



October 6, 2010

The Honorable Elisse B. Walter  
Commissioner  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Subject:** NFMA Comments on “The State of the Municipal Securities Market”

Dear Commissioner Walter:

The National Federation of Municipal Analysts (NFMA) appreciates the opportunity to provide comments to the Commission on “The State of the Municipal Securities Market.”

The NFMA was established in 1983 with the goals of providing an informed perspective in the formulation of legal and regulatory matters relating to the municipal finance industry, improving primary and secondary disclosure in the municipal market, and promoting professionalism in municipal credit analysis. NFMA membership includes approximately 1,000 members, most of whom evaluate credit and other risks of municipal securities. These individuals represent many of the participants in the municipal market, including mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

As we have previously commented both publicly and privately to Commissioners and staff members, the NFMA believes that disclosure in the municipal market has made great strides in the last sixteen years since the adoption of the 1994 Amendments to Rule 15c2-12, and in the last six years since the establishment of the Central Post Office. We would also like to applaud the MSRB on its prodigious efforts to launch EMMA, which provides both issuers and investors with the single location each side has been seeking to deliver and retrieve disclosure documents.

In general, the NFMA believes that primary-market disclosure has improved over the last 20 years, with some sectors of the market having made greater strides than others. We began making recommendations on disclosure in 1990 with the publication of the NFMA Disclosure Handbook, and have continued with almost annual publications or comments on the issues, including sixteen Recommended Best Practices in Disclosure or White Papers on various sectors in the market. Issuers in many sectors have responded to our suggestions with improved information in official statements.

However, despite these achievements, disclosure in the municipal market continues to trail substantially that of other areas of the US financial markets, while the municipal market has become far more complex than it was in 1994.

## **The State of the Municipal Market: Large and Complex**

As municipal issuers have become involved in increasingly complex debt structures and financial engineering on par with some corporations, the level of disclosure has not increased accordingly. Historic arguments about the small size and simplicity of the municipal market no longer hold much water. For example, in the years prior to the recent financial crisis, the steepness of the yield curve and easy access to credit led even medium and small issuers to enter the auction-rate and variable-rate markets. In doing so, they accepted counterparty risk to banks, bond insurers and swap providers; basis risk for many of the swaps they executed; as well as the risk of acceleration of debt repayment. Issuers, not all of them large and sophisticated, have paid out hundreds of millions of dollars in swap termination and debt restructuring fees in the last few years. Whether these were appropriate risks for some issuers or whether they knew what they were getting into is not the point at hand here. The point is that none of these risks are representative of a small and simple market. Similarly, many issuers have taken advantage of a federally subsidized program, the Build America Bonds program, to reach out to non-traditional investors in the municipal market, including international investors. Again, this is not characteristic of a simple market.

The NFMA believes that the municipal market has become large enough and complex enough to warrant a more comprehensive and streamlined approach to the disclosure process. We do not believe that the municipal market lends itself to a one size fits all approach to regulation but there should be a few basic requisites to participation in the public markets: the issuance of audited GAAP financial statements within 150 days of the fiscal year end, an annual demonstration of compliance with financial covenants contained within the bond indenture or resolution, such as debt service and liquidity coverage, as well as quarterly unaudited financial updates to include information specifically related to the pledged source of revenues. Beyond these basic requirements, given the differences among issuers and debt instruments offered in the municipal market, it is difficult to prescribe specifics for either the contents of official statements or financial statements.

The aforementioned requirement to issue audited GAAP financial statements within 150 days of the fiscal year end may result in the issuance of financial statements that contain less information than a Comprehensive Annual Financial Report as designated by GASB. We would take the opportunity to point out that the CAFR is intended to address a far wider audience with different informational needs than those of investors, and that the more streamlined financial reports would solely be intended to meet the market’s needs, and are not intended to replace the CAFR.

## **The Current State of Official Statements**

The information included in official statements has made great strides in the last decade or so. Many issuers and issuer groups have responded to recommendations from the NFMA and other industry groups on this subject with substantial improvements. However, a few items continue to have room for improvement. When a new issue comes to market, the offering documents should include the most recent audited financial statement and often include a three or five year historical table of the issuer’s operating funds and balance sheet, but often there is very little up-to-date information. There appears to be a misperception among many in the issuer community that they should limit their financial disclosure to audited information. Given that most issuers

only undergo audits annually with delivery of such at a substantial lag after the end of the fiscal year, this often results in fairly stale financial information being included in offering documents. While this situation has improved in the last few years, perhaps in response to the financial crisis, it is still fairly common to see an official statement that only includes audited financial information that is six to nine months old. The NFMA recommends that, in addition to the most recent audited financial statements and annual operating information, an official statement should also include more timely unaudited quarterly or semi-annual financial and operating information, as well as up-to-date collections information for the revenues which are securing the bonds in question.

In addition to the lack of timely financial information, official statements also often lack detailed disclosure of an issuer’s debt profile. The total amount of debt outstanding is not sufficient in an age when an issuer may have multiple liens within a particular security pledge, overlapping liens on a revenue stream or a complex debt portfolio that incorporates fixed-rate, floating-rate, variable-rate and put debt, and the need for continued market access in relation to existing, not just new money, debt.

### **The Current State of Secondary Market Disclosure**

With regard to secondary market disclosure, our comments are far less glowing. Secondary market disclosure continues to be spotty, particularly among infrequent issuers and those who have historically issued only with primary market bond insurance. These are typically smaller, less sophisticated issuers, but there are many of them, so these situations arise frequently.

