WILL IT WORK?

RECOGNIZE THIS PLACE?
WE SHOULD – WE'VE BEEN HERE BEFORE!

CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

THE BOND BUYER

RE-WRITING THE RULEBOOK: *Regulatory Change and the Municipal Market*

Pre-conference to The Bond Buyer's

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Outline of Remarks by:
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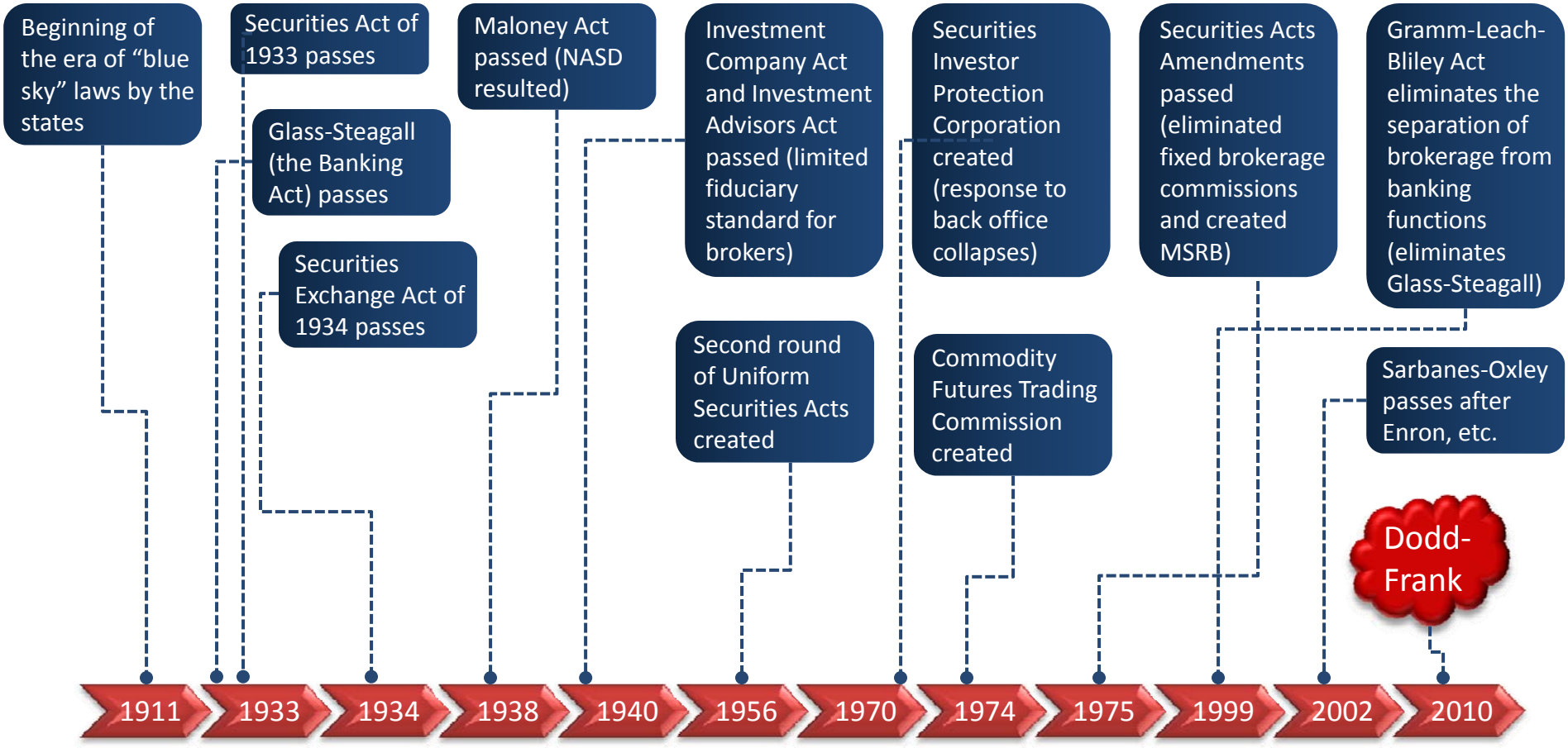
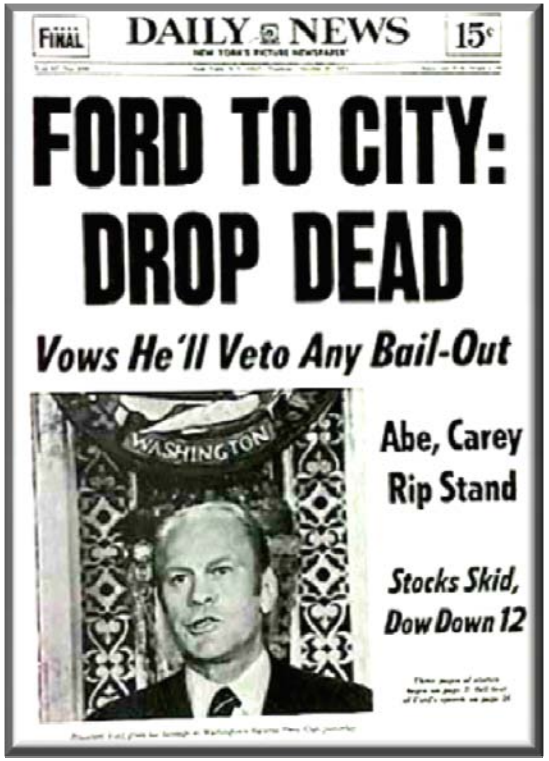
Major Securities Laws Aren't New . . .



