisors that are out there. So Dodd-Frank talks about, you know, your traditional municipal financial advisor or your GIC broker or your swap advisor. Those are three types of advisors that, you know, someone in the municipal finance industry is very familiar with. But Dodd-Frank also defines municipal advisor to include a third-party marketer, a solicitor, a placement agent; those entities or people that interact with state and local government pension plans. So they have a very different kind of business model, compensation model, than a traditional advisor. So the first step is to really identify the different kinds of advisors that are out there.

And Dodd-Frank also talks about, you know, law firms, engineering firms, accounting firms that go beyond those traditional services and start acting as advisors. So the first step is really identifying the kinds of advisors that are under Dodd-Frank having significant outreach, identifying who those people and those firms are and having significant and ongoing outreach

with those entities. We have focus groups that we've set up, we have outreach events. We've had one in New York, Chicago, Los Angeles, Texas is coming up. So, you know, we have a very extensive outreach and education effort.

I think it's going to take a while before all of the advisors out there sort of self-identify or understand that they need to register with the SEC and then the MSRB. I think it's going to take guidance from both of our organizations about who is and who is not an advisor. It will likely take enforcement action to, you know, make sure that, you know, people that should have registered are called to task on that.

And then, the second piece of it is our rulemaking and the proposals is even more important than ever. So we really have to make sure that we get all the input from our board members, the advisors, as well as issuers and other market participants who know the world of advisors and their fiduciary duties. We have to re-double our efforts to make sure that we solicit public comment. We have to continue working very carefully with Martha and her colleagues at the SEC to make sure that the rules are appropriate and consistent, and we have to follow the restrictions under Dodd-Frank to make sure that they're not unduly burdensome for small advisors.

So we are ready to go. We are really excited about this. But it's more important to take our time and do it right. And so, for example, during our first board meeting, we extended our rule on fair dealing to the relationship between a municipal advisor and its customers. SEC was perfectly comfortable with that, put that out. At this board meeting, we have a proposal, which we're working with the SEC on right now about extending the pay-to-play rule for the municipal advisory community. And that's the entire community, especially those that interact with state and local government pension plans. And then, we plan to put out some guidance again after working, you know, closely with the SEC on articulating what a federal fiduciary standard is.

So this is sort of the tip of the iceberg. These are what we consider to be the most important things that we need to get out, but there are, you know, many, many other kinds of rules, which, again, it's more important to do it right than to do it quickly.

Benjamin Asher: Yeah, I don't have a lot to add, but to say that the diversity and breath of the definition of municipal advisors is unbelievable. I mean, you know, there's our world of financial advisors, which we acknowledge is there's a group of us, we vary in size from one and two-person shops to larger firms. Our firm is approximately 40 employees. And again, our business is traditional financial advisory work, including providing investment services and swaps.

But to be frank, this whole world of advisors and the pension funds is just going to -- I mean, I don't know much about it, to be honest with you, because I'm on the financial advisory side. But I think it's going to be a real challenge to uncover every entity that meets this definition, at least that's my sense of it. And, therefore, I think taking a considerable amount of time and to first identify those and then to figure out what, you know, what are the standards are going to be. You know, am I going to be, you know, have to know about pension funds and providing services to pension funds when my core business to providing advisory services is on debt and capital programs? Yes, you know, these worlds sometimes overlap, but -- or conversely, do they need to know about, you know, how to assist issues with price securities and then structure bonds? I'm not so sure. So I think there's going to be some challenges to establishing some standards that apply to all.

Leslie Norwood: On its face, the SEC's registration for municipal advisors that went into place on October 1 seemed plain and simple. You had to register if you were a financial advisor. Although as with anything, the devil is in the details, particularly when you look at large banks and broker dealers who may have many different types of businesses, many of which are walled-

off from each other for ethical purposes and other reasons. It is really a complex, a knit of different relationships. And as submitted to the SEC in the Frequently Asked Questions document that SIFMA put together on this registration paradigm, we have concerns about how the exemptions work, how the new duties under the FA rules might affect existing and ongoing principal relationships and possibly prohibit those, about how firms that are in the request for proposals process to be an underwriter might possibly be deemed to be a financial advisor before they get the underwriting assignment and then be conflicted out pursuant to G23 from taking that assignment. So there is a lot of complexity, I think, in terms of the application of the rule and we look forward to working with the SEC in working out many of those issues.

Elisse Walter: Do you feel in the wake of Dodd-Frank that the rulemaking process for the rules of the MSRB has -- is working smoothly? It sounds like you do. But are there additional changes in addition to those that were mandated by the act that you think would be advisable? And I would ask both the regulators and the non-regulators on this panel the same question.

Lynnette Hotchkiss: I think that, you know, the continued good-working relationship between the MSRB and the SEC is even more important now to make sure that the advisor rules that we promulgate go to the commission, we get your input, you know, we discuss the implications. And so, I think that's even more important.

The issue that I am aware of that still is yet to be resolved is the SEC/CFTC/MSRB jurisdiction over swap advisors and sort of where those lines are. And I understand that that's still being worked out. But maybe it's premature to answer that question. But right now, we don't see any problems or big issues.

Elisse Walter: Can I come back to something that was mentioned earlier, which is the addition of protection of issuers to the MSRB's mandate. To the extent you can project into the future, all of you, do you see that as being potentially problematic in terms of having the possibility of putting you in a situation where you're headed in two different directions at the same time? I don't -- a conflict, perhaps, or something close to a conflict without -- do we need to develop mechanisms to deal with that?

Lynnette Hotchkiss: I think that's certainly a possibility. We have not really identified a specific conflict yet. But, again, it's a possibility. I think the next step for the MSRB board is to articulate what exactly protection of issuers means to them. And I don't personally believe that it is protecting an issuer against bad decisions or substituting your judgment for that of an issuer. But it is likely to be making sure the issuer has full disclosure -- disclosure of any conflicts, disclosure of compensation arrangements, transparency of the process, information with which to make good decisions. Perhaps it's making sure that they have all the tools necessary, but I don't think it is being paternalistic or frankly restricting access. That's my opinion, but it's something that our board is thinking about, and the next step is really to start to articulate what that means.

Thomas Selman: I mean, I can add just from our experience, we have -- although, Leslie's right, our primary mission is protecting investors. We do have rules, such as the corporate financing rules, which are designed to protect issuers from practices engaged that could be engaged in by corporate underwriters or broker dealers. We really haven't found too much tension or difficulty in that. I think the primary reason is you're really dealing with functions, different functions. And the idea of protecting an issuer against regulated entity that's performing one function may be a different set of rules than would -- those rules that address another function by broker dealers or other regulated entities. So we have not come across that as a major issue in our corporate financing rules at least.

Leslie Norwood: We do have concerns, but we are looking to see the rule makers write fair rules with the clear burdens and benefits to the marketplace, and it's just hard to tell at this

point in time so early in the new authority of the MSRB how everything is going to work out. So we're playing a wait-and-see approach.

Benjamin Asher: I guess just as an independent financial advisor, I guess I'll weigh in here a little bit in terms of the potential conflict. I mean, I think ultimately, it's going to depend on the ultimate definition of protection, but clearly, broker dealers' interests at a table during a pricing or other circumstances, can vary from an issuer. Is that not protecting the issuer? I think that needs some further discussion, but, I mean, I think it's self evident that broker dealers, you know, have a different role than in certain circumstances, may come in conflict with the interest of an issuer.

Leslie Norwood: I think it's more clarity about the principal role versus the fiduciary role is key here. I think just because we're in a -- the broker dealer's in a principal relationship, you know, I think that as long as the parties understand that and operate pursuant to Rule G23 as it stands now -- probably going to be changing -- but the roles of each party at the table are clearly understood by everyone else that we felt historically that was a very fair system. And I hear you that the problem is if the roles are not understood and that there be some misunderstanding about the role, and, of course, we support the vigorous enforcement of all the roles, as written, but to us, it's very important that if a principal is a principal that they allowed to be -- to operate in that manner.

Elisse Walter: Any further questions? Lori?

Lori Schock: What's the retail investor to do in this area? I mean, we have the MSRB, we have FINRA, we have self-regulatory organizations, we have the SEC. It's a bifurcated system between rulemaking and enforcement. Where -- what can we do to help educate people in this area? I hope you saw the previous panel, you know, where we -- those are the folks who are investing in these. So what can we do to help?

Thomas Selman: Well, FINRA, for one, has a very robust investor education program. I mentioned one of the alerts that we've issued, and we have a very large and robust program for investor education. I think as far as a question of the bifurcation of regulatory oversight in this area or any other area, it's important to keep in mind to me the principal that investors shouldn't have to care. It should be a seamless regulatory response to any kind of problem. It should be a situation in which the investor can simply have a relationship with a professional or make an investment decision without worrying about which bucket, regulatory bucket that activity falls into. And where our regulatory system, in general, doesn't work that way, I think it needs to be fixed.

But in this area, I think, as we've said already, we work very closely together and the relationship with us and MSRB and with the SEC to both of us, I think has worked well enough that investors should be comfortable knowing that the oversight is quite seamless in this area, at least at the federal level.

Lynnette Hotchkiss: And, you know, certainly making sure that the suitability rules and the disclosure rules are vigorously enforced. Obviously, that's key. We feel very proud of the EMMA system. And for those issuers who want to undertake, you know, an independent credit analysis, the tools are there. Not only the disclosure documents and the trade information, but information on what to do with that, you know, how to look at the trade data and make -- you know, draw your conclusions from that.

I think the challenge is, you know, we want to empower retail investors to do that. How do we do that? You know, how do we make the step from "I trust my broker" to, you know, some sort of responsibility at the individual level to, you know, to look at the disclosures that are available.

And, obviously, the disclosures have to be complete, timely. And that's really just the sort of the obvious part of that.

Leslie Norwood: I second what Lynnette just said. I think that, you know, investor responsibility is an important leg to this, that you can make the disclosures, the information can be available, but the investor needs to read that information and understand and hear what the broker is telling them and the suitability discussion and be honest and fair with the broker and the suitability discussion.

I think that many groups have worked very hard to try to educate investors. Certainly, Tom's FINRA website is very robust. Lynnette's MSRB EMMA system is an outstanding new system that has many, many new features very, very helpful to the investor community. And SIFMA has had the investingandbonds.com website, which takes the MSRB feed as it has since real time trade reporting went into place on January 31 of '05, and has been also a very robust place for investors to get individual information about municipal securities and other securities.

Elisse Walter: Do you all have an opinion as to whether the information that's available now is sufficient, given the nature of the marketplace and how trading takes place?

Lynnette Hotchkiss: Well I think you heard from the institutional investors that, you know, they certainly employ their own credit analyst, you know, to look at the information that's available to look beyond that information. I think if you are -- I think that you continue to hear from investors that more timely financials are important. Issuers, I know do go above and beyond the minimum requirements. And we've seen on the EMMA system, filings of budgets, which are very powerful disclosure documents, monthly city council meetings, quarterly financials. I mean, so we are seeing more and more voluntary disclosures filed.

I am very optimistic that the market will reward those issuers who do have better disclosure programs than what is minimally required, and maybe that's what it will take to encourage others in the issuer community to get there.

Leslie Norwood: Market forces have already mandated those increases. For instance, many hospital transactions currently require in the continuing disclosure agreement for the hospital to provide quarterly financial statements. And that has been something that's developed out of market practices. The investors have demanded it, and now it's market standard in many jurisdictions.

Elisse Walter: Well, I think what we've heard has been very much of a mixed bag. We've heard about improvements and we've heard about some market-driven trends. On the other hand, we've heard both from retail and very sophisticated investors that they don't have what they need. So I wondered if you had an evaluation of that? I mean, one of the things that bothers me is that it is both something we really need to look at. It is the length of time for financial information to come out coupled with the relative ill-liquidity in the market so the pricing mechanism that the marketplace provides in terms of transactions isn't as robust as it is in some other markets. And I don't know if you agree with that as being a good focal point for concern without knowing where'd we go with it yet.

