



**Remarks Of**

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**Update on  
Improving Secondary Market Disclosure**

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

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**I. Introduction**

**I recently was asked to prepare a short essay providing my thoughts on the impact of the Government Finance Officers Association's ("GFOA") Disclosure Guidelines for State and Local Government Securities ("Guidelines"). This is the fifteenth year since the Guidelines first were published. In this time, the practice of the industry, and the role of lawyers in the offering process, has changed substantially. In the early 1970s, official statements for traditional governmental issues consisted of only a few pages setting forth the terms of the offering. Moreover, some bond lawyers were willing to debate whether the federal securities laws even applied to municipal offerings. In the early 1970s, it may have been inconceivable to many, that bond lawyers would be meeting in a forum like this to discuss the federal securities law responsibilities of participants in the municipal securities markets.**

**Much has changed since the Guidelines first were published in 1976. Outstanding volume of long-term municipal securities has grown to over \$800 billion - roughly equivalent to the outstanding amount of corporate debt. Moreover, the transactions have become**

increasingly complex. The three page official statements of the 1970s now can exceed one hundred pages. Although the test of good disclosure should not be the number of pages in the official statement, there is an awareness of the requirements of the federal securities laws now that was not present as recently as a decade ago. The GFOA's Guidelines, new accounting standards, private litigation, and Commission releases, as well as investor demands, have led to improved disclosure in primary offerings.

II. Improving the Secondary Market

A. Recognize the Differences

Now, however, we are faced with a more difficult task of improving disclosure in the secondary market. As we begin to encourage issuers and trustees to supply information to the secondary market, we are confronted with an absence of guideposts that would lead us toward the solution of many difficult issues. Many of the Commission pronouncements, and many of the concepts developed over the past fifty years in the corporate

**equity markets, although derived from general antifraud principles, are not tailored to the unique nature of municipal securities transactions.**

**For example, in lieu of officers and directors, traditional governmental issuers have elected officials not schooled in the principles of the federal securities laws, and arguably are susceptible to less restraint than their corporate counterparts. Indeed, the concept of a "quiet period" seems antithetical to the "hurly burly," chamber of commerce world of state and local politics. One need only to have looked at the dialogue between officials of the State of Connecticut and of the City of Bridgeport to understand that financial matters of public issuers often are the matter of public debate. Moreover, unlike a corporation that can exercise significant controls over the release of financial information, public entities continually supply reports and projections for various purposes that could be relied upon by an investor in determining whether to purchase or sell an issuer's securities in the secondary market. In addition, in both the**

corporate debt and the municipal securities markets, we are just beginning to learn that concepts developed in insider trading cases involving the equities markets do not fit neatly in the municipal bond world. In short, the very different natures of the corporate and municipal issuer, and the markets in which their securities trade, present a variety of disclosure issues that have yet to be addressed.

**B. Investors Need Information**

At the same time, however, investors in municipal securities are growing increasingly dissatisfied with the continuing disclosure that is available to them. In the place of periodic reports required of public companies under the Securities Exchange Act of 1934, municipal investors may negotiate with issuers in each transaction to obtain continuing disclosure. In most cases, however, the investors will simply rely upon information that the issuer voluntarily supplies to the market. Or, they can obtain information indirectly through reports provided to a variety of state and federal agencies

and through official statements prepared in connection with more recent offerings.

The current problems experienced by investors, including tax-exempt money market funds, that invested in bonds insured by Mutual Benefit Life Insurance Company ("Mutual Benefit") illustrate the need for access to secondary market information in order to support liquidity in the bonds. As most of you will recall, in late July, New Jersey state insurance regulators seized Mutual Benefit, which had insured over \$650 million of industrial-revenue bonds financing forty-seven real estate developments. Coincidentally, at the same time, the rating agencies decided that Mutual Benefit no longer deserved their highest ratings. Within a matter of days, highly liquid bonds, many with variable rate demand features that offered investors seven-day puts, had become illiquid. In some cases, there was very little information about the underlying credit to support an investment decision, which caused any potential secondary market to evaporate.<sup>1</sup>

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<sup>1</sup> The problems experienced by Mutual Benefit investors also illustrate a point that the Commission and GFOA have made that credit enhancement does not obviate the need for disclosure

I realize that it is far easier to say that improved secondary market information is necessary than it is to confront the difficult legal and practical issues that would need to be addressed before improvement can take place. As everyone recognizes, the municipal markets include a large number of small and infrequent issuers whose securities rarely trade, and for whom the provision of ongoing information would entail unnecessary expenses.

