Risk Management Update
January 2011

REGULATORY UPDATE: CURRENT STATE OF THE MUNICIPAL SECURITIES MARKET

Municipal securities, including municipal bonds, comprise a $2.6 Trillion Market, two-thirds of which are owned by individual investors.[1] State and local governments annually issue such securities in an effort to raise money for schools, roads, hospitals and other needs of the municipality. In return for their investment(s), municipal securities holders receive principal and interest payments, many of which are exempt from federal and state taxes.

As the efficiency and health of the municipal market is vital to both investors as well as the general public, it is not surprising in this era of financial reform that the municipal securities market is receiving heightened attention from regulatory authorities such as the Securities and Exchange Commission ("SEC") as well as being subject to new rule proposals under the federal government's Dodd-Frank Financial Reform Act.

Most recently, two focus areas financial firms should pay close attention to include:

1. Heightened disclosure requirements and other transparency rules; and
2. Rules governing and requiring registration of Municipal Advisors with the SEC;

Heightened Disclosure Requirements (Effective 12/01/2010)

Historically, municipal securities, such as municipal bonds, have been exempt from the disclosure requirements of the federal securities laws. Thus, oversight of the securities by the SEC as well as the availability of disclosures for investors regarding the securities has been sharply limited. As adopted in 1989, SEC Rule 15c2-12 commenced scrutiny of the market, by prohibiting brokers, dealers, and municipal securities dealers from purchasing or selling municipal securities unless they reasonably believed that the state or local government issuing the securities had agreed to disclose such things as annual financial statements and notices of certain events, such as payment defaults, rating changes and prepayments.[2]

In May of 2010, Rule 15c2-12 was amended to provide for greater transparency and heightened disclosure requirements. Some of these disclosures include:

- Events that affect a bond's tax exemption
- Disclosure of Important Events; For purposes of this section, an important event includes:
  (1) failure to pay principal and interest;
  (2) unscheduled payments out of debt service reserves reflecting financial difficulties;

[1] http://www.sec.gov/news/press/2008/2008-286.htm.
[2] As seen at http://www.sec.gov/news/press/2010/2010-85.htm.

(3) unscheduled payments by parties backing the bonds, reflecting financial difficulties, or a change in the identity of parties backing the bonds or their failure to perform;
(4) defeasances, including situations where the issuer has provided for future payment of all obligations under a bond; and
(5) rating changes.

- Disclosure of such events within 10 days of occurrence
  - *Notices of the events listed in the rule must now be disclosed in a timely manner not more than 10 business days after the event.*

As stated by SEC Chairwoman Mary Shapiro, (these) "measures will strengthen existing requirements for the scope of securities covered, the nature of the events that issuers must disclose, and the time period in which disclosure must be made." [3] For more information, please visit: http://www.msrb.org/Municipal-Bond-Market.aspx.

Registration of Municipal Advisors

Furthering the trend of heightened oversight over the municipal securities market, the SEC has proposed further rules in support of the Dodd-Frank Financial Reform Act's ruling requiring the registration of Municipal Advisors. Using the Dodd-Frank definition of "Municipal Advisors," financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and certain swap advisors that provide municipal advisory services would be required to register with the SEC.[4]

As released by the MSRB, any municipal advisors who have engaged in any municipal advisory activities on or after October 1, 2010 must have registered with the MSRB by no later than December 31, 2010 in order to avoid violating MSRB rules.[5] Importantly, registration of municipal advisers must include registration with two regulatory bodies: the SEC and MSRB. [6] For information regarding registration with the MSRB please see: http://www.msrb.org/Rules-and-Interpretations/MSRB-Registration.aspx.

Similar to the registration requirements imposed upon investment advisers, under the new rule, municipal advisors will soon be subject to electronically filing a Form MA with the SEC. The Form MA involves more detailed information including identifying and contact information, as well as indicating the type(s) of municipal advisory activities in which they engage. Detailed disciplinary history, similar to what the SEC obtains from registered broker-dealers and investment advisers will also be required disclosures. Moreover, registrants must certify that they

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[3] As seen at http://www.sec.gov/news/press/2010/2010-85.htm.
[4] http://www.sec.gov/news/press/2010/2010-253.htm.
[5] Please see: http://www.msrb.org/News-and-Events/Press-Releases/Press-Releases/2010/MSRB-Reminds-Municipal-Advisors-of-Registration-Deadline-and-SEC-Guidance.aspx.
[6] *Id.*

have met or will meet the qualifications and regulatory obligations required of them and will amend the Form MA when the data provided becomes inaccurate. [7]

As the SEC has yet to finalize the rule governing the registration of municipal advisors, municipal advisors may temporarily satisfy the statutory registration requirement by submitting certain information electronically through the Commission's public website on the Form MA-T, which is designed for this purpose.[8] For information, including instructions for completing and filing Form MA-T, please visit the designated site at: http://www.sec.gov/info/municipal/form_ma-t.htm.

Conclusion

The SEC's heightened regulation of the municipal securities market is not surprising in light of the impact municipal securities have on the economy and society as a whole. The SEC has set up a series of hearings across the nation , with locations including San Francisco, California, Chicago, Illinois, Washington, D.C., Tallahassee, Florida, and Austin, Texas. The hearings are tasked "with the purpose of examining different sets of issues, including investor protection and education; financial reporting and accounting; market stability and liquidity; the Municipal Securities Rulemaking Board; municipalities as conduit borrowers; offering participants, professionals and market intermediaries; Build America Bonds; and 529 plans."[9] As a result of these field studies and hearings, it is foreseeable that additional rules and regulations governing the municipal securities market will be forthcoming in 2011 and beyond. CCLS will keep you posted as there are further regulatory developments.

Author: Nicole Miller; Editor: Michelle L. Jacko, CEO, Core Compliance & Legal Services ("CCLS"). CCLS works extensively with investment advisers, broker-dealers, investment companies, hedge funds, private equity firms and banks on regulatory compliance issues. For more information about this topic and other compliance consultation services, please contact us at (619) 278-0020, info@corecls.com or visit www.corecls.com.

[7] http://www.sec.gov/news/press/2010/2010-162.htm.
[8] http://www.sec.gov/info/municipal/form_ma-t.htm.
[9] http://www.sec.gov/news/press/2010/2010-164.htm.