Lynnette Hotchkiss: I think the only thing that we are concerned about is the EMMA system is a powerful tool, so we are, I think, a very appropriately concerned that any kind of gold star, seal of good, you know, housekeeping, your financials are in, you know, within a certain amount of time or you provide quarterly disclosures, that that not been seen as an indication of credit quality because it's perfectly logical that, you know, someone might get in their financials, you know, in a very short amount of time, but it's a dog credit. And, you know, you want to make sure that the retail investor looking at EMMA or using EMMA doesn't draw conclusions that shouldn't be drawn.

Leslie Norwood: We have certainly a lot of concerns about any sort of uniform standard for disclosure. I think that we've certainly long held that the tarmen [phonetically spelled] is appropriate and that uniform disclosure is probably not appropriate. A GO is not like multi-family housing bond, California locality is not necessarily the same thing as New York City MTA. And so we think that the disclosure paradigms for each of these different issuers is probably likely different and appropriately so. And so, we just have concerns about some further pushes in this area that are not necessarily market driven.

Elisse Walter: Any other questions?

Robert Cook: I'm going to ask about the convergence of products over time and how that affects the rationale for different SROs and different SRO rules, in particular, the, you know, the muni market has developed over a long period of time and the corporate debt market was more subject to FINRA rules, and probably when this was set up, there weren't a lot of retail investors in corporate debt. But now there are. And FINRA has done some studies that show the retailization of the corporate debt market. Now, how does this eventually -- how does this impact the role of the two SROs in this area? To what extent does it make sense to continue to have different rules for based on the bond when you may have the same parties to the transaction? You have a broker dealing with a retailer investor who may be interested in munis, may be interested in corporate debt. Why should there be two sets of rules applying to that? And you could ask the same question about some of the advisory pieces of it too, the MSRB will be developing the rules around advisory relationships by muni advisors, should there really be a completely different rule set for them than applies to other types of advisors? What are your thoughts on that?

Lynnette Hotchkiss: I think that's sort of a question that a lot of people have. It's not uncommon, but it's an important to recognize it's just such a different market. And so, you have 50 to 80,000 different municipal issuers. You have the issuer community who are not directly regulated or subject to those same kinds of disclosure regime as the corporate model. You have a different distribution investor base. You know, it's totally different. There is, you know, you've got your largest state and city issuers and you've got, you know, the small fire district who comes to market once every 20 years. So unless the rules recognize the difference in the market, I don't think that you're going to be an effective regulator.

So as I said earlier, where it makes sense to have the same rules, gifts, and gratuities, and certain recordkeeping rules, absolutely makes sense. But there are rules that, by virtue of the markets being so different and the product being so different, it's not a commoditized product, like a lot of corporate debt is. So that mandates or requires a very different way to look at things.

And I think the rules in most cases are very consistent, they make sense. Where they are different, it's -- there is a very easy-to-understand explanation for that, the mark-up rule being a good example. And we feel very strongly that, you know, we can use the same kind of basic analysis of mark-up disclosure, but that the uniqueness of the municipal market has got to be recognized and the liquidity issues in that market have got to be recognized in order to maintain a functioning market.

Leslie Norwood: I guess, you know, we're on record for disagreeing about the mark-up rule being harmonized. We certainly supported the old fair pricing rule that the MSRB had on its books and thought that was a very fair way of determining price and mark-up to the investor. But certainly, we've got a comment letter outstanding with the MSRB on that issue.

Lynnette points out the differences in the market, and it's not only the tax exemption. It's the nature of the issuer. It's the fact that we have 1.2 million CUSIPS in our market versus in the

corporate area, approximately 200,000. And that really does have a significant impact on the liquidity in the market. So I think that we maybe have differing opinions on how many rules could be harmonized, but certainly, if it's rational to harmonize because of similarities in the markets, we are in favor of that.

Elisse Walter: Well, thank you all. I think we've come to the end of our allotted time. Thank you so much for joining us and thank you for your help in this effort. We're going to take a five-minute break and come back with the accounting panel.

[break]

Transcript: Field Hearing On The State Of The Municipal Securities Market Panel IV

Elisse Walter: And I will turn the mic over to Amy Starr.

Amy Starr: Here I am talking about mics and I didn't even turn mine on. Thank you, Commissioner Walter.

Here we are now at Panel Number four on Accounting. Our panelists this afternoon will explore the role accounting plays in municipal securities disclosure and the role of the government accounting standards boarder GASB in setting accounting principles or standards for municipal entity financial statements. The panel also will explore the use of such accounting standards, sometimes referred to as GAPA set by GASB, or some other people will call it "GASB GAAP," by municipal issuers, the comparability of financial statements among municipal issuers and the use of other financial information presentations to provide information to investors.

Our panelists this afternoon are David Bean, the director of Research and Technical Activities for the Government Accounting Standards Board. David also will be the deputy chairman of the International Public Sector Accounting Standards Board beginning this January. We're also joined by Timothy Firestine, who has been the chief administrative officer for Montgomery County, Maryland, since 2006. Mr. Firestine is also the chair of the Budget and Finance Committee of the D.C. Water and Sewer Authority. Next, is David Jones, who is the National Managing Partner for Public Sector Assurance Services for Deloitte and Touche, where he leads the public sector practice for the firm.

I will now ask David Bean to please start with his presentation.

David Bean: Thank you, Amy, Commissioner Walter, and the other staff at the SEC. As Amy mentioned, my name is David Bean. The views I express today are my own. Official positions of the Governmental Accounting Standards Board are only issued after extensive due process and deliberation.

As many of you know, the GASB was established in 1984 under the auspices of the Financial Accounting Foundation. Our mission is to issue pronouncements that will improve state and local government financial reporting. Over the past 26 years, the GASB has issued high-quality standards and other communications that have been the foundation of financial reporting from Native American nations and state governments to mosquito abatement districts. Those standards are officially recognized by the American Institute of Certified Public Accountants as generally accepted accounting principles in the United States.

Thirty-eight state governments have requirements, either in statutes or regulations that compel some or all of their political subdivisions, including counties, cities, and school districts to follow GASB pronouncements. Those mandates are enhanced by certification programs sponsored by organizations, such as the Government Finance Officers Association and the Association of School Business Officials International, that provide recognition to governments that issue high-quality GAAP financial reports.

The GASB pronouncements are established by a seven-member independent board that includes individuals from a wide variety of backgrounds, including financial statement preparers, financial statement users, the audit community, and academia. Currently, the chairman serves on a full-time basis, and the remaining six members devote approximately one-third of their time to the

GASB's activities. Since its inception, the GASB has approved 62 statements and numerous other pronouncements. Those standards have been codified since 1985.

Prior to 1984, state and local government financial reporting standards were established by the National Council on Governmental Accounting and two predecessor bodies. The NCGA pronouncements were the genesis of today's financial reporting. However, the 21-member body was under-funded and under-staffed. In the early 1980s, the Financial Accounting Standards Board included state and local governments in the scope of one of its standards. However, that provision was ultimately withdrawn primarily because the governmental community did not believe that the FASB had the sufficient understanding of the government environment to be in a position to establish standards for them. The concerns raised about the FASB's efforts, however, did provide the needed push to finalize the establishment of the GASB.

So why is GASB needed? GASB has published the white paper entitled "Why Governmental Accounting Standards and Finance Reporting is and Should be Different." To help answer this question -- and I'll submit a copy of that report for the record -- the white paper highlights that government's role to maintain and enhance the well being of citizens through the provisions of public services results in information demands that are different than those of business enterprises. There's a diverse set of users and potential users of state and local government financial reports, and, therefore, we have a wide range of user needs.

Governments obtain resource of primarily from involuntary payments of taxes, which establishes a need for greater accountability. And government assets are used in the provision of services, not to generate profits. Governments generally do not operate in a competitive marketplace and do not have equity owners. Consequently, measures of net income and earnings per share have little or no meaning to users of governmental financial reports.

Instead, users need the information to assess the government's stewardship of public resources, including information to evaluate the manner and the extent in which those resources are devoted to specific services, the costs that were incurred to provide those services, and the extent to which revenues provided cover those costs. Users also need information to determine compliance with legally authorized spending authority that generally is established through the budgetary process.

This environment and the needs of financial statement users that operate within that environment, strongly influence the GASB's objectives of financial reporting and relative qualitative characteristics of financial reporting.

I do not have time in my opening remarks to comment further on the objectives. However, I would like to point out that two of the qualitative characteristics -- timeliness and comparability -- are often cited as areas of concern about current government financial reports. I just want to emphasize that these characteristics are also important to the GASB. On that point, I'd like to note that the GASB is finalizing a study on timeliness of state and local government financial report, and we will submit a copy of that report for the record when it's issued.

One of the most significant challenges that the GASB has is meeting the needs of a diverse set of financial statement users. Not only is the GASB concerned about meeting the needs of investors, or in our world, it's primarily creditors, we also focus on the needs of citizens and their surrogates and also legislative and oversight bodies. Because of the unique nature of government, accountability has been identified as the cornerstone of financial reporting. Accountability manifests itself in the GASB pronouncements in a wide variety of ways, from criteria used to define the financial reporting entity to disclosures of violation of finance-related legal and contractual provisions, accountability information is key to a well-functioning democratic society.

Meeting user needs also requires decision-useful information on the myriad of transactions that governments enter into each year. From pensions and retiree healthcare benefits to public private partnerships, to derivative instruments, the GASB has been moving the ball forward in our effort to enhance transparency by improving financial reporting.

Great strides have been made over the last 26 years, including introducing accrual accounting standards that could be applied by all governments. However, there is still much to do. The GASB is currently in the process of enhancing its pension accounting finance reporting standards, and we're also exploring the need for fiscal sustainability information as part of general purpose external financial reporting related to the government's economic condition. Again, it should be noted that financial statement users are not as concerned about the growth potential of a government, as they are concerned about the government's ability to continue to raise resources, provide services to its constituents, and meet its financial obligations as they come due. With the help of its constituents, the GASB stands ready to meet the financial reporting challenges of the future.

After the remaining introductory remarks, I welcome any questions and comments you may have for me. Thank you.

Amy Starr: Thank you, very much. Our next panelist is Timothy Firestine. Tim?

Timothy Firestine: Thank you. Commissioner Walter and Mr. Cook and Mr. Kroeker, thank you, very much, for inviting me to testify today at the SEC Second Field Hearing on the Municipal Securities Market. As it was mentioned, I'm Tim Firestine, the chief administrative officer for Montgomery County. Prior to that, I was also the director of Finance for 15 years, and prior to that, I worked in the budget office for 12 in the county. So I do have a local government background in finance. I'm also a member of the Government Finance Officers Association Executive Board.

GFOA's leadership in governmental financial transparency is long standing and well documented. Its role in promoting enhanced financial reporting stretches at least as far back as the 1936 publication of the first edition of the now classic Blue Book, the governmental accounting, auditing, and financial reporting textbook. Since 1945, the GFOA's certificate of achievement for excellence in financial reporting program has played a crucial role in promoting compliance with generally accepted accounting principles. Likewise, the GFOA was a leader in the effort that led to the establishment of the Government Accounting Standards Board in 1984 and has remained a significant financial supporter of the GASB ever since.

GFOA led the very first efforts to define GAP from municipal governments and issued a best practice in 1983 titled "Governmental Accounting Auditing and Financial Reporting Practices," which urges all state and local governments to prepare their financial statements in conformity with GAAP.

In addition, the majority of governmental debt issuers exceed GAAP standards as recipients of the GFOA certificate of achievement for excellence in financial reporting. This program promotes the preparation of high-quality financial reports through the development of a comprehensive annual financial report and plays an important role in improving the quality of financial reporting in the public sector.

An entity receives a certificate from meeting exceptional standards in the presentation of its financial data. Each year, approximately 3,500 governments participate in the program, including 88 percent of the nation's largest cities. In fact, Montgomery County has received this award more times than any other county in the United States, starting in 1951. Just put that little plug in there for the county.

The CAFR allows investors to easily compare the financial health of multiple governments and get the apples-to-apples comparison they are seeking. This is one reason why GFOA strongly recommends that all governments prepare one. Required information in the CAFR includes 10-year financial trend data, 10-year revenue capacity items, 10-year debt capacity information, 10-year economic and demographic information, and 10-year operating information.

The annual financial statement, which is submitted by debt issuers to EMMA, as defined in SEC Rule 15c2-12, also provides a wealth of information available to investors. The GFOA recommends that issuers submit their CAFR for this purpose. For many, doing so exceeds the requirements that they must file in accordance with their continuing disclosure agreements.