Whether or not trading markets exist in their securities, for many issuers, a great deal of information is available. The National Association of State Auditors, Comptrollers and Treasurers, along with the GFOA, recently conducted a research project that looked at the amount of information concerning state and local issuers collected by four different states. Their report describes a multitude of types and sources of information concerning issuers in North Carolina, Texas, Ohio and California. The report describes information provided to state auditors, data centers, state building authorities, state housing finance agencies, state water

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concerning the underlying obligor - even in the context of short-term securities.

commissions, municipal advisory councils and local governments, among others. What is clear, is that there is not a dearth of information, but there may be a need for relevant, easily accessible information.

### III. MSRB Proposal

Many of you are aware that last June the Commission tabled a proposal by the Municipal Securities Rulemaking Board ("MSRB") to create a system that rapidly transmits pre-default notices from trustees to the market. The proposal, dubbed the Continuing Disclosure Initiative/Electronic Submission ("CDI/ES"), would have been limited initially in its scope, yet it could be expanded in the future to allow for the submission and dissemination of other types of relevant secondary market information. In fact, issuer groups, including the National Council of State Housing Finance Agencies and the National Council of Health Facilities Financing Authorities, as well as the American Bankers Association's Corporate Trust Committee, began efforts to develop uniform periodic reporting

formats in anticipation of disseminating the information through the MSRB's facilities.

Several Commissioners, particularly the Chairman, expressed concern about the initially limited scope of the MSRB's proposal, and the requirement that information be submitted only in electronic form. While I would eventually like to see a more comprehensive approach, there are a number of difficult issues that would need to be resolved before it will be prudent to undertake a more significant effort. Among other things, as I alluded to earlier, the secondary market information currently produced comes in a variety of formats that, in many cases, bears little resemblance to the periodic reports that are produced by public companies for Exchange Act purposes. Moreover, the MSRB, itself, is constrained from requiring issuers to submit information or to dictate the form and content of documents that are supplied.

The lengthy documents that municipal issuers use for other purposes, including comprehensive annual financial reports, may prove difficult to disseminate, and in some cases would provide

only limited marginal benefit to investors. In my view, it simply is not realistic to expect any repository to act as a dumping ground for useless information. Before an efficient central source of secondary market information can be established, the first step must be for issuers and investors to develop uniform forms that will present information that is relevant and can be economically justified.

Because of the diversity of this market, one size may not fit all. Work will need to be undertaken on a segment-by-segment, state-by-state, basis to produce acceptable formats for disclosure. Moreover, even in a voluntary system, norms will have to be created by the market that recognize the cost to issuers of producing secondary market information.

The Commission receives approximately 48,000 annual and quarterly reports yearly from public companies. Another 11,000 Form 8-Ks were received in 1990. The collection of these forms and the operation of a public reference facility entails a significant commitment of Commission personnel resources. At the

**Commission, the government is reimbursed for its operating costs through the trading and registration fees paid by issuers and broker-dealers.**

**While there are far more municipal issuers than public companies, most are smaller or infrequent issuers that are less likely to file continuing information. Nevertheless, collection and dissemination of continuing information by a relatively small percentage of these issuers could prove to be an expensive long-term commitment.**

**Who will bear the cost of what will likely be an expensive commitment to develop and operate a central storage facility? Ideally, private repositories would step forward and fund such a project in the municipal markets, with the expectation of recouping their costs by disseminating the information. Indeed, in limited segments of the market, they already have done so. However, there may be little incentive for private entities to pursue broader efforts if the product of their efforts, improved information, would immediately be made available to their competitors. Moreover,**

**because of the small number of nationally recognized repositories, anti-trust considerations may limit their ability to work jointly.**

**A central repository for secondary information surely will produce benefits for the market as a whole. I believe that the creation of such a facility must be viewed as a public utility. While it should ultimately be cost efficient, the expense of creating the facility and working to develop acceptable formats for disclosure should not fall disproportionately on the shoulders of any particular group, whether it be underwriters or issuers.**

#### **V. Conclusion**

**The market for municipal securities in this country is in good shape. But there is room for improvement. I would like to applaud the members of the MSRB for their decision last week to examine modifying their proposal for a central repository to include limited written, as well as electronic submissions. The MSRB's proposal, if approved by the Commission, will move municipal disclosure further along the road toward an efficient secondary market for municipal securities. The MSRB's effort, alone will not carry us all the way to**

**our destination. Further commitment will need to come from other segments of the industry, including lawyers, and, I wish to emphasize in closing, perhaps the Commission and Congress may also have a role to play.**