



Remarks Of

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**The Continuing Need for
Municipal Secondary Market Disclosure**

**78th Annual
National Association of State Auditors,
Comptrollers & Treasurers Conference
August 24, 1993
Baltimore, MD**

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

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The Continuing Need for Municipal Secondary Market Disclosure

I. Introduction

I appreciate the opportunity to participate in this conference of the National Association of State Auditors, Comptrollers and Treasurers ("NASACT").

I intend to discuss today the need for secondary market disclosure in the municipal securities market, to identify and to commend a few of the many voluntary initiatives that are making progress in this area, and to encourage all municipal securities market participants to intensify their efforts to improve secondary market disclosure.

II. Overview of the Municipal Securities Market

The municipal securities market continues to be an exciting and active one. The record-breaking municipal securities issuance volume in 1992 of \$275 billion¹ may very well be surpassed in 1993. In the first six months of this year, a total of \$143.7 billion of municipal securities were issued.² I understand that this represents the heaviest municipal securities issuance volume since the last six months of 1985, when issuers and underwriters scrambled to bring their bonds to market before the effective date of the Tax Reform Act of 1986.³ By the end of July of this year, the issuance number had risen to a stunning \$166.1 billion, which represents a thirty-one percent increase over the same period a year ago.⁴ Well over half of these new municipal issues are refundings.⁵

Low interest rates, of course, are the primary driving force behind the new issues and the continuing number of refundings brought to market. The

low interest rates have not only made many capital intensive projects less expensive, but they have also encouraged municipalities to refinance their callable debt.

Overall, investor demand continues to keep pace with the ever-increasing supply. The anticipated continuing increase in individual tax rates appears to be the driving force behind this surge of individual investor interest. Investors ranging from individuals to mutual funds continue to invest heavily in the municipal market, even as commercial banks and insurance companies turn to other investment vehicles.⁶ However, I should note that the banking industry at least is re-emerging as a heavy investor in municipal securities, although as an indirect one, through their bank-sponsored mutual funds.⁷ The demand for municipals on the part of individual investors is expected to continue to rise,⁸ particularly as tax rates continue to rise.

While sales activity in the municipal market is booming, some shadows are overhanging this market. Indeed, the municipal bond market is currently undergoing more intense scrutiny than it has in many years. Reports continue to surface concerning frauds perpetrated on investors in the unrated bond area, often involving health care facilities.⁹ Further, investors have not forgotten the defaults engendered by the failures of Mutual Benefit Life, Executive Life, and Tucson Electric Power.¹⁰

The recent spate of early bond redemptions from state and local governments has caused many investors to reel in "call shock."¹¹ The re-refunding of certain bonds that have already been escrowed to maturity has raised questions both at the Commission and at the Department of the

Treasury.¹² Such a situation raises particular concerns if issuers engaged in a refunding fail to clearly disclose that the refunded bonds remain subject to optional redemption. This problem will continue, and may even increase considerably, since the call phenomenon is expected to continue for at least two more years.¹³

Moreover, recent allegations of political influence peddling involving bonds issued by the New Jersey Turnpike Authority and of undisclosed conflicts of interest involving bonds issued by the Massachusetts Water Resources Authority have called into question the processes through which issues of municipal securities are awarded to underwriters.¹⁴ As a result, Congress, and the Commission, among others, are investigating the extent to which underwriters' practices of making political contributions and of entering into side undisclosed contractual agreements are consistent with the requirements of the federal securities laws.¹⁵ The Municipal Securities Rulemaking Board ("MSRB") recently has announced that it intends to adopt a rule governing direct and indirect political contributions by municipal securities underwriters.¹⁶ In addition, in response to these allegations of influence peddling and of conflicts of interest, some municipal issuers are shifting to offering securities only on a competitively bid basis.¹⁷

These incidents, while apparently isolated, could undermine the integrity of the municipal securities market, which has traditionally been largely trouble-free.¹⁸ Their existence should encourage municipal issuers and regulators alike to do all in their power to shed light on municipal securities market operations. I believe that improving secondary market disclosure, while unrelated to these

incidents, is one of the steps that could and should be taken in an attempt to enhance the integrity of this marketplace.