It's important for the SEC investors and the public to realize the amount of time and resources that go into preparing these statements, which, again, yields far more information than can be found in corporate financial reports. Some of the specific points to highlight include:

GAAP requires government reports to include financial data from legally separate component units over which the government has little practical control. For such governments, completing their own annual financial report depends on the timely issuance of financial statements by legally separate entities, entities that they cannot compel to comply in a specific time frame.

The audit opinion is issued at the level of each major fund, not just at the total financial report level. This results in much lower levels of materiality, an increased use of actual amounts for accruals rather than estimates, and more detailed and time-consuming audit procedures.

State and local governments also face specific audit challenges as part of the year-end audit, such as specialized government auditing standards and federal single audit standards compliance.

Due to the changes over the years in the accounting and auditing profession, there are a limited number of auditing firms that specialize in government accounting. Additionally, the more competitive, often lower rate per hour that auditors can charge and that local governments are willing to pay for audits, further limits those able and willing to focus on governmental auditing. This dearth of qualified professionals adds to the time frame when annual financial statements can be completed and submitted to EMMA.

Innately, governments are very different than corporations in ways that add significant time to close the books and prepare financial reports before they are audited. Some of these differences include government budgets are legally adopted and the government lives and dies by its budget. Therefore, there is a lower level of tolerance for estimates in closing the books. The focus, instead, is on capturing actual expenditures and revenue accruals.

Governments' activities are captured and reported in a multitude of funds, federal operating and capital grant activity is included in a local government's financial statements and is subject to less tolerance for estimates and more detailed single-audit testing, and government activities are reported on several different bases of accounting -- modified accrual for governmental funds, which include separate accounting for purchase order encumbrances, and full accrual for proprietary funds. All modified accrual activity has to be converted into full accrual for the top-level financial statements. Budgetary reports are also required, and these can be on a third basis of accounting. This takes knowledge of GASB and FASB standards and additional time to close the books on two or three bases of accounting. Regarding the time it takes to prepare and submit the annual financial statements, it takes an extensive effort to compile this information and go through an audit.

GFOA's own certificate program allows governments 180 days to complete their annual financial statement. Montgomery County is subject to the State of Maryland-mandated deadlines, which

require local governments to submit audited financial statements prepared in accordance with GAAP, along with electronic submission of selected condensed financial statements. For governments with a population over 400,000 in the state, the mandated reported deadline is January 1 or 180 days.

Creating short-term deadlines could diminish the value of the financial information, as it might persuade any number of governments to abandon preparing a CAFR altogether in favor of a greatly reduced set of basic financial statements.

Additionally, governments, especially smaller governments, may choose an auditor with less optimal government accounting and auditing experience. Additionally, smaller governments, again, many of which do not issue debt, find it difficult and cost-prohibited to adhere to dozens of GASB standards. But it's wrong to assume or make a statement that when governments aren't following GAAP according to GASB that they aren't following any accounting or auditing standards. A government can still receive an audited opinion when they are following other accounting standards. We hope that the SEC will acknowledge this and help educate the public that not following GAP GASB does not mean not following any accounting standards.

Thank you, again, for the opportunity to be with you today.

Amy Starr: Thank you, very much. Our final panelist to speak today is David Jones. David?

David Jones: Thank [inaudible] today. Good afternoon. I'm David Jones. I'm a partner with Deloitte & Touche, and I've been involved in the accounting profession for about 35 years, and a significant portion of that time has spent auditing state and local governments. Over the 35 years that I've been in the profession, I've served as the leader of the public sector practice for Deloitte. I've been an audit partner for both the SEC registrants in large public sector entities. Most recently, I served as the audit partner for the City of New York, the Port Authority of New York and New Jersey, and the MTA in New York.

Prior to Deloitte, I was the first person that was hired by the Governmental Accounting Standard board as a staff person, where I was a project manager in charge of their financial reporting project. As part of that project, I was the principal researcher for the user-need study performed by the GASB, and I was the principal author of the GASB research report, the needs of users of governmental financial reports. And prior to that, I was the staff person to the chairman -- or to the chair of the National Council of Governmental Accounting, which was the predecessor to the Governmental Accounting Standards Board.

I'd like to note that the views I express today are my own and don't necessarily represent the views of Deloitte.

In my career, I've witnessed significant change and improvement of financial reporting by state and local governments, both in terms of better financial reporting --

[fire alarm]

I'll submit your written response. This is of governmental financial statements.

The GASB has identified diverse user groups that include citizens and citizen-user groups, legislative and oversight bodies, and investors and creditors, all of which use financial statements for differing and diverse reasons.

Citizens and citizens groups tend to use financial statements to assist them and determine if governmental officials are complying with the laws and regulations concerning the spending of taxes and to assist and determine if good stewardship is being exercised with regards to

government assets, and to gather information useful in helping them to decide if the government is efficiently using its resources.

Like citizens, legislative and oversight officials seek information from financial statements to assist them in determining if government managers are complying with legislative mandates and complying with certain finance-related legal requirements. One would assume that legislative bodies would be able to demand the information and, therefore, would not need to rely on financial statements to provide this information. However, the research indicates that a primary source of information that's grouped users in their decision-making with regard to financial practices are financial statements prepared in accordance with generally accepted accounting principles.

Investors and creditors have also identified as users of financial statements issued by state and local governments and use governmental financial statements to assist them in making decisions regarding the ability of governments to liquidate liabilities and to make future debt-service payments.

While investors are defined as a user group, the term "investor" really is direct -- really means "those who directly make loans to local governments through the purchase of municipal securities." Unlike an investor in the private sector who make investments hoping for growth in the basic business in which they're investing, the current governmental financial reporting model views government investors as those primarily concerned with assessing the ability of the government to continue to fund operations in the future and repay its financial obligations.

While researchers identified diverse users and uses of financial statements, surprisingly, the research indicates that the user groups use the same or similar information to assist them in their diverse decision-making. For example, the research found that all user groups consider budgetary information and disclosures very useful for the decision purposes, but the information was used for significantly different purposes among the groups.

Citizens and citizens groups use budgetary information to assist them in analyzing questions regarding the stewardship of their tax dollars and determined if the funds were spent in accordance with budgetary restrictions and finance -- certain financial-related legal requirements. These groups also used information to assess the future burden placed upon them by decisions made by management and legislative bodies.

Legislative and oversight bodies use budget information to assess compliance with legal requirements set forth in the budget and other laws and regulations. They also use it to review the use -- the restrictions on the use of proceeds and to some extent, to help them in assessing the future financial impact of their decisions.

Surprisingly, investors and creditors also view budgetary information to be very useful. While they're less concerned with the legal compliance issue than the other groups, they use budgetary information to assist them in their understanding of the budget practices of governmental entities, which provide some indication of the ability of the government to exercise prudent judgments in the use of resources and to some extent provides information that may be useful in determining if governments have the ability to live within their means without placing an undue burden on the tax base. They're also concerned with identifying future demand on resources that could negatively impact the ability of governments to repay their obligations.

Not surprising, investors view information concerning the tax base of the government and the future demands on the tax base to be very useful information about assessing the government's ability to repay its obligations.

One of the significant attributes that really separates generally accepted accounting principles for state and local governments is the requirement that the financial statements demonstrate compliance with finance-related legal requirements. It's actually an accounting principle. When what that means is that in those circumstances where a government fails to materially comply with one of those requirements, they're required to self-disclose that they haven't complied with those finance -- with those financial requirements, either in the financial statements or in the notes to the financial statements. And that is, by the way, a very big difference generally between a public sector entity and a private sector entity.

I'd be pleased to answer any questions that you may have or address any comments. Thank you.

Amy Starr: Thank you very much.

Elisse Walter: Thank you all so much. Perhaps we could start, David, with a little bit more of an explanation of GAAP and what GAAP means in the governmental context and where the generally accepted part comes from and how that differs from the private sector just so we can set the stage.

David Bean: When we talk about GAAP, of course, both our set, both in the private sector and government, are set by two bodies recognized by the American Institute of Certified Public Accountants. They're the ones who bestow the GAAP ledger on both the FASB for publically traded companies, private companies, and also not-for-profits. We establish GAAP for governments, primarily state and local governments, and we have a third body, being the Federal Accounting and Standards Advisory Board, which establishes GAAP for the SEC, the federal government. So you have three bodies who establish GAAP in the United States.

As far as differences as everyone on the panel has discussed, there are unique environmental differences, and those differences are reflected in GAAP standards. And that runs the gamut. As far as additional, again, accountability, as I talked about in my opening comments, budget to actual information, in which, of course, you would not see in the private sector because of the legal nature of the budget found in governments, we have individual fund reporting.

There were discussions as we developed the financial reporting model that was issued in 1999 that really introduced accrual accounting for all governments. At that time, we discussed whether we should just focus on what we called "government-wide financial statements" or whether we should retain fund reporting, and we have various funds and governments spend money -- tend to spend money in silos. And we heard back almost to the person from the government user community that they wanted to see fund reporting be a part of the basic financial statements. And that led to -- made a difference. When you look at a government report, it has a different look and feel than you would find with a private sector report because of that.

And then you see basic differences as far as transactions. Asset impairment is one of my prime examples. When you look to see if a private company's assets have been impaired, you look at cash flows. Again, as I mentioned in my comments, though, the purpose of government assets are not to generate profits, it's to provide services. So what we look at is service potential and service capacity of the asset. Has that service capacity been impaired, rather than how the cash flow's been impaired. So we do look -- when we look at the transactions, we look and say is there something in the government environment that warrants differences than what you would see in the private sector. And we have found those differences, not only for assets, but in also in other cases for liabilities.

And, depending on the issue, there are issues where the FASB gets in front of the GASB and there are issues where GASB gets in front of the FASB. And pollution remediation is a prime

example of that, where we require a different standard than FAS 5, but we're looking at a probability notion as far as the calculation of liabilities. And I think that eventually, the FASB may get there, but that's just an issue that we looked at in front of the -- instead of for the first time in front of the FASB. But right now, of course, the FASB is concentrating on convergence efforts on the international side, and, therefore, we do find cases where one or the other boards gets out in front of each other.

David Jones: I'd like to address the issue of the legal basis of generally accepted accounting principles. Actually, there's two places. One is it appears in state law for the most part. Each of the states are either by law or regulation set forth the accounting principles that have to be used by the local governments or the state itself in its preparation of financial statements. The AICPA, on the other hand, has issued -- has its Rule 203, which basically says that auditors performing audits, state and local governments, you know, have to report on the use of generally accepted accounting principles as described by the governmental accounting standards board. So it's really two places. And I would say that there's a good bit of diversity among the states and how they do it. And for the most part, the vast majority of states do recognize the Governmental Accounting Standards Board GAAP as the GAAP for state and local governments, some don't.

Male Speaker: Would that mean you could call something GAAP even if it wasn't a GASB compliance set of financial statements?

David Jones: No.

Elisse Walter: Can you all discuss a little bit about comparability? How much difference does it make, both in terms of whether or not the financial information is comparable if you've got one entity that is using GASB GAAP and the other is not? I mean, how different are they and how much difference does it make in the tax exempt area where your investors are primarily residents within a certain jurisdiction?

Timothy Firestine: I made the point about smaller issuers use different bases of accounting. And to that extent, we were saying it was still okay, as long as their statements were audited, as we're finding, smaller issuers do have. But the problem is, I think you're going -- the comparability gets lost. And most of the largest issuers, I guess most issuers, do follow GAAP. And I think the value of the financial statements that are prepared on that basis are very comparable. I know we do benchmarking all the time when the financials. And the first place you go is to the, you know, the financial statements that are prepared according to GAAP. I do think there's a great advantage to that.

However, I guess from a management perspective, if you're trying to compare governments since -- how governments do their budgets, it's very different across the board. You can get comparability on the financial statements, but you really have to get a sense of how it reconciles back to how they prepare their budget to get an understanding, as Mr. Bean says, the accountability factor.

So again, I think there's great value provided by the GAP prepared statements, you know, so that you can do those comparisons.