MUNICIPALS CAME LATE TO THE PARTY . . . .



Before 1975 – Despite outstanding debt of as much as $50 billion, there was essentially no regulation of municipal securities.

1975 – New York City's moratorium on payment of short-term debt, and especially the events leading up to the moratorium, changed that. So did abundant abuses in the secondary market. Securities Acts Amendments were adopted, including the "Tower Amendment," which specifically exempted regulation of issuers.

Later, President Ford reverses his position displayed in the headline to the left and signs Federal legislation that guarantees $3.0 of New York City debt

November 1975: the MSRB establishes the foundation of the regulatory framework that focused on . . . .

- ✓ Registration of the <u>people</u> instead of the <u>securities</u>

1976 – 1978 the MSRB establishes administrative rules (the "A" rules) and early, foundational rules for governing certain practices and behaviors:

1. Standards of professional qualifications (G- 2)
2. Uniform practice rules for trade confirmations, settlements, etc. (G-12)
3. Underwriting practices (G-11)
4. Fair practice rules, including suitability & pricing (G-17)
5. Standardized yield comparisons (G-13 &G-15)

Supreme Court defines "materiality" in *TSC Industries, Inc. v. Northway, Inc.,* no more *"I'll know it when I see it."*

Thirty-Five Years Later, We've Got Even More Rules . . . .

1989 –SEC adopts Rule 15c2-12, the "reasonable basis" rule, requiring underwriter to obtain agreement from issuer to furnish official statement.

1990 – MSRB adopts rule requiring submittal of official statements

1993 – SEC releases staff report with recommendations for improving the municipal securities market in general.

1994 – MSRB adopts Rule G-37 – the "pay-to-play" rule following what SEC Chair described as "the continuing problem of political influence and patronage."

1994 – SEC expands Rule 15c2-12 to require continuing disclosure "to deter fraud and manipulation in the municipal securities market."

1996 – MSRB adopts Rule G-38, requiring reporting of third-party "finders."

2000 – SEC adopts Regulation FD, requiring issuers who disclose material information to analysts to release also to the general public.

2006 – MSRB releases a conceptual framework for establishment of an "all electronic" disclosure system – later called "EMMA."

2007 – SEC Chair decries proposals by several states to enact legislation enabling avoidance of GASB standards for financial reporting.

2009 – MSRB begins releasing market statistics on EMMA.

2008 – SEC expands Rule 15c2-12 to designate EMMA for secondary disclosure, eliminate materiality determinations for certain events and add some new.