III. Secondary Market Disclosure

While improved secondary market disclosure will not eliminate defaults, or even eliminate the problems that I have just outlined to you, it will enable investors in the secondary market to better understand the risks they are taking in purchasing a security and the return available to them for taking those risks. It also should give greater confidence to purchasers of bonds in initial offerings that material developments with respect to those bonds will be made known to them in a timely manner, rather than only to a select few market insiders. By reducing information gaps in the market, the bond owner and the potential bond buyer in the secondary market will have greater confidence in their respective evaluation of the security, dealers will be able to more readily form a reasonable basis for recommending particular securities, and pricing of municipal securities will be more accurate. This increased confidence and accuracy should benefit all municipal securities market participants, including issuers.

The ability of thousands of governmental issuers to enter the municipal bond market repeatedly in order to finance the needs of their communities depends upon the strength of the relationship that has been forged with investors. The integrity of the municipal securities market, which is central to this relationship and central to the success of that marketplace, could only be enhanced by improved secondary market disclosure. Municipal securities have traditionally been viewed by investors as a relatively "safe" investment, and I that believe that everyone here would like for that view to continue.

III. Industry Efforts Toward Secondary Market Disclosure

I acknowledge that many municipal securities market participants have been working diligently to encourage adequate secondary market disclosure. While some progress has been made, the slow pace of these improvements has been frustrating.¹⁹ This slow pace has become increasingly frustrating for me recently. Hopefully, as the hothouse of publicity heats up the municipal securities arena, these voluntary efforts will begin to bear fruit.

In my view, there are threshold requirements for developing adequate secondary market disclosure in the municipal securities market. First, a national, central repository system that makes information readily accessible to investors must be available. Second, the disclosure provided must be cost-effective and designed to inform investors.

Secondary market disclosure practices in the corporate securities market are aided by the discipline of mandated periodic reporting. No similar discipline exists in the municipal securities market.

Further, unlike the corporate securities market, the absence of an effective repository system in the municipal market has been used as an excuse to forego continuing disclosure practices. This lack of a central repository system, however, may be remedied by the MSRB's CDI pilot system for secondary market disclosure.²⁰

While submissions to the CDI system are voluntary, it has received strong support from industry groups including the Public Securities Association and the American Bankers Association's Corporate Trust Committee. The CDI system should, in time, go a long way toward providing the repository necessary to

make secondary market disclosure information readily available. The municipal community, unfortunately, has been slow to embrace the CDI system. As of the end of June, I understand that only a dozen banks had filed notices over CDI.²¹

NASACT's efforts to improve the collection of secondary market disclosure within states have been instructional in assessing the sluggish reception of CDI. Through its fourteen state study on disclosure practices, NASACT has shown that some state agencies already collect a tremendous amount of ongoing information about municipal issuers and their securities.²² As NASACT has correctly pointed out, however, that information generally is not collected in a central place. In addition, that information may not be comprehensive or timely. Because the pertinent information for a given issuer may be scattered over several state agencies, it is not easily accessible to the investors who need it. NASACT's study has been useful, and I encourage further examination of the extent of existing disclosure.

Other groups also have been active in the secondary market disclosure area. Over the past few years, the Government Finance Officers Association ("GFOA") has worked actively with the National Federation of Municipal Analysts ("NFMA") on a number of projects designed to enhance secondary disclosure in the municipal market.²³ Most recently, the GFOA and the NFMA have announced their plan for a three part program to assist issuers in improving secondary market disclosure.²⁴ Under this plan, the GFOA and the NFMA would develop a handbook for issuers, which, among other things, would include information regarding how to use the MSRB's CDI system.

This plan also contemplates establishing a training program that consultants, state agency staff members, private companies, and trade groups could use to educate issuers on the use of both the handbook and the CDI system. In addition, the GFOA and the NFMA intend to develop a marketing strategy for the handbook and the CDI system.²⁵ I am heartened by the extent of the cooperation between two such influential industry groups as the GFOA and the NFMA. I applaud their efforts in this area to date and encourage further future efforts.