David Jones: I think comparability, as we use in the traditional sense, is a little more difficult in the public sector -- for public sector entities than it is in the private sector entities because basically, there's divergence of services. I mean, service -- some services are provided by counties in certain jurisdictions and cities than others. So unless you have -- I mean, if you want true comparability, you'd almost have to compare, you know, cities of like types, and that's a little difficult to do.

What I found that investors -- you know, investors are concerned with having GAAP-based financial statements because it does give some credibility and it does give some consistency in the information that appear within the financial statements because remember, they're judging the ability of the government to, you know, make debt service payments as they come due. So comparability, I don't think is as important, I think consistent use of information is very important, and I think the use of GAAP financial statements is extremely important.

Elisse Walter: And maybe I've lost you. Isn't what you're talking about comparability? I mean, if I'm -- from an investor's point of view rather than a different point of you. You were talking about whether one entity is going to be able to make its -- meet its obligations and whether the other is going to be able to. And the question -- I guess the question I would ask is, is that -- I would assume if you're talking about a New Jersey entity that is comparable to one that's somewhere else, there are differences that you're not going to be able to decipher. What I don't know is how important that is because how much crossover there is in the investor body.

David Jones: It depends on which user of the financial statements you're talking about. If you are a citizen group, they're most concerned and looking at cost for service information.

Elisse Walter: Here, where I think we were mostly talking about investor groups.

David Jones: And with investors, the answer is, you know, because of the diverse nature. Having information that's used -- that's gathered on the same basis of accounting among investor groups, I think is important, and I would suggest that that should be GAAP.

David Bean: From an accounting-standard-setting viewpoint, one of the things that -- to address the comparability issue that we're attempting to do is to as we go back and look at our standards that have been set in the past, look at new transactions that we're dealing with for the future, such as service concession arrangements or part of public private partnerships, is to reduce the amount of alternative reporting. You know, there are in current GAAP, whether it be private or public sector, there's a lot of options. There's a lot of alternatives to choose from. And one of the goals of our pension project is to reduce the number of alternatives that governments have to select from to increase comparability. So I mean, that certainly remains in the forefront for us and it's, you know, for GAAP to get its own house in order.

But it becomes an even bigger issue when you start dealing with either another comprehensive basis of accounting or, as David alluded to earlier, when you have states who set up a regulatory basis of accounting, and you see a lot of divergence between state to state, and, therefore, it, at least from our standpoint, it would make the investor or creditor's job much more difficult.

Male Speaker: Just asking if he could give some examples of the options or alternatives that the government might have now that you're saying maybe it would make sense to reduce the range of those alternatives.

David Bean: Well, for example, the current pension standard is based on more of a funding-based notion rather than an accounting notion, and, therefore, you'll see allocation methods, number of allocations, six allocation methods that are currently allowed for pensions. And at least we are proposing to reduce that to one. So that's one example of that.

You've seen the FASB world, and we haven't yet taken on the issue of inventory, you know, FIFO, LIFO, and whether you should, you know, take LIFO off the table. That's not -- governments generally do not have large inventory so its not that major of an issue, but that's another alternative that's out there.

So we have -- one of the things that we did with our Statement 34, and, actually, again, we were out in front of the FASB, but back in 1999, we required for the business-type activities a direct method of cash flow, you know, rather than having two alternatives as far as presentation.

So again, there are some alternatives that are appropriate and, you know, we're just not in the business of eliminating all alternatives and putting things into one box. But when we don't see user needs being met through the use of alternatives, we believe those should be eliminated.

David Jones: Yeah, I think the biggest, the biggest difference that you see among governments and alternatives is the use of funds. Again, it's this legal basis. You know, some governments would report an activity and say -- a special revenue fund where there's, you know, certain restrictions placed on the use of funds. Other governments, however, will report that as part of its general fund activity, the basic -- as part of the basic operations of the government. That does create a lot of issues when you're trying to compare Government A to Government B to Government C. And, by the way, some of those rules, some of those funds are created by law or by constitution. So I mean, they have no other choice but to do that. But I think that may be, you know, the most material one.

David Bean: If I could follow up on that. It's very similar to, again, what's facing the private sector with segment reporting. You know, the FASB went through, you know, a number of steps and a number of standards over the years where they were very prescriptive on what a segment was and how a segment should be reported. And they finally came to the conclusion that that, you know, provided comparable information, but it didn't meet user needs. So, therefore, they took an approach of the segment should reflect how the business operates and should be accounted for as the business operates. And we're not to that point with funds. I mean, we do have a prescribed method of accounting for the funds, but yet, we also have some parameters set as far as the use of funds and how they can be used, but we still tried to reflect in the financial statements how the governments operate. And in other words, you know, an example would be the City of New York has chosen to basically provide their operations in one font, whereas, you know, I came from the State of Illinois, and that was one of my former lives was to prepare the State of Illinois' financial statements at the time, there were 365 fonts for the State of Illinois, and now there are well over 600. So it just kind of depends on how the government chooses to operate.

Elisse Walter: And how much difficulties does that create for an investor trying to understand what the financial condition of that entity is?

David Jones: I don't think a lot. You know, the one thing that I have found about municipal investors, particularly when I was doing the research, is while the individual investor may not be as financially sophisticated with regard to the use of financial statements, there are surrogates that exist out there that have a reasonable, a very good understanding of how the accounting works and how to apply it. And after -- if I look at it purely from an investor, from an investor-creditor, I mean, they really are trying to make an assessment. My belief is they don't make assessments between governments. They make a judgment about -- for lots of reasons, by the way.

There's lots of other reasons that come into play with regard to municipal investments, you know, tax location, local tax laws, lots of those things. So they're making a judgment other -- after they've made some of those decisions, they're making a judgment about the ability of that government to be able to repay its obligations, and they really are focused on its tax base because that -- by the way, governments have one really big asset, and that's their tax base. So they're looking at that tax base and the stability of the tax base.

They're also looking at the practices, the budgetary practices, followed by the local government. If their, you know, if their budgetary practices, you know, if they have budgets that are out of

balance on a, you know, vary all the time, then it raises some questions about the ability of that government to have the discipline to meet its financial obligations. So they look at tax base, budgetary practices, and then make some judgment about the ability of that one government to be able to repay its obligation.

Elisse Walter: Can I ask one question about that? Who do you view as those effective surrogates by category? I mean, not --

David Jones: Well, you know, when I did the research, I mean, we basically certainly the rating agency were considered to be substantial to that process. There were also a number, believe it or not, there were some sophisticated members of the press that reported on financial information at that time. And we considered those to be surrogates, as well, because there were financial columns dealing with municipal securities. And we would -- I actually interviewed those guys probably more so than I did any other group about their ability, and it was more focused on their ability to understand those financial statements, and found that there were some that were actually quite good.

David Bean: Commissioner, there's two things that the GASB has done to address the concern that you've raised. Again, with the, I'd like to say new financial reporting model, but it's been in place now for 11 years, so it's not so new. But we introduced government-wide financial statements. So, you know, someone who did not have either the expertise or wanted to take the time to better understand the funds had the overview of the government on an accrual basis of accounting to look at the governmental activities and the business-type activities and their component units.

The other thing we introduced is management's discussion and analysis, again, trying to reach the less sophisticated user, to explain the results of the financial performance and financial position in a manner, a plain-English manner that any investor can understand. So we believe that those two elements of the financial reporting has really opened the door to users, to the investors, to the less sophisticated investors that the information wasn't there before, or at least required them to have a level of expertise as it related to government accounting that many didn't have.

Timothy Firestine: Yes, I would, I guess from the investor's perspective, we have to be careful we don't over-emphasize the weight, from an average investor's perspective, that we don't over-estimate the weight that's put on the financial statements. You know, I think to the average investor knowing that it was a clean opinion if they can look at the front of the CAFR and see that there was a clean opinion, that's one thing.

Second, I sort of think that the complexity of the financial statements is beyond what an average investor can comprehend. I mean, working with analysts in the securities industry, they understand it because they do it, you know, day in and day out. Working with the rating analysts at the rating agencies, they understand it because they work with multiple governments, and they look for the issues of comparability, and they know the right questions to ask.

But I have to say that based on the complexity of the financial statements -- and I disagree to a certain extent with David -- I think that the government-wide statements, I have never had a question asked of me about information on a government-wide statement. It's done on an accrual basis. The main focus always tends to be on the fund statements, and, quite frankly, it's on the sort of mother fund, which is a general fund, and everybody's focused on, you know, what's the health of that fund, what's the status of that fund, what are the reserves, you know, and then they'll ask maybe some questions about what's in the reserves and how you're accounting for things in the reserves. Those are the most questions we get.

Beyond that, most of the focus is on a lot of other things that we provide. It's the budget, which has a ton of additional information that goes beyond just reporting what happened last year, but it goes to forecasting. It shows projections. It's the day to day media. It's questions about, you know, front page of the Washington Post. You know, what was that article in the Post last week about Montgomery County and the fact that [unintelligible] is cutting \$350 million. You know, those are the places where people, who are average investors, seem to go and ask us questions.

James Kroeker: David, you mentioned a couple of times the FASB getting out in front of the GASB or vice versa. I assume by that you mean they have standard advances the body of accounting knowledge and transparency, you know, more quickly one versus the other. I wonder -- and I think you addressed why have a separate board in GASB when you talked about measures like earnings per share aren't particularly relevant service ability. But I wonder if it also poses the risk that things that are similar don't get accounted for similarly, like, pension accounting where somebody might say is there really a difference in a pension liability, whether you're private or public or a similar pension plan, are there measures that the two boards take to coordinate their activities or learn from each other -- mitigate the risk that one gets out in front of the other?

David Bean: Certainly. You know, we have meetings every month to talk, you know, about issues such as this. But, again, you have to look and say what are the user needs and how do we best meet those needs. From the FASB, you tend to look, you know, people tend to look at issues from a strictly a balance sheet perspective, but, again, you want to know the net worth of a company, you know, because the stocks are traded on a daily basis. Governments are not that way. They're in for the long haul. And our focus tends to be on cost to providing services. And that focus on what is the cost to provide services, sometimes drives us to a different answer than what you may find in the private sector.

Again, trying to meet specific user needs, rather than having the tail wag the dog of just because whoever got there first has the right answer, and, therefore, the other -- the board must follow, you have to be true to the objectives of financial reporting. You have to be true to your conceptual framework. And that framework has to be based on solid research on what needs are.

So we do coordinate our efforts. I mean, certainly, if you look to our leasing standards, our leasing standards are very well coordinated. When we look at that transaction, we say a lease is a lease and, therefore, they should be accounted for separately. But we do look at other transactions and say there are differences if we're trying to look at, again, the cost to providing government services, it may lead us to a different answer.

Amy Starr: I had a question. We talked a lot about budgets and financial statements. What kind of comparability is there between the information set forth in a municipal budget and the information that's set forth in the financial statements, and do investors understand the distinctions? Because there is so much stress and information and desire to get the budget information.

David Jones: The answer is that there are literally three bases of accounting. I think Tim talked about that before. I mean, there is -- there is the entity-wide basis, there is the fund-perspective basis, and there is the budgetary basis. And for the most part, the budgetary basis is determined by law. I mean, it's set forth in, you know, in rules. Now, some governments have adopted GAAP as the defining rule for budget preparation, but few have.

This information is all put together, but it's reconciled. There is a reconciliation that appears within the financial statements that reconciles the budget basis for the fund's perspective and provides an explanation about what created those differences. And users of financial statements readily understand that. And it may be one of the first or second places they look when they

read the financial statements so that they can understand those differences while they're looking at them.

David Bean: And I should make it very clear that government budgeting is not within the authority or the mission of the GASB. We do not set budget to a GAAP basis, when David comes in to do -- perform the audit, he's not auditing that assertion, that they have a GAAP-based budget.

Where you will find out if there's differences between generally accepted accounting principles, and the budget will be identified in that reconciliation.

Timothy Firestine: And that's the key. We find each year there is something that the legislative body does that we sit down and have to try to figure out how to reconcile to GAAP. And we just had one this week, and it was on the liability side. It was a question about how firm the commitment was by the legislative body because they had changed the language in the resolution, so we had to try to figure out how to capture that within the fund statements in terms of the designations. So you run into it all the time where you're trying to reconcile the two.