2010 – Rule G-37 expanded to include reporting of financial support to ballot campaigns.

. . . . AND, WE STILL HAVE SERIOUS PROBLEMS

JEFFERSON COUNTY

Who should have been protecting whom?

The distinction between suitability and fiduciary duties.

The role of disclosure to <u>decision-makers</u>, not just investors.

The genesis of some of the new regulation of municipal advisors.

HARRISBURG

"Safe sector" credits maybe aren't as safe as we thought.

The critical difference between "ability to repay" and "willingness to repay" when politics don't align.

Disclosure: *". . The City's current financial situation precludes us from making any transfer to fund for these debt service payments at this time. Please inform all appropriate parties accordingly."*

VALLEJO

The importance of adequate disclosure about labor agreements and the potential future impact of them on the issuer's financial operations.

Getting "bankruptcy smart" is a decidedly new skill for municipal buyers and market participants alike. Is it a harbinger of things to come?

BELL

Disclosure. Again.

Despite continuing disclosure filings about rating changes on the City's GO bonds and taxable pension bonds, there has not yet been any additional disclosure on other events such as (a) the state-ordered refund of property taxes; or (b) the recent arrest of eight City officials on charges of alleged corruption.

This Time, It's Different . . . . or, Is It?

Financial legislation by the pound:

1. The Federal Reserve Act (1913): 31 pages
2. The Glass-Steagall Act (1933): 37 pages
3. The Sarbanes-Oxley Act (2002): 66 pages
4. The Securities Acts Amendments (1975): 75 pages
5. The Gramm-Leach-Bliley Act (1999): 145 pages
6. The Dodd-Frank Act (2010): 2,300 pages

Of course, the devil is in the details. With so much regulatory action required, it's probably too early to say just how different. Many are still trying to read the doggone thing! And, others in the Congress are already trying to "fix" it!

The bill claims to "fix" some problems:

- ☑ Registers advisors
- ☑ MSRB membership altered
- ☑ Fiduciary standard for advisors

But, leaves other important issues unresolved:

- ☐ Improvements to disclosure protocols
- ☐ Fiduciary standards for others
- ☐ Scope of advisor activities affected

What Makes it Different

- MSRB reconstituted
- SEC's Office of Municipal Securities grows in prominence.
- Numerous studies ordered, including a new look at the Tower Amendment (*"advisability of repeal"*).
- Sale of derivatives to state and local governments regulated.
- Municipal "advisors" (goes way beyond yesterday's "financial advisors") are now held to fiduciary standard – likely to be similar to standards imposed on investment advisors.

- Municipal "advisors" (goes ***way beyond*** yesteryear's "financial advisors") are now held to fiduciary standard – likely to be similar to standards imposed on investment advisors.
- Municipal advisors must register with SEC – stand by, there will be more than we think!
- Specific anti-fraud provision aimed directly at municipal advisors.
- SEC given specific, significant authority over activities of municipal advisors.

Making Sense of It

1. ***Must "middle-market" issuers develop the skills required to understand, analyze, then implement increasingly complicated financial "products" offered by Wall Street firms*** (and others) in order to reconcile them with "good" public policy and standards of prudence? Will anyone be left to help them?

2. The pool just got a lot bigger. The municipal advisory community will have to learn to "go big" or "go home." Many wanted the "legitimacy" implicit in governmental registration. Now we've got it. The question is: ***"What will we do with it?"***

3. Significant risks will always be present in land development deals, many redevelopment deals, health care issues, most industrial development issues, and almost anything that is tied to economic development, including tourism and sports facilities. ***How will a fiduciary duty be fulfilled in those environments?***

4. Will state and local issuers ever come to grips with absolute need for improved disclosure and take measurable steps to improve the quality and timing of it? Will the lack of such improvements "freeze out" the smaller issuers and make the market a place only for the most experienced and sophisticated? ***In other words, is that sunshine ahead, or is it an oncoming train? Is Tower at risk?***

Will it Work?

"What this all means is, it depends."

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