Two other NFMA actions designed to advance secondary disclosure in the municipal securities marketplace are also noteworthy. First, in January of 1992, the NFMA introduced its Certificate of Recognition program through which it recognizes municipal issuers that provide ongoing audited financial statements and other such information relevant to their outstanding securities. I further understand that the GFOA encourages its members to participate in this program.

In addition, the NFMA issued its Model Language Resolution, calling for municipal bond official statements to disclose, at the time of sale, the extent of issuer commitments to provide secondary market disclosure of financial and credit information. I understand that, to date, nearly one hundred issuers nationwide have pledged to provide such ongoing information.²⁶ The MSRB's recently announced secondary market disclosure initiative appears to be leading toward imposing similar disclosure on broker-dealers. I hope that the NFMA

pledge and/or the MSRB's recently announced initiative will eventually trigger a market pricing and demand reaction to issuers who are forthright in their voluntary dissemination of future credit information.

Further, a number of prominent bond attorneys have decided, correctly in my view, that existing securities regulations, which require timely disclosure of all material information, in effect, require issuers to identify what continuing disclosure they are obligated to make by contract and by law, and what they plan to do as a matter of policy.²⁷ By stating clearly what information will be made available and to whom, an issuer arguably has satisfied this aspect of the materiality disclosure standard, and the marketplace is then in a position to react accordingly. The MSRB's recently announced secondary market disclosure initiative also appears to conceptually endorse the view that this information is material and should be disclosed to investors in a timely manner. Again, it is my hope that, over time, the marketplace will reward those issuers who pledge to provide secondary market disclosure with a "liquidity premium."

In order for secondary market disclosure initiatives to work, the disclosure provided must be designed to inform investors and must be cost-effective. The usefulness of this information to investors, of course, will depend upon its timeliness, reliability, relevance, and accessibility. In terms of cost-effectiveness, frequent issuers will receive more benefits and experience lower marginal costs from providing disclosure to the market than will infrequent issuers. Moreover, for many small issuers that go to market infrequently, the economic benefits obtained from providing secondary market disclosure may not justify the costs.

One major problem will be to find the right balance of disclosure that will

satisfy investors but will not impose excessive costs on issuers. This is why the joint GFOA/NFMA projects to provide issuers with standardized methods of disseminating secondary market disclosure are so important. I must note here that in January, the NFMA approved the first standardized format for tax-exempt issuers and trustees to use for providing disclosure to the secondary municipal securities market.²⁸ It is my hope that improved, cost-effective, and more frequent secondary market disclosure by the appropriate issuers will result from these efforts.

The lack of secondary market disclosure will continue to impede the liquidity and efficiency of the municipal securities secondary market for some time to come. The heightened awareness of this problem in the industry, however, indicates that the pace with which improvements are made should be increasing. I hope that soon municipal securities secondary market disclosure will improve dramatically through such voluntary means.

IV. Regulatory and Legislative Alternatives

Having outlined the need for secondary market disclosure in the municipal securities market, as well as having pointed out some of the more noteworthy voluntary efforts to improve such disclosure, I must emphasize that, although I prefer to see adequate disclosure established in the market through voluntary means, my patience is growing increasingly thin. The most effective way of achieving such disclosure would be through regulation or legislation.

Some market participants already appear to prefer immediate regulatory action over waiting for voluntary efforts to bear fruit. A study conducted late last year by the NFMA indicates a significant number of municipal analysts and

institutional investors apparently would favor Commission requirements compelling issuers to disclose whether they will provide periodic reporting, and even a higher number would favor Commission requirements compelling issuers to provide such periodic reporting.²⁹

One option, if rulemaking action is deemed necessary, would be for the Commission to adopt a rule, along the lines of Exchange Act Rule 15c2-12, which would require securities professionals to have considered material, current information from issuers before recommending a municipal security trade in the secondary market. If this approach were to be taken, the Commission first may need to spell out in more detail the existing primary disclosure responsibilities of issuers as well. This approach, although awkward, has some merit and is attractive to me. The continuing absence of substantial progress through voluntary efforts could prompt such regulatory action to establish minimum secondary market disclosure standards.