Elisse Walter: Not to be a broken record, but to come back to comparability, you've said that you think that the average investor will look more to budget information than to historical financial statements. And if those are prepared on hundreds of different bases because they've determined on maybe thousands that they're determined on the bases of a variety of different -- of state statutes and different circumstances, does that create a problem in terms of people understanding what the budget represents?

Timothy Firestine: I think it's a good point. I mean, if you think regionally in the Washington region, most of the, I would think average investors are not picking up CAFRs but they're reading the paper and they're seeing comparability around the region, they're seeing a story about Fairfax's budget problems and then they'll see a story about Montgomery County's budget problems, and, you know, from an investor perspective, they're saying well, you know, why is their number different? There's no way to compare the two, but it's the information that is out there. I mean, it's you have to try to sort through it.

I think Mr. Jones said, you know, there are concerns about tax based. There's a lot of information that gets published about tax basis. You look for things about housing values, if it's a property-tax based commercial construction. There's a -- that type of information, that I think the average investors are looking at.

And I think you make a good point in that, you know, sometimes it's tough to get comparability, you know, because reporters are going to report what basically they're being told about the budget from that jurisdiction versus -- you know, I've never seen a story regionally about that compares the, you know, annual financial report to the general fund in any of the governments in the region.

Elisse Walter: We've heard some talk today and we've heard a lot in other context about timeliness of financial reporting, which tends to focus on annual financial statements. So I guess there are a number of questions about that.

One is, is there anything that can be done to either incentivize, to simplify the process for the benefit of investors, particularly, investors, I think you can't assume that all investors in municipal securities are holding for the long term, or they may change their minds, they may need the money. And if you have particularly an infrequent issue or that doesn't have the push of another financing coming along to bring it's financial condition in order, I understand the cost and logistics arguments, but how do we current information out into the marketplace? Is it -- do

we do that? And I know some people do it either through EMMA, through their own websites or both by putting out current periodic budget information in terms of the status. What's the answer to that so that there's enough information out there so that the pricing mechanism and the secondary market works and that people aren't being misled as to what the value is and what they're holding or what they want to sell?

Timothy Firestine: I think we've had discussions before about the wealth of, I think information that is available from issuers that's already out in the market. And it has to do with, you know, Web sites that they've created to provide information. There's a lot of media attention on the fiscal status of government, especially during tough times.

I want to go back to your question about timeliness of the report. Since I think it's only one piece of it, timeliness is important, but when I was finance director, I asked the same questions about why it took us six months to close. And I sort of -- we set an objective to try to do that faster. But every year, they would -- our fiscal year closes June 30, and they'd put a little bow on it and give it to me for Christmas. And, you know, they could never seriously reduce the time. And so we tried to break it down.

And it's the fact that there's so much even preplanning that goes into getting ready for the annual closing process, it starts, you know, six to eight months before the year ends meeting with the component units. And it's not for a lack of resources. I mean, we put -- we have 20 full-time accountants involved in preparing the financial statements. But until you get information from the component units, our budget's \$4 billion dollars, 57 percent of that is the school system. It's our largest component unit. We have to wait until they close their books. And they've got a team of 12 to 15 accountants working on it from their side. And that's just one of our five component units.

Going through the whole accrual process for the fund statements to decide, you know, what was actually purchased against an encumbrance. And then if it wasn't, you know, to get the true accounting on that. There are just a lot of pieces of information, preparing the transmittal letter, preparing the MDNA section, that are very staff-intensive.

So no matter how hard we tried to meet all the requirements and the complexity of preparing those statements, we could never really get it down to less than 180 days.

The other thing is the use of estimates. As I mentioned in my testimony, the fact that, you know, you could probably do some of this faster if you're willing to accept the estimates, but then you create a less accurate, I think, financial statement versus trying to get, you know, more actual information.

David Jones: Yeah, there's -- to answer your question about time limits, it is an issue. It absolutely is an issue. I have, you know, over my time, you know, I've tried to compare this issue with SEC registrants, compared to local governments that, you know, have good staff, good systems, good processes, and to try to understand it. There is a difference in the way that things have to be processed as first how they're processed, then they, you know, in a private sector entity, and the answer is, there's not.

It is this belief that everything has to be to the penny. There is a big of tradition about how things are always done, and that's how we do it. The dates generally are related to some requirement, either at an oversight level or within some of their local finance laws. But at the same time, I've seen large governments issue financial statements very quickly. For example, the City of New York has a mandate to issue its financial statements no later than the end of October. And if, you know, I've been involved with that process for a while. And they're physically able to do that before the statutory deadline, so they do it fairly quickly. Now, some of that's because they make some decisions about funds and the use of funds and whatever.

Public authorities tend to operate very much like a private sector entity. If you look at the Port Authority in New York and New Jersey, for the last 30 years, it has issued its financial statements by the end of February, and it has a December year-end. So it's possible to do that.

I think it's a bit of training, I think it's a bit of custom that has to be dealt with, and I do believe it's okay to use estimates. You know, if they have a reasonable process in place to make estimates, there's absolutely nothing wrong with that. Governments now keep the books open for months after the end of the year, accumulating data. So that's -- there's not a real good reason. I think, by the way, governments generally recognize this as an issue, and I think there's a good bit of work going on out there right now to try to address some of those issues.

David Bean: I made note in my comments that we have a study that -- finalizing on the timeliness issue. And what we have found, and this certainly reflects what David had said earlier, is that special districts, large special districts, tend to get their reports out within 126 days. So that's, you know, it's four months. You know, it's getting there. Whereas, localities, counties, it's in the 181, 172-day range. And there's been other studies in the past that have looked at the number of days.

But one of the things that we did was we talked -- we sent out surveys to financial statement users. And what we found was that particularly after you get past six months, the usefulness, how they find those statements to be useful, drops significantly. So, you know, when you ask does anybody look at things like government-wide financial statements, well, if they're issued so late that they don't find them useful, then you see less use for them. And it's -- so it, again, that chicken and an egg situation that the lack of timeliness of financial reports results in the lack of use of those reports.

Elisse Walter: I think, yeah, that makes a whole lot of sense. I guess what gives me cause for concern, and I continue to come back to this issue, is that it places the holder of the bond at a disadvantage. You can go to sell your bond and there will probably not be very many transactions in the same instrument. You don't have a robust pricing mechanism. You don't have a sense of what the financial condition is once the financial statements become stale, whatever magic moment in time that is. And so they're left holding the bag. In some senses, you've gotten to a point where if you really want to be certain that you're getting value, you really can only sell periodically. And that doesn't make a whole lot of sense to me. So I wondered if there's -- I mean, we say that there's a lot of work going on in terms of people doing analysis, I'm just trying to explore whether there are any sorts of things that we can encourage or mandate or we can get the private sector to do that will move things more in that direction more quickly.

David Jones: Certainly. I mean, one of the things that they've talked about, and it is an issue that a number of governments rely upon what they refer to as component units who may have different auditors, different management, different boards, and there's very little ability of what referred to as the oversight government to basically mandate. Now they can twist arms, they can shout, but those entities still go about their own process, and they may also believe that they have to close to the penny. And, therefore, you know, it takes a bit of time to do that.

What I have found, and at least if I compare public sector to private sector, is generally, the systems -- there's a generally more investment in private sector entities in the systems that are required to produce financial statements timely than there is in the public sector. And the reason is, is because they need access to the capital markets. I mean, it is a must. And in order to have access to the capital markets, they have to produce timely financial reporting. And a bit of it's the human resource issue too.

If you look at governments, now, while there's a lot of accountants, and if you compare it necessarily to a private sector entity, there's more reason to invest in human resources in a private sector for the exact same reason we talked about. So it's a bit of both.

And then, by the way, I do mention this, and it's important, custom does matter. You know, tradition does matter. So if it's a tradition of issuing your financial statements within six months, and that's been okay, and there's no other incentive other than that, then we'll issue them in six months.

Elisse Walter: Is there any sort of consistency in how often people update their budget information? And on the alternatives that you were talking about, Tim, you were talking about budget. I can see that as helping to fill the gap and much less comfortable, with all due respect, to the members of the media who are here and others. And as good a job as they can do to have media reports fill a gap for securities law purposes makes me extremely nervous. But do people generally have a practice of updating budget information monthly, quarterly? I mean, how does that work?

Timothy Firestine: Yeah, I don't think there's a general practice across the board. But I guess the one thing that I would say is consistent is that most places that I've had experience with, there is an update. In Montgomery County, there's an ongoing discussion about the budget, there's a routine where we report to the legislative body in a public session about what the latest is on revenue, what our forecast is for the next year, how that's changing.

I also sit as a member of the D.C. Water and Sewer Authority. In that case, they actually do a -- it's a utility, basically, is accounted for like a private business, but they close monthly. They do monthly financial statements. I chair the budget and finance committee. We have a monthly meeting. At each monthly meeting, we start the session out with a complete discussion of where we are on the financials. They'll show what the closing was for the previous month, how revenues are doing, how expenses are doing, and then they'll give a full year projection. And I do think that's what's out there in other places. Whenever -- because legislative bodies meet in public session, they have routine discussions about where things are on the financials.

James Kroeker: We talked about the use of GASB standards. Are there any themes in those standards where there tends to be deviations? Any themes in where those areas might be on one hand? David, you talked about the mosquito abatement district, and I could understand if that didn't happen to be an issuer and somebody said just given the size of the entity, cash basis accounting is what they selected and they were transparent about that. That might be one thing that could be different than a fairly sophisticated set of operations that enters into either derivatives or, you know, has pension plans and deviations of saying we want to do cash basis accounting for a pension plan. So I'm just wondering if the themes are size, type of transaction, both?

David Bean: Jim, again, it gets back to the tradition issue. Again, many states, they will provide some exceptions for smaller governments. You know, when we talk about 89,525 governments, I mean, many of those are very, very small entities. And matter of fact, I think if you look at the top 30,000 governments, you get about 98 percent of the total revenues. So, you know, there's -- so do you cut it off and say we're going to focus on the 30,000 and the other 50,000 or 60,000 are more akin to mom and pop grocery stores? You know, if you walked into your neighborhood grocery store and asked them where their FASB financial statements were, they would probably look at you like, you know, what are you talking about. So we have to put that into perspective.

And, again, our goal is not to have every government in the United States adopt the GASB standards, but we do feel that, you know, if there is a strong user need, whether it be from the investment community, whether it be through the legislative body or from citizens, that they

should adopt those standards. But in -- at least in the past, based on tradition, it's been a state-by-state basis and some have, you know, for example, Utah would say, you know, all entities should adopt GASB standards, where there are others who have said only entities above a certain size should adopt those standards.

Elisse Walter: David Jones, I would think this question would be for. We have heard anecdotally that there is at times, issuers will include financial statements in disclosure documents without either getting the auditor consent or disclosing the consent that's not been obtained. Have you heard that? If so, is that a real, incredible one-off problem --

David Jones: The answer is --

Elisse Walter: -- or is it more frequent than that?

David Jones: -- it happens. And it varies from place to place. I mean, some of it depends on the law firms involved, the underwriters involved, and the cities involved. But there are some -- there are some -- by the way, even the GFOA basically has a policy statement that says thou don't have to involve your auditors unless you want to because it's your financial statements and the report on those financial statements you paid for and you should use as you see fit.

Now, you know, and there's a little difference among the accounting firms also. There are at least two firms that insist on being involved if their -- if an organization is using their report. There are a couple of -- I'm talking about the major firms, the four -- and there are a couple that basically, as long as they're not notified, as long as they're not associated, they don't really have a position.

Our firm is one of those that insists on being involved. And if they're not involved, we have -- and if we find out about it after the fact, we believe in notification that we weren't involved. And if we aren't involved, we insist in big, bold print that the firm hasn't been involved in either the preparation or review of any of the documents. But it does happen, and it's fairly inconsistent.

I'd say as many required the consent -- actually, consent's a bad word in the literature. It's actually an agreement to include. Unlike in the registrant where, you know, where there's a definition of an expert, in a public sector, we aren't defined as experts, so we don't have those assurances. So we issue an agreement to include probably about half the time.

Elisse Walter: Thank you.

James Kroeker:

Any other observations on audit quality? You talked about the specialized auditing literature. Just observations on whether if there's a greater dispersion of firms that might be practicing with respect to a larger number of municipalities than there might be in the public company space, and whether there's the same commitment to training and, you know, internal -- I guess investment in the audit practice in this space.