The major challenge in secondary market disclosure continues to be the timeliness and completeness of filings. While most issuers meet their promised deadlines for filing financial updates, the deadlines are typically 270 days after the end of the issuer’s fiscal year, at which time the information is significantly out-of-date. These deadlines compare very poorly to those which corporate issuers must meet, and are further exacerbated by issuers who do not meet their deadlines and may extend their filings to a year or more. This behavior is not limited to small issuers. For example, one of the largest counties in the Midwest allows themselves fifteen months to file their annual financial reports and, on occasion, misses that deadline, as well. Regardless of the low default rate in the municipal market, investors should not have to wait for over one fiscal year to be updated on the financial strength of their investment.

We support the MSRB’s recommendation for issuers to adopt a shorter deadline of 150 days for filing financial statements down from the current 270 days. However, as the recommendations are subject to voluntary adoption by issuers, we are concerned that adoption will be limited to those issuers who already file within a shorter time frame and not by the greater municipal market.

In addition to more timely annual disclosure, for several years the NFMA has also been calling for interim financial disclosure from all issuers. Currently more frequent financial disclosure is generally limited to the healthcare sector and to some larger issuers who are in the market several times annually.

During the current recession, many state and local governments have experienced double-digit declines in revenues, including sales taxes, personal income taxes, property taxes and mortgage recording taxes, among others, all of which separately or jointly secure tax-exempt debt. Investors during the period were often left relying on financial information gleaned from newspaper articles because secondary market disclosure lagged so substantially and was so infrequent. Many issuers seem to believe that because the municipal market default rate is so low that investors should be content with annual updates. From our point of view, this was not a valid argument when over 50% of annual municipal debt issuance was insured, and it certainly is not valid now with bond insurance penetration below 10%.

The NFMA will continue to include recommendations for interim disclosure in its Recommended Best Practices papers but it has also begun working with the GFOA to develop guidelines for the issuance of more frequent, unaudited financial information by governmental issuers. The guidelines have not yet been completed, but we hope to arrive at agreement with the GFOA to recommend disclosure of unaudited quarterly financial information, likely limited to the balance sheet and income statement, with some minimal notes. As issuers already prepare interim statements for internal use, we do not anticipate that the additional step of filing a limited financial update for the market will present an undue burden, particularly given the user friendly format provided by the EMMA system. We are pleased about the GFOA's interest in working on this issue with us, and hope that issuers will rapidly adopt the recommendations once they are released. However, these will be guidelines only and, unless an issuer incorporates the more frequent releases in their continuing disclosure agreements, they will be entirely voluntary.

Another area of concern is an increase in incomplete filings. Most issuers include in their continuing disclosure agreements a list of items of information which were included in the official statement and which they promise to include in secondary disclosure filings. And many meet those promises for some period of time, but after a few years the filings may shrink to only the audited financial statements and the additional items of information disappear. These items may range from annual updates for assessed valuation, property tax delinquencies and tax appeals, all of which are critical for assessing a general obligation bond, to operating information for a water and sewer system, or patient data for a hospital, which are also vital to a thorough analysis of the associated bonds.

We do not want to suggest that this is a problem with all issuers; there are certainly particular sectors of the municipal market that do provide more frequent financial information, as well as many large and frequent issuers who are attuned to the needs of investors. Many large issuers are in the primary market multiple times during the year and so are required to provide more up-to-date information. Most, although not all, of the problem lies in the medium and small issuer portion of the market which has the largest number of constituents, given that the municipal market has over 50,000 issuing entities. While some might argue that the filings are an unnecessary burden, given the low rate of default among municipal general government issuers, we feel strongly that the issuers have availed themselves of the benefits provided by issuing debt in the public market and must be prepared to follow through with the promises they have made to investors to provide complete and timely information. Further, the ease of filing through the EMMA system greatly reduces the historic argument against more frequent financial disclosure.

For a clearer view of the timeliness of annual financial filings, we urge the Commission to request that the MSRB review the information in EMMA and issue a report detailing the current state of filings. EMMA has been the designated repository of annual financial filings for over a year now, and the information is captured in the system. For each issuer/obligor, EMMA contains both the stated filing deadline as well as when the information was posted to the system. The MSRB could issue such a report annually to include statistics on compliance with stated deadlines, as well as both the proportion of substantially earlier or later postings. The report could also include a list of all issuers/obligors that did not meet their deadlines.

We would also like to express concerns regarding the poor quality of material event filings. Our concerns relate to the timing and the completeness of filings, specifically that many notices are filed weeks or months after the event, or they are not filed at all. Most recently we have learned of issuers failing to report unscheduled draws on debt service reserve funds or credit enhancement policies, and the failure to file adverse tax opinions has been a perennial problem. There are numerous issuers currently under financial stress about whom newspaper articles frequently appear who have not released any updated information through EMMA. In many instances, issuers have cited the materiality standard in Rule 15c2-12, but one could argue that materiality is in the eye of the beholder and should not be left up to the determination of an interested party.

Finally, we support the Commission’s recent amendments to the Rule but are concerned that the amendments will only slowly and incompletely be applicable to the \$2.9 trillion in outstanding municipal market debt. Some portion of the municipal debt currently outstanding will never be subject to the amendments, leaving those investors at a disadvantage in making decisions as to the disposition of their investments. We feel strongly that the Commission should take the steps necessary to provide investors in all outstanding municipal debt the comfort of knowing that after they have purchased a municipal bond that they will have access to timely and complete information with which to make on-going decisions regarding those investments.

Sincerely,

/s/

Mary Colby  
NFMA Industry Practices and Procedures Chair



Cc: Martha Haines, Chief, Office of Municipal Securities, SEC