I believe that a strong argument can now be made that the Commission should attempt to establish minimum secondary market disclosure standards in the municipal securities market through a rulemaking effort. Unfortunately, as a result of jurisdictional limits now imposed on the Commission, such a rulemaking effort does become rather awkward. I would prefer that any such rulemaking effort include issuers directly, and that approach may be difficult to utilize without legislation.

It appears to me that municipal issuers, except possibly in the case of issues less than \$1 million and in the case of state general obligation issues, should be subject to mandatory, minimum secondary market disclosure

standards. Certainly those issuers have primary disclosure responsibilities in accordance with the federal securities anti-fraud provisions. Although as a native of the deep south, I am sensitive to state's rights concerns, the state's rights argument against the imposition of such standards goes out the window in my view when securities are offered to an out-of-state investor. However, as I indicated, legislation may be necessary to implement directly such a regulatory scheme.

Congress, too, appears impatient with the industry's voluntary efforts. A bill was introduced in the U.S. House of Representatives this summer by members of the House Banking Committee which would, among other things, repeal the Tower Amendment and require municipal bond market professionals (including underwriters and bond lawyers) to disclose all political contributions made to elected officials of the political subdivision whose securities are being issued.³⁰ Moreover, members of the House Energy and Commerce Committee have requested that the Commission report on the adequacy of existing municipal securities market regulation. As a part of their request, these representatives have asked the Commission to evaluate whether the Tower Amendment should be repealed, either in whole or in part. Hearings are expected to be conducted by the House Energy and Commerce Committee on this subject in September.

While the Commission has not yet decided what, if any, legislation it will recommend to the Energy and Commerce Committee, a number of alternatives are being considered. One possible recommendation is to amend the Exchange Act to provide the Commission with a specific grant of authority over municipal securities issues. This would clarify the Commission's oversight responsibilities

in this area and would offer additional authority for Commission rulemaking. It would also eliminate the awkwardness present in the currently available regulatory alternatives. Although I recognize that achieving the congressional consensus necessary to enact such legislation would be a formidable challenge, I am strongly considering advocating this approach, at least as a backup in the event that the currently available rulemaking alternatives are not effective.

Another possibility would be for the Commission to recommend that different types of municipal issues be subject to different secondary market disclosure requirements. Some studies, including the NASACT fourteen state study, have shown that significantly more information is available for general purpose units of government than for special purpose units, institutions without general purpose government oversight, and conduit issuers. In addition, some studies have shown that many bond defaults come from unrated issues and, more specifically, that most of these defaulted issues are related to private activity or special district financings.³¹ Perhaps in varying the extent of federal oversight, Congress could avoid subjecting all municipal issuers to more arduous and burdensome disclosure requirements than are necessary and could avoid sweeping the industry with an over-broad broom. However, this latter approach also could very quickly become awkward and could just as easily bog down in a series of legislative definitional struggles.

I suppose yet another approach to this issue would be neither to engage in a rulemaking effort, nor to seek legislation, but rather to wait and see what the MSRB secondary market disclosure initiative develops into and what that initiative is capable of accomplishing. While I have become fairly frustrated at

the rate of progress on improving the state of secondary market disclosure in the municipal securities market, I also recognize that sometimes "haste does make waste."

V. Conclusion

Although, other than in the tax-exempt money market fund area, I am not at this time advocating a regulatory or legislative approach mandating minimum secondary market disclosure standards, I am leaning in that direction. I believe that the municipal securities marketplace could voluntarily impose its own secondary market disclosure discipline in a manner that provides economic benefits to all concerned but to date has not.

I do believe that it is important that municipal securities market participants continue to make progress with the voluntary initiatives underway. The integrity of the municipal securities market is now being challenged, and improving secondary market disclosure could help shore up this market's integrity. While I commend the many efforts made in developing voluntary initiatives in this area as of late, I must also emphasize my frustration that these initiatives have not yet met with wider acceptance. I recognize that NASACT has been active in this area, with the most recent example being the Report of the Blue Ribbon Committee on Secondary Market Disclosure being released this week. I encourage the members of NASACT to intensify efforts to accelerate the voluntary pace of improvements in this area.