David Jones: The answer is there's a lot more firms involved. And if you look at public companies, the vast majority of them are audited by the major accounting firms. It's right the opposites for state and local governments. The vast majority are audited by generally very small accounting firms.

I can say that the accounting professional recognizing this and I can say that the federal government over time has performed certain reviews of the work that's done by the public accounting profession for state and local government entities because the federal -- the federal granting agencies do rely on their external audit. The external auditors of cities provide them

certain assurances with regards to the use of federal grant proceeds, and the reports have been not real -- they've been a bit critical.

As a result of that, there was the act, the American Institute of CPAs, created a Quality Center for Governments. And that's been going for several years now. Matter of fact, I'm a member of the executive board of the Quality Center for Government. And it's actually done a lot to improve audits of state and local government entities. The state boards have accountancy and the federal agencies have also been pretty active in policing those circumstances where there's real egregious incidents that's been reported with regards to the audits of state and local governments.

So the answer is, there's a lot more firms performing the audits. I think for the most part, the vast majority -- the vast, vast majority of the audits are performed okay and there's not a problem. And, you know, I don't think there's probably any difference in the number of audit problems that you would see in state and local governments compared to registrants.

Elisse Walter: I think at this point, unless you have any other questions, I want to thank the panel. This was terrific. And we'll take a five minute break, and then the next panel will come up. Thank you.

[break]

Transcript: Field Hearing On The State Of The Municipal Securities Market Panel V

Elisse Walter: I think we're ready to get going if everybody can take their seats. Martha, take it away.

Martha Haines: Panel 5 of today's field hearing will focus on Build America Bonds. In February of 2009, Congress authorized the American Recovery and Reinvestment Act of 2009, which authorized the issuance of Build America Bonds and certain other taxable municipal bonds that had associated tax credits or some direct federal payments to the issuer.

This new variety of bonds raises many interesting issues because it introduced a new group of investors who typically bought corporate and other non-municipal debt to the municipal market. And many of these investors, such as pension funds and foreign investors, were not accustomed to the municipal bond structure or to municipal bond disclosure practices. This program will expire at the end of this year, unless it is extended by Congress. And the one thing that I think we should not cover today or try to speculate on is whether or not Congress will extend this because it is -- could be an unending and useless debate at this point. Only Congress knows.

So today we would like to discuss how the advent of this new program has served the municipal bond community. We're very fortunate to have with us today, Nancy Kopp, the Maryland State treasurer; John Cross, the Associate Tax Legislative Counsel at the Treasury Department; Bart Hildreth, the professor of Public Management and Policy at Georgia State University; and Derek Wolff, who's a vice president and senior research analyst at Navina Asset Management. They will provide us with important insights about how this program affects issuers, investors, and public policy initiatives.

I don't know if you were here earlier, if you want to speak when questions are being asked, one of the ways to indicate is to stick your name tag up like that. But, of course, you can waive or do whatever else you want to get attention too.

We'd like to start with five minute-ish introduction from each of you. And John, why don't you give it a start.

John Cross: Thank you, very much, Martha, and Commissioner Walter and other distinguished members of the SEC staff. I appreciate the opportunity to appear before you today. And let me just say, as some of you may know, I'm a particular fan of the SEC staff.

[laughter]

I'll take a couple of minutes to give a little perspective of the Build America Bonds program, affectionately called "BABS," which I will use. As a disclaimer, my remarks do not represent any formal position of the Treasury Department.

Brief background. Let me just start with, the current tax law delivers federal borrowing subsidies for municipal debt in three different ways -- classic tax-exempt bonds. The borrowing cost is lower because the interest income is tax-exempt to the investor. Tax credit bonds. The borrowing cost is lower because investors receive tax credits to replace part of the interest. And direct subsidy payment bonds, in which the borrowing cost is lower because the federal government makes direct payments to municipal issuers to cover part of the borrowing costs, and Build America bonds are in that category. They're an optional new municipal borrowing tool under the American Recovery and Reinvestment Act.

What are they? Build America bonds are conventional taxable bonds. The Treasury Department makes payments to issuers equal to a portion of the borrowing costs, measured by 35 percent of the coupon interest. This program is based on a long-standing good government model for direct municipal borrowing subsidies. It was first considered by Congress in 1969. The subsidy payments are treated like tax refunds so there's an ongoing appropriation to make these payments.

Let me turn to highlight some of the positive aspects of this program and their structure. A key structural positive feature of Build America Bonds is that they give municipal issuers potential access to a bigger and broader market. Since their taxable bonds sold without regard to tax preferences, they appeal to a broader market of investors such as pension funds and other long-term investors as compared to tax exempt bonds. The tax exempt bond market is about a \$2.8 trillion market with a predominately retail investor base. Individuals and mutual funds own about 70 percent of tax exempt bonds whereas the Build America Bond Program offers access to the much bigger and broader \$30 trillion conventional taxable bond market which includes more long-term institutional investors. Access to this broader market should give state and local governments more liquidity, transparency and lower borrowing costs.

Another positive feature of BABs is they deliver an efficient federal subsidy directly to state and local governments. Economists for a long time have always thought that tax exempt bonds are always inefficient and within the sense that their value depends on the tax bracket of the investor, whereas this isn't the case with BABs. Stated differently, there aren't enough rich people in the highest marginal tax bracket to set market clearing rates on tax exempt bonds. Since 1986, tax exempt bond rates have been about 20 percent lower than comparable taxable bonds whereas the federal revenue costs are more in the 25 to 30 percent range of the borrowing cost.

Now on to the Recovery Act and the subject of much debate has been sort of the subsidy level on BABs; and it is a 35 percent share of the interest cost. It was intended to be a deeper subsidy tax exempt bonds to encourage public investments and infrastructure in the last two years. The assorted debates over extending this program largely have focused on what is an appropriate subsidy levels your going to have an ongoing program.

Another positive feature of Build America Bonds is that they offer a potential streamline compliance framework that focuses directly on municipal issuers, whereas both tax exempt bonds and tax credit bonds are sort of a more awkward three-legged stool in which investors are viewed as tax intermediaries.

Another market thing related to Build America Bonds is that they offer more demand at the long end of the yield curve. Treasury data indicates that the average maturity rates for BABs have been about six years longer than traditional tax exempt bonds. The long end of the yield curve for tax exempt bonds has suffered from some demand constraints and higher cost for municipal issuers. This program would allow issuers to reduce use of synthetic long term debt such as variable rate demand bonds and auction rate securities which suffered a lot of dislocations in the financial crisis. Basically, they offer more sustainable long term financing.

At the same time, let me just stress that this program was intended to be an optional alternative to municipal bonds. They have had a positive effect on the regular tax exempt bond market by shifting a portion of municipal issuance to taxable markets. BABs relieves the supply pressure on taxes and bonds and have helped to reduce borrowing costs on tax exempt bonds. In short, BABs and tax exempt bonds can co-exist peacefully as complimentary programs.

Build America Bonds have had a successful market reception from April 2009 through November 2010. Based on Bloomberg data over 165 billion of BABs were issued in over 2,000 transactions in all 50 states plus D.C. and two territories representing 22 percent of the municipal market.

Both small and large issuers have had access to BABs. There have been about 12 billion in savings over traditional tax exempt bonds and savings have been at all ends of the yield curve with about a 31 basis point savings on a 10 year bond and a 112 basis point savings on 30 year bond in comparison to tax exempt bonds.

Now, why has the market accepted Build America Bonds so readily? I think that part of this is they're playing vanilla taxable bonds. They rely largely on known tax exempt bond rules, the IRS has been making payments reliably, a treasury inspector general report, you know, underscore that there's been accurate guidance and timely processing of these payments. Last year, the administration made a proposal to make this program permanent at a 28 percent subsidy rate and to expand eligible uses to include not just public capital projects, but also current refinancing for interest cost savings, short term working capital, and financings for non-profits. Let me turn and just touch briefly, very briefly, on a couple controversies and feel free to have another fire drill at any time on this portion.

Female Speaker: This can be arranged.

John Cross: Yeah I'm saying. Some critics of this program have expressed a concern that the federal government either guarantees BABs or will bail out municipal issuers on default. This concern is simply wrong. Structurally BABs are municipal debt, not federal debt. The statute doesn't contemplate that the federal government will be responsible for repaying the principal on this debt and with respect to the federal direct subsidy payments to issuers for a portion of the interest on the bonds. I think treasury IRS guidance on which we're working will consider the circumstances in which the federal government would cease making payments, either on payment defaults or, basically, on audits at the end of the process on a program violation.

A related controversy has been a so-called off set issue. Basically, in general the federal government offsets or reduces federal payments including BAB's subsidy payments by outstanding tax liabilities and non tax federal debt. Arguably, this off set issue would be considered minor and manageable, attendant to prudent federal debt collection laws and the amounts of off sets on BABs have been extremely limited, less than two percent of total payments and less than a half percent of the state level payments.

Another criticism of BABs is they've only benefit large states. Well, yes it's true that larger states have made greater use of BABs in other jurisdictions, but this is a function of greater populations and greater public capital infrastructure needs. The same could be said for tax exempt bonds. BABs have been used by small and large issuers; treasury publishes data on its website monthly that shows the breath of the usage. And to underscore generally, since BABs helped to reduce tax exempt bond yields, they've also benefited municipal issuers even who don't use them.

Two other controversies and then I'll conclude. One is underwriting fees. At the inception of the program, some asserted that underwriting fees were unduly high. In this regard, since the start up phase of the program, underwriting fees have declined continually are now comparable to those for tax exempt bonds. Basically, analysis on third quarter of 2010 showed virtually identical underwriting fees of six tenths and one percent for Build America Bonds and tax exempt bonds. Also, the statute only allows two percent of the proceeds of these bonds to be used for any kind of bond issuance costs.

Last controversy, about which I won't talk much but I'll just mention so you know I'm aware of it still. One of the legal standards in the area involves a concept of issue price of the bonds; two statutory requirements for BABs depend on the issue price. One basically is the simplifying provision that says, "Issue these bonds at par, rather than at premiums so that you can use plain, vanilla coupon interest rates to compute the subsidies rather than premium amortized effective yields." So here, you look at the issue price to decide if you've issued the bonds at par.

Similarly, the arbitrage investment restrictions focus on issue price on determining the effective yield and their part of the focus is to not send underwriting compensation to arbitrage yield. There's been some controversy about this topic. Basically, issue price looks through underwriting cost to the price to the public. We have -- treasury has a guidance project on this and we know it's important and any future guidance would provide full opportunity for public notice and comment before making any changes.

To conclude, I'd just say that the treasury thinks that BABs sounds like good government model for direct, lower cost municipal borrowing subsidy that has great potential for access to a bigger broader market that may be more sustainable and is a useful, optional, complimentary tool to tradition tax exempt bonds. That's it for me.

Nancy Kopp: I first of all would like to endorse everything that John has said including a couple things I was going to say, so I won't say them over again. Let me just remind you of who these issuers are and why they're issuing because I think it is important. BABs were created in 2009 although based on an earlier model and I know do represents differences of opinion of what is most efficient and perhaps even equitable way of doing what. And the "what" is building schools, roads, prisons, and other public facilities on behalf of the tax payers of this country. So I think it's just important to remember why it is we're going to market and who it is who is going to market. Maryland has used BABs in its bond offerings. Partially BABs, partially tax exempt, we think they are both very good tools to have in the tool box in order to be able to fund these projects and there was a credit crunch. The states are now going through very difficult times and in order to build long term facilities, in Maryland predominately schools, but also universities, roads, et cetera, we have to be able to borrow money on behalf of the taxpayers effectively and BABs have allowed us to do that. There has been a savings; that savings has rolled into being able to employ more people and essentially doing a little more building for the same price, which was as I recall, one of the original reasons Congress endorsed them. It has enlarged the pool for the reasons that John said and it has allowed us to issue, in fact, the tax exempts at I believe a meaningfully lower rate than we would have because it did deal with this problem of the long term. Now, what -- since we don't have some of the options and variable rates that we had a couple of years ago, what will happen without BABs is not quite clear, but I think it is quite clear that the cost of construction on behalf of the people will go up. The cost of long term borrowing will go up and we'll have to factor that into our budgets.