ENDNOTES

1. See "Municipal Market Update," Public Finance Digest, a newsletter published by the Government Finance Group, Inc. (Jan. 1993), at 1.
2. See Mitchell, "Municipal Bond Issuance Leaps Despite Investigations," The Wall Street Journal (July 1, 1993), at 10.
3. Id.
4. The Wall Street Journal (August 11, 1993), at A1.
5. Mitchell, supra note 2. See also Fuerbringer, "Corporate Issues Drop Off in April," The New York Times (April 27, 1993), at D16.
6. See King, "Mutual Funds Top Insurers as Holders of Tax-Free Debt," The Bond Buyer (Oct. 7, 1992), at 1; King, "Continued Rise Seen for Municipal Stakes Held by Households and Mutual Funds," The Bond Buyer (Dec. 18, 1992), at 1; Davies, "House Panel Wants to Hear SEC Views on 'Cherry Picking' Practices by Dealers," The Bond Buyer (April 1, 1993), at 1.
7. Talley, "Banks, Hit by Bond Fire, Nearly Doubled Muni Fund Offerings Since End of 1991," The Bond Buyer (June 30, 1993), at 1.
8. "Majority of Investors Considering Municipal, MBIA Survey Reports," The Bond Buyer (April 6, 1993), at 2.
9. See Schifrin, "Hello, Sucker," Forbes (Jan. 18, 1993), at 40; Wayne, "The Fuss Over Nonrated Bonds," The New York Times (Jan. 24, 1993), at F15. See also Long, "How S&P Will Weigh Funds Holding Unrated Municipals," American Banker (August 3, 1993), at 11. According to one survey, disclosure problems are greatest among bonds for hospitals, nursing homes, and other facilities that are issued by authorities created by local governments, and not by the local governments themselves. Analysts speculate that such bonds are a problem because their issuers are "often nothing more than paper creations organized by bond dealers and local government officials." Quint, "Aiming For More Data About Municipal Bonds," The New York Times (June 28, 1993), at D5.
10. The Bond Investors Association, for one, has complained vociferously about the failure of Mutual Benefit Life to identify which of its guaranteed bond issues are self-funding and which are running negative cash flows.

11. Herman, "Municipal-Bond Holders: Watch Out for 'Call' Shock," The Wall Street Journal (Aug. 29, 1992), at C1; Gasparino, "Balancing Budgets Through Lease Deals May Pose Credit Risks, Rating Agency Warns," The Bond Buyer (Jan. 25, 1993), at 1.
12. Hume, "Rise in Re-Refundings of Escrowed Bonds Likely to Gain Attention at Treasury, SEC," The Bond Buyer (May 12, 1992), at 1.
13. The bond call problem may be exemplified best by the controversial decision of Memorial Health Services, a non-profit medical center in California, to redeem certain bonds that had been escrowed to maturity. See Walters, "Dealer Asks SEC to Investigate Call by Hospital in California," The Bond Buyer (Oct. 21, 1992), at 1.
14. See, e.g., Dickson & Pressman, "Consolidated Armacon Ties Raise Securities Law Questions," The Bond Buyer (June 4, 1993), at 1; Wilke, "Massachusetts is Roiled by Bond Scandal," The Wall Street Journal (July 21, 1993), at C1.
15. See, e.g., Stamas, "Dingell, Markey Extend Deadline for Regulators' Response on New Rules," The Bond Buyer (July 8, 1993), at 1; Stamas & Racine, "SEC Alters Its Request To Obtain Information On Political Donations," The Bond Buyer (August 3, 1993), at 1.
16. See, e.g., Stamas, "Coming MSRB Ban on Political Contributions Would Bar Both Direct and Indirect Donations," The Bond Buyer (August 6, 1993), at 1; Harlan & Vogel, "Bond Group Moves to Curb Political Gifts," The Wall Street Journal (August 5, 1993), at C1.
17. See, e.g., Vogel, "Furor Over Munis May Spur Competitive Bids," The Wall Street Journal (August 12, 1993), at C1; Napach, "More Munis Seen Going to Lowest Bidder," Investor's Business Daily (June 9, 1993), at 1.
18. See, e.g., "Sleazy - America's Municipal Bonds," The Economist (June 12, 1993), at 90.
19. See, e.g., comments from industry participants in Stamas, "Lawyers, Analysts Like MSRB Contributions Proposal; Underwriters Still Don't," The Bond Buyer (August 11, 1993), at 5.
20. Stamas, "MSRB Sets Jan. 21 to Launch its Pilot Program for Improving Disclosure in the Secondary Market," The Bond Buyer (Jan. 15, 1993), at 7. The MSRB's Continuing Disclosure Information Pilot System ("CDI") was approved by the Commission in Securities Exchange Act Release No. 30556 (Apr.