So it's important to realize who is using them, what they're using them for, what the impact will be if we don't have BABs. They have, I think, also usefully spurred the issuers to a greater degree of transparency. As John said, people are focused now. A broader pool of investors are focused now on the issuances. I think it is very fortuitous that they came about it the same time that EMMA became such a strong tool as a basis of comparison, but also the individual websites of I think -- I know the states, but I believe also the larger range of issuers have I think become much more useful. They are not where they're going to be. But because of the focus on borrowing that BABs and the whole discussion has brought up, for instance, commissioner, the more frequent, non-audited revenue estimates, the more frequent, non-audited other statistical components of an OS are now on the websites and quite candidly, personally, not speaking for anyone else, is not clear to me why they shouldn't be.

So I think that actually having BABs, the discussion about BABs and the focus on the need for the public to issue that in order to achieve things that they want to achieve, has in fact, also resulted in some progress in transparency and in public discussion we hadn't even anticipated when they came on.

Male Speaker: Interesting.

Nancy Kopp: And I look forward to answering questions. Again, on behalf of myself only, but to reflect on what our fellow issuers have done.

Martha Haines: Mr. Wolff would you like to go next?

Derek Wolff: Sure. Sure, thank you Commissioner Walter. Thank you for inviting me to appear before this panel to talk about our perspective on Build America Bonds, its impact on investors, issuers, and a broader muni market. My name is Derek Wolff; I am a vice president and senior research analyst at Nuveen. We are a wholly owned subsidiary of Nuveen Investments. We have a relatively unique place, we believe, in the muni market. Nuveen was founded in 1898 as an underwriter of muni bonds. We manage about 160 billion in assets. Nuveen asset management itself is one of the largest managers of municipal bonds with more than 75 billion in municipal assets under management. We manage for both individuals and institutions in mutual funds, closed in funds, index funds, and separate accounts. And regarding Build America Bonds specifically this year we've launched in addition, two separate accounts, we've launched two closed in funds in the United States targeted really toward retail investors to invest primarily in Build America Bonds. We also manage BABs for institutional clients and for international clients.

Our approach to muni investing, and some of what I'm going to say I think has already been stated so I'll try to skip through, we are a fundamental research based shop. Our approach we believe is essential in a market, such as the muni market, which is vast, complex and relatively inefficient. We maintain one of the largest municipal research teams in the industry. Our staff focuses exclusively on evaluating distinct features of municipal credits and we develop specialized expertise and specific sectors in regions of the country.

In addition to in depth analysis, we also focus on security, collateral provisions, market position and market health. And we maintain an active and ongoing surveillance process to ensure the credit quality of our investments. This research process has translated well in the evaluation of BABs, which as we've stated are essentially muni bonds issued in a taxable format. Many of the borrowers are familiar names that we've followed for years and we've used our expertise to help new investors navigate their way through the muni market, an area of capital markets which is historically and relatively a limited investor base. As Treasurer Kopp stated that we agree with, we believe a broader investor base should also positively affect disclosure and transparency as more investors will demand that.

While the muni market, from an investor perspective initially expressed some reservations over whether or not BABs would provide a viable option for issuers, the market for Build America Bonds has grown markedly following the first issuance in April of 2009. As issuance of BABs has grown, the impact on traditional tax exempt market has also grown. Let me outline just a couple of the ways we've seen the impact of the BABs market. And again, I think some of this has been stated already. The expansion of issuance under BABs has greatly reduced the supply of higher quality bonds from the tax exempt market. Although the municipal market itself is more than 2.8 trillion, in 2009, annual issuance was about 400 billion. Of that total, BABs was approximately 65 billion or 15 percent of the total issuance. In 2009, however, in the months that BABs were issued, they represented approximately 20 percent of municipal issuance. So far, this year, that market share for BABs has grown through the first three quarters of 2010 with greater market acceptance; BABs have represented approximately 25 percent of municipal issuance. As the program nears its end, BAB's issuance has certainly accelerated reaching as much as 40 to 50 percent of new issuance supply in a given week. By and large, the market has been investment grade. And these are bonds we feel otherwise would have been available to tax exempt investors.

These changes in the supply dynamics of the municipal market and, namely, pulling higher quality new issue supply out of the tax exempt primary market along with other factors have

contributed to driving down absolute tax exempt municipal yields during most of 2010 to historically low levels. This has certainly benefited municipal issuers, both taxable and tax exempt by lowering the overall cost of borrowing. Municipal governments that can issue BABs have enjoyed a lower cost of capital, and issuers that don't qualify for the BABs program and may have otherwise been crowded out of the new issue market have been able to issue debt amidst the lack of supply and have been able to issue that debt at the time of historically low municipal rates. If BABs were to go away, however, particularly as we've seen some volatility in the past couple of weeks as the BABs debate goes on, we feel the municipal market may experience some significant volatility.

As taxable bonds BABs have also expanded the investor base for the municipal market among retail and institutional investors in the U.S. as well as abroad. We view a deeper market and broader investor base as a net positive for the market as a whole. Indeed, over the course of the past year or so, we've held dozens of meetings with investors new to the sector to educate them about the municipal market.

In our view, the compelling yield offered by BABs, especially relative to corporate bonds is being driven by a number of factors. A new investor base that's still working to understand the market and the bar were base, uncertainty over extension of the program, concerns over liquidity in the market, a lack of track record on how BABs will trade, whether they'll trade with traditional tax exempt, muni credit, with the treasuries with the taxable market, et cetera. Headline risk related to municipal credit conditions have certainly effected pricing and most recently, prices on bonds have been impacted in large part by the deluge of BABs supply as issuers push to get their deals down into the market before the program ends or the subsidy drops. Thank you for the opportunity to speak, I'd be happy to answer any questions you may have.

Martha Haines: Professor Hildreth?

Bartley Hildreth: Good afternoon. Commissioner Walter, thank you for the invitation to serve as the cleanup hitter today. My experience comes as an issuer official, a policy participant, an investor, an academic, and an editor-in-chief of the only academic journal devoted to municipal securities, The Municipal Finance Journal. I've also studied Canadian provincial and municipal securities which are exclusively taxable and frequently foreign. A few years ago, when I lived in Wichita, I was the only academic on an industry taskforce that went to Beijing to brief century officials on the design of a sub-national capital market. In the meeting with senior staff involving restructuring China's central economy the most senior official waited until the very end of the session to ask me, "What is the role of the president when the city of Wichita wants to issue bonds?" Well, as you know, the answer is that neither the president, nor the governor has any role in the specific decisions of local officials concerning the purpose, the amount, the timing, or the structure of the borrowing decisions. Local discretion is a key fiscal federalism issue.

Now that perspective leads to our big question: Should we reform state and local government securities and their access to the capital markets? The momentum is toward yes. Although the taxable bond option is moving to the end of its two year experiment, it's 40 years in the making. Now the option part is at risk. The final report of the president's deficit commission includes elimination of the tax exempt market. Moreover, the Dodd Frank Act calls for enhanced scrutiny of the municipal market and yes, there are calls for the repeal of the Tower Amendment.

Well let's look at the policy history. I want to use the debates over the taxable bond option from back in 1969 and 1976 to look at BAB's policy. Advocates of the taxable option sited at least three key problems with tax exemption. Opponents focused on six problems with a taxable option. So to advocates of a taxable option, the first problem with tax exempts is that it narrows the potential investor base for state and local government obligations. At your San Francisco field hearing, California's treasurer reported that foreign investors purchased 28 percent of a

recent BAB's issuance. According to second quarter data, foreign holders account for about three percent of all state and local government securities here.

So foreign investors and their demand has picked up. However there are risk with foreign holders. And all we have to do is follow the logic of Warren Buffet as outlined in his 2008 letter to shareholders where he said that state and local government officials may at some point yield to political pressure to take care of local basic services before paying debt service to outsiders. Now personally, I don't think that's likely to happen. But that was Warren Buffet.

Second, there is a tax equity issue. The lowest marginal tax bracket clears the market. So there is a windfall to higher income tax bracket investors with tax exempts. This fact is always brought up in Canada when a tax exempt option is discussed. Now our taxable bond option by design gives the direct pay subsidy to the issuer. In Canada, there is no direct pay subsidy.

My third point is an efficiency argument. Issuers can save on their cost of capital by issuing direct subsidy bonds and the key feature is the taxable bond option subsidy rate now set at 35 percent, but there are proposals for 28 to 32 percent. And now as an incentive for the use of the taxable option, that's at the lower range of the old estimates from the policy debates. However, research on the BABs experiment justify the low rate. The U.S. treasury staff found that the savings range is between 31 to 112 basis points over the yield curve. A published study found a savings of 54 basis points. A working paper presented at a recent academic conference found a 70 point savings for California issuers.

Now arguments against the taxable bond option have reemerged with the BAB's program. And I'll focus on six points of that opposition policy history. First, the constitutional question can be discarded. In 1988, the Supreme Court held there is no constitutional protection for the tax exempt market. We told South Carolina not to carry that case forward, but that's South Carolina for you.

Second, the opposition focused on the uncertainty of a federal appropriation compared to a tax expenditure. Earlier taxable bond option proposals dealt with this issue by setting it up as an automatic permanent entitlement. So a permanent BAB's program may have to address this more concretely.

Now the flip side of a concern about congressional inaction was a third concern: federal interference. That is interference with the freedom to access the capital market of choice as long as there is an ability to pay, a willingness to pay, and access by the market. The 1969 proposal said there would be no central control and the current BABs program basically follows the same path. But there are the fears of federal offsets and other issues that John Cross mentioned earlier.

More revealing is the tone of a key senator's letter about BABs to the GAO on November 16. The letter calls for an inquiry into the project's funded any [spelled phonetically] incentives for issuers to overpay, the rewards for lower quality credits to gain higher subsidy payments, the lack of detail reporting any evidence of fraud, waste, and abuse, and the overall lack of transparency of the BABs program.

A fourth point of opposition was the fear of substitution. That is a fear that the taxable bond option would disrupt the tax exempt market. Back then, an estimate pegged the potential share of taxable bonds at 17 percent of municipal borrowings. BABs by contrast represent about 25 percent of the municipal market.

A fifth concern focused on federal cost. On the one hand, there is the tax expenditure amount of federal revenue laws associated with tax exempt interest. I note in today's bond buyer notice

that I got sitting out here today that one of the members of Congress has called this a spending program disguised as a tax program.

But on the other hand, there's a need for a budget appropriation for the direct subsidy taxable bond option. And the early debates, cost estimates varied widely. And that's also the case with BABs. It's very hard to put a dollar tag on some future estimate.

A sixth issue is that taxable securities offer the potential for an issuer to make a market for its own debt. I understand that this type of problem may have risen with BABs. My work on Canadian provincial and municipal securities confirms that this can happen, even to the point of officials requiring such non-market behavior. The incentive to do so escalates when the public capital market is not accommodating.

So in summary, the BABs program has been a success. It was built when over 40 years of questioning the tax exempt structure. Decentralized fiscal decision making has served this country well. So a taxable bond option offers another tool. However, complete elimination of tax exempt securities raises fundamental questions for state and local governments and their tax payers. Thank you.

Elisse Walter: Thank you all very much. I guess I'd like to start with the disclosure issues that I think Treasurer Kopp raised. And what you talked about, if I heard it correctly, was greater transparency primarily through what I would call post offering disclosure that then appears on websites like non-audited revenue figures and essential non-statistical components or maybe it's also contemporary with the offering. That's what I wanted to find out. Have you found that there has been an improvement of the quality of disclosure that's in the offering statements themselves and does that translate to the tax exempt market as well?

Nancy Kopp: I would say yes. Because I think there's been a greater focus on the offering statements themselves. And then going forward, as I said, with simply a greater focus on the municipal market, I think, there also has been a greater focus and part of this is following discussions with the SEC commissioners and others of continuing disclosure, which includes also things like continuing revenue, not tied necessarily, in fact, to a particular offering, but simply as in our case an ongoing disclosure, quarterly, regularly, unaudited, updated financial and other including demographic information.