- 6, 1992), 56 FR 12534. The CDI project functions as part of the MSRB's Municipal Securities Information Library, which was approved by the Commission in Securities Exchange Act Release No. 29298 (June 13, 1991), 55 FR 28194.
21. Stamas, "SEC Officials Say They May Seek Rule Requiring Disclosure In Secondary Market," The Bond Buyer (June 23, 1993), at 1; Quint, "Aiming for More Data About Municipal Bonds," The New York Times (June 28, 1993), at D5; Stamas, "MSRB Asked to Help Finance Secondary Market Disclosure Initiative," The Bond Buyer (August 4, 1993), at 2.
 22. Stamas, "Panel is Formed To Help Out States In Their Collection of Continuing Data," The Bond Buyer (Nov. 16, 1992), at 1; Stamas, "Blue Ribbon Panel Seeks To Upgrade Secondary Market Disclosure Data," Public Finance/Washington Watch (Nov. 13, 1992), at 7.
 23. For example, the GFOA and the NFMA have collaborated on an Illustrations and Examples of Disclosure publication, which, among other things, will provide examples of, and worksheets for, secondary market disclosure for general obligation, revenue, and special district bonds. See "Muni Issuers, Analysts Join Forces on Secondary Market Info," Wall Street Letter (Sept. 14, 1992), at 6. This publication should be a useful supplement to the NFMA's Disclosure Handbook for Municipal Securities, the NFMA's 1992 Update, and the GFOA's Disclosure Guidelines for State and Local Government Securities. See generally, "Shall We Dance? Disclosure and the National Federation of Municipal Analysts," The Bond Buyer (May 19, 1993), at 6A.
 24. See Stamas, "MSRB Asked to Help Finance Secondary Market Disclosure Initiative," The Bond Buyer (August 4, 1993), at 2. The GFOA and the NFMA have requested funding from the MSRB for this project.
 25. Id.
 26. Stamas, "Lawyers, Analysts Like MSRB Contribution Proposal; Underwriters Still Don't," The Bond Buyer (August 11, 1993), at 5.
 27. See Stamas, "Issuers' Intentions on Secondary Disclosure are Starting to Appear in Official Statements," The Bond Buyer (Dec. 14, 1992), at 1.
 28. See Stamas, "Analysts Group Approves Standardized Disclosure Format," The Bond Buyer (Feb. 1, 1993), at 5.

29. "Membership Survey Results," Municipal Analysts Bulletin, a newsletter published by the NFMA (Nov. 1992), at 3. According to this survey, almost 60% of the analysts and over 80% of the institutional investors surveyed supported the proposition that the Commission should require issuers to disclose whether they would provide periodic reporting. Moreover, almost 75% of the analysts and almost 80% of the institutional investors surveyed supported the proposition that the Commission should require issuers to provide such periodic reporting.
30. "House Seeks To Increase Disclosure On Municipal Bonds," The Wall Street Journal (June 22, 1993), at C24. The bill was introduced by Representatives Henry Gonzalez (D., Texas) and Jim Leach (R., Iowa).
31. See, e.g., Letter from Victoria Westall and Richard Ciccarone, Chairpersons of the NFMA Board of Governors and the NFMA Standards and Practices Committee, respectively, to Harold L. Johnson, Deputy General Counsel, MSRB (Dec. 16, 1992) (citing data compiled in 1992 by the Bond Investors Association, showing that 64% of all municipal bond defaults between 1980 and 1992 were unrated issues, and that the majority of these defaulting unrated issues were related to private activity or special district financings).