Elisse Walter: Has that been limited to BAB's issuers or is there a trickledown effect --

Nancy Kopp: No, what I'm saying is I think has expanded the focus -- this is my personal opinion -- expanded the focus in general, but it was because of -- to some extent because of all the discussion about BABs, about different instruments, about how the role of the state and the issuers that this discussion -- which had been going on I think has speed it up.

Elisse Walter: Thank you. Also, we talked about both the expected difference in the investor base and the fact that there is a difference in the investor base. Could one of you go into a little bit of more depth about how the investor base is broader with respect to BABs and tax exempt? How has it actually turned out in practice?

Derek Wolff: I can make some comments. I obviously don't know all the statistics and can't say anything for certain since I don't know if there are statistics who show who the exact buyers are on every issue, but as your probably aware, it's tax exempt muni's have typically been a retail market and certainly there have been property and casualty companies who have been investors in BABs. We have found the most reception from longer term investors that haven't traditionally had a reason to invest in the municipal market because the yields weren't sufficient. So suddenly, the idea of investing in a triple-A, a long dated triple-A security, seems very appealing for a pension fund that has long term liabilities or an endowment that has sort of long

term capital needs for spending purposes as well as potentially for international investors, banks, life insurance companies and the like. We've seen as sort of the greatest interest in the BABs market from an institutional perspective.

John Cross: I would just add to underscore that point, one just on the basic tax point that the tax exempt market is limited to those who need tax preferences. Well, that eliminates just a \$30 trillion pile of capital that comprises the taxable markets including pension funds, sovereign wealth funds, foreigners and I think the tax exempt bond market conspicuously experienced that in the financial crisis at the end of 2008. And looking when there was such a liquidity crisis, the only -- well in the early '80s banks, for example, used to be big investors in tax exempt bonds because of tax restrictions. They basically quit buying tax exempt bonds after 1986 except for the local small issuer transactions because the tax rules essentially disallow their carrying costs associated with their funding for tax exempt bonds. So really, as Derek mentioned, the only other intuitional investor to speak of in the tax exempt market has been property and casualty companies and their needs vary. So it's just a conspicuous, I think, difference in breadth and size of the market when you don't have tax preferences as a driver. And I think also the individual investors and the tax exempt market have a shorter horizon. They don't look out 30 years nearly as much. They look more like 10 to 15, 20 years and are much more competitive with BABs at the midterm maturities, but not so much at the long end.

Bartley Hildreth: One little piece of evidence, I am aware that there were some bond mutual funds set up in Canada devoted to BABs purchases only. So that got a new investor base out of a foreign set of investors to come in and buy just BABs.

Elisse Walter: I think each of you, or at least most of you, has sited strikingly consistent statistics about the portion of the market that BABs represent. Do we have a real sense as to whether it in effect there was 100 percent of the market for munis and BABs took X percentage of that market or whether that came out of the taxable bond market or whether simply it actually caused an increase in what could be successfully sold? Does anyone really know?

Bartley Hildreth: No, it's hard to prove a counter-factual, what would have happened otherwise. So no, the evidence is not there to prove conclusively that it carved out what otherwise what would have been there.

John Cross: I would just add to that anecdotally. Yes there was a certain element of increased issuance for stimulus purposes where some capital projects were accelerated in their financing because of the deeper subsidy with BABs. However, you can look a total -- at treasuries [unintelligible] sort of this market share size and sort of the 20 percent of the market kind of range for BABs. I think we have data on that. But you can look at total municipal borrowings over the past five years and you won't see a huge change just as a result of BABs. So I mean you can compare basically the total debt that municipalities have done.

Nancy Kopp: Can I just add, I do think it's important to stress though the question of the long term market? The municipals are -- municipal issuers are particularly interested in the long term because again, going back to what we use it for, although I do understand that the investors are all not for long term, but one of the question is without this support and without the other types of instruments that we had before this what the impact is on the long-term and on that part, that total part of the market without if there were not the support of BABs regardless of the subsidy level.

Martha Haines: Well I wonder if we can turn to what happens, if and when this bond market BABs end, assuming at some point that may happen. What kind of challenges would that pose for this market? Do you think that BABs would become particularly illiquid because there would be no new issues coming in? Might it spur the development of new products that were -- like

[unintelligible] that were designed to convert essentially long term debt into short term debt? If you could speculate about those possibilities, I'd appreciate it.

Nancy Kopp: Martha, I'll let the professionals do it, but just say that was a good example of this sort of option that we are now being steered away from at the variable rate, the asset backed -- I mean the one long term thing in fact that is left supporting this market are the BABs at the moment. Now it is true, we talk about them and we're used to them but really, it's less than two years ago that BABs were created in the first place. So some of the answers is not clear. But I do think that there will be a gap in the ability of the states and the other governments to fund and -- enhanced volatility, I mean you can see that in the market right now. First BABs were new and then people got used to them, the spread [inaudible] and now because we're not sure whether -- I believe -- because we're not sure they're going to continue because we're not sure what it means down the road that they are again becoming more volatile and seeing is potentially riskier.

Derek Wolff: Right, I would agree with that. I think you can see that today right after news came out that BABs were not necessarily included in the potential tax cut plan, the market backed up considerable. And I don't know if there's a direct relationship there necessarily, but I think it's pretty clear that the market is concerned about what will happen both with BABs and then what is going to happen to the municipal market once BABs goes away. Will there be any sort of crutch still available for long term municipal issuers? I think it's also pretty clear that BABs don't just benefit -- we've had this discussion a little bit -- don't just benefit state issuers, but a lot of the smaller issuers. Even though they have to pay maybe a little bit of the premium to issue in BABs and may cost them an extra 50 or 60 basis points, the \$50 million school district issuers, it is still a cheaper alternative than what they get in the municipal market which is why they do it. If BABs goes away and there's a potential for the whole municipal market to cheapen substantially, then I think everybody's impacted it and I don't want to say to the degree of size you impact it more or less, because California certainly is large but has been impacted to a large degree, but there is the potential for issuers large and small to be negatively impacted by the absence of BABs.

John Cross: If I could, let me just add a couple quick points of that. One is -- and maybe this is obvious -- in the same way BABs benefited the municipal market by relieving supply pressures, if you get rid of them, they will have the converse effect of increasing supply pressures in the municipal market. And one of the developments that we don't know the full impact of is the impact of the increasing difficulty that the synthetic long term instruments have in the tax exempt bond market. If you recall, there was a 330 trillion auction rate securities market two years ago, which is gone forever and in the other synthetic long term bonds for tax exempts that involved dependence on bank liquidity facilities, so called variable rate demand debt that aims at the dominant money market fund buyers who have insatiable demands, well the banks between the new accounting standards so called Basal II and III and all of their other issues generally. Liquidity costs have increased significantly so that's a much harder sector of the market to tap into. I think -- I know that at treasury the domestic finance folks have worried a lot that those synthetic alternatives will be less available and that BABs -- they view BABs as providing a more sustainable option for longer term financing.

Nancy Kopp: Could I just add, I think even at a higher level, one of the things for us to be looking for I think is a sort of a barbell effect among issuers as this market gets tighter, as the options are removed. The difference between the very high quality issuers and the less high quality issuers potentially get to a point where some simply can't afford to go to the market. That's interesting financially, but it also means, as I said, an impact on whether there are going to be schools built, whether there are going to be roads. This is real life, this is not simply paper.

Robert Cook: I wanted to ask a little bit about the offering and underwriting process and how that's worked with BABs. To what extent has that been materially different from the tax exempt and think of it terms of if the program were to be extended are there any aspects of the rule set or the custom and practice around the offering process including disclosure process that you think we should be considering, either revising or encouraging market participants to think through differently?

Derek Wolff: I guess that's directed toward me primarily. Well our sense we don't do underwriting and we're on the by-side -- is really it's all been run through the municipal desks, same sales coverage, same bankers. We view it as essentially the same as the municipal market has run. Although, there seems as though there have been quite a few competitive deals and on the tax exempt side, there's general and more of slant toward a negotiated process. In terms of disclosure, from our perspective, the more the better and to the degree that there is a certain degree of disclosure prior to issuance. Different sectors have different degrees of disclosure as well. Some of the revenue back sectors perhaps have more disclosure than the general obligation sectors. We just -- the more disclosure the better I would say we think it's been fine but can obviously be much better and fuller, but we think that has particularly as new investors who aren't used to this market demand that as they're trying to understand the market, we think that actually will have a positive benefit for everybody because they're going to need to get comfortable with what they're buying and who the issuers are. And as new investors they're not going to know other than to look at documents and financials and materials. So that we think will be a positive overall.

John Cross: Let me touch on that also. In the most general sense, I think that the bigger taxable market offers the potential for greater transparency and pricing just because there's more players looking at things. Part of the development here has coincided with the MSRB and Lynette Hotchkiss' efforts with EMMA and increasing transparency on pricing in the tax exempt bond area as well. Coincidentally, this technical tax issue price standard which for BABs aimed at a very simplistic thing, that is, sell plain vanilla par bonds so you don't have to calculate amortization at bond premium. Also, sort of puts a laser emphasis on making sure you got the issue price right and kind of calls into question and raises for great debate and angst, what is the appropriate standard for making sure that you've got a bona fide public offering process, you've gotten prices to the public that have gone beyond the underwriters and how best to accomplish that. And certainly this has highlighted that area. And that is an area where the SEC and treasury have related kind of themes to look at.

Nancy Kopp: John, not all of them have been issue negotiated either [inaudible], we've been issuing the BABs the same way we've been issuing the GO bond [inaudible].

John Cross: Yeah and that's in another theme and that whole area has been, some folks -- there's a lot of negotiated transactions in the municipal area. Some folks, one of the topics there is whether or not policy should encourage more competitive sales, or whether you need different rules because the process for distribution ultimately is different. And negotiate sale underwriters usually sell all the bonds before they sell the bond purchase agreement. And competitive sale it seems very, sort of, open bidding. But that's before the underwriters have done any sales to the public. So it's a very different process and may compel different approaches.

Elisse Walter: Well, I think we've come to the end of our time. I want to thank all of you very, very much for being here. This is very helpful. We're just about done for the day. I have a few, brief closing remarks I won't keep anybody very long. I want to thank not only the participants who are here right now, but everyone who participated in today's hearing. You were all so generous with your time and sharing your insights. Today's discussion contributes to our growing body of views, which also includes the perspectives of the folks that we spoke with in

San Francisco at our San Francisco hearing, and those who have submitted comments via our website. We hope that number of people will grow.

Today we discuss issues concerning the stability and liquidity of the muni market. For example, the panelists spoke about the correlation between leverage and stability and between availability of information and liquidity. Clearly, this is such an integral component of a well functioning regulatory environment that we plan to schedule at least one more panel on the subject at a future hearing.

We also heard from a panel of retail investors, a real joy, at least in my view, because we do not frequently enough hear directly from the people we are here to serve. These investors discuss the quality, timing, and readability of relevant information about muni issuers, information that's critical to informed decision making. They also raise questions about the training, expertise and incentives of some financial professionals who are instrumental in assisting retail investors in this market.

This afternoon, we discussed the advantages and limitations of self regulation. We heard how important transparency is for SROs, or IROs as was suggested as a new acronym, in order for these organizations to earn investor confidence. I was gratified also to hear the strong SEC oversight of SROs is valued by the market and by SRO's themselves.

Although briefly interrupted by our fire alarm, we also discussed accounting issues; and maybe that was a statement about accounting -- as the daughter of an accountant, I resent that. But we discussed the fact that while most muni issuers prepare their financial statements according to GASBY [spelled phonetically] GAAP, this is not uniform across the country. We heard about how these differences of accounting standards along with many other factors may impact an investor's ability to compare financial information between muni issuers. And even for those who prepare financial statements using GASBY GAAP, we heard about some of the range of reporting options that may detract from a comparability goal.

We also most recently had a very interesting discussion concerning BABs including reflections on how investors in BABs carry from investors in traditional tax exempt bonds and how their disclosure expectations and needs may differ. In addition, we heard concerns expressed concerning the potential impact on the market from possible expiration of the BABs program.

As much as we've learned today, we have more still to discover before our team will be prepared to issue a report with recommendations. So I will close with a stay tuned message. Thank you all again and a special thank you to Martha and to Amy for being so effective and organizing and moderating your panels. Thanks again, please thank you for being with us today.

[applause]

[end of transcript]