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Report to Congressional Committees

July 2012

MUNICIPAL SECURITIES

Options for Improving Continuing Disclosure



GAO-12-698

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GAO Highlights

Accountability * Integrity * Reliability

Highlights of GAO-12-698, a report to congressional committees

Why GAO Did This Study

Municipal securities are debt instruments that state and local governments issue to finance diverse public projects. As of March 31, 2012, individual investors held up to 75 percent of the total value of municipal securities outstanding. These securities are exempt from certain federal disclosure requirements applicable to other securities sold publicly. Disclosure provided in the primary market, where these securities are issued, generally consists of official statements. Continuing disclosure is information provided in the secondary market, where these securities are bought and sold after issuance. The Dodd-Frank Wall Street Reform and Consumer Protection Act required GAO to review the information issuers of municipal securities must disclose for the benefit of investors.

This report addresses (1) the extent to which information currently provided on municipal securities is useful for investors and the extent to which existing regulations reflect principles for effective disclosure, and (2) options for improving the information issuers disclose to investors of municipal securities. To conduct this work, GAO reviewed disclosure rules and compared them with principles for effective disclosure cited by SEC and the International Organization of Securities Commissions, surveyed selected experts and market participants, and interviewed issuers.

GAO provided a draft of this report to SEC, MSRB, and the Financial Industry Regulatory Authority (FINRA). SEC and MSRB provided technical comments, which GAO incorporated, as appropriate. FINRA did not provide comments.

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What GAO Found

Market participants indicated that primary market disclosure for municipal securities—official statements—generally provides useful information, but investors and market participants cited a number of limitations to continuing disclosures. The most frequently cited limitations were timeliness, frequency, and completeness. For example, investors and other market participants said that issuers do not always provide all the financial information, event notices, or other information they pledged to provide for the lifetime of a security. While GAO's analysis of current regulatory requirements for municipal securities disclosure found that they largely reflected the seven principles of effective disclosure, regulators and market participants said that there are some limitations on the enforceability and efficiency of the regulations. However, the effect of these limitations on individual investors largely is unknown because limited information exists about the extent to which individual investors use disclosures to make investment decisions. Nevertheless, regulators remain concerned about this market, in part due to its size and the participation of individual investors. As discussed below, the Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB) have been taking or plan to take actions to improve disclosure.

Experts and market participant groups GAO surveyed suggested options for improving disclosure, some of which would require statutory changes while others could be achieved within the existing regulatory framework. One suggested statutory change was the repeal of the Tower Amendment, which some experts believed would allow federal regulators to directly require issuers to make disclosures, but SEC and MSRB staff did not agree. The Tower Amendment prohibits SEC and MSRB from requiring issuers of municipal securities to file certain materials with them. While MSRB and SEC staff said that repealing the Tower Amendment would remove the prohibitions on requiring issuers to file certain materials with them, they noted that it would have no real effect on what they can require issuers to disclose because municipal issuers are exempt from SEC registration and MSRB does not otherwise have affirmative authority to regulate municipal issuers. Other suggestions from experts and market participant groups requiring statutory changes included mandating accounting standards and requiring the submission of financial information at intervals more frequent than annually. Experts and market participant groups suggested other options to improve disclosure that could be achieved within the existing regulatory framework, including further improving and promoting MSRB's Electronic Municipal Market Access (EMMA) system, which since July 2009 has served as the official central repository for disclosures about municipal securities. While experts and market participants said that EMMA had greatly improved their access to information on municipal securities, many suggested that further enhancements to EMMA would increase the usefulness of the system to investors and issuers. MSRB issued a plan in January 2012 to improve EMMA and recently has taken steps to enhance EMMA's functionality. Further, SEC staff indicated their plan to release a staff report in 2012 to include recommendations on measures to improve primary and secondary market disclosure practices, market practices, and associated regulation.

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Abbreviations

CUSIP	Committee on Uniform Security Identification Procedures
EMMA	Electronic Municipal Markets Access
FASB	Financial Accounting Standards Board
FINRA	Financial Industry Regulatory Authority
GAAP	generally accepted accounting principles
GASB	Governmental Accounting Standards Board
MSRB	Municipal Securities Rulemaking Board
SEC	Securities and Exchange Commission
SRO	self-regulatory organization

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GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

July 19, 2012

The Honorable Tim Johnson
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

Municipal securities are debt instruments that state and local governments issue to finance transportation, housing, hospitals, education, and other diverse public projects.[1] The value of municipal securities outstanding was an estimated $3.7 trillion as of March 31, 2012, with individuals (also known as retail investors) holding 50 percent of the total outstanding directly, such as through purchases from broker-dealers, and up to another 25 percent indirectly through investment funds.[2] There are approximately 51,000 state and local government issuers of municipal securities and the number of separate outstanding municipal securities is estimated to be more than 1.3 million, according to information cited by the Securities and Exchange Commission (SEC).[3]

[1]For the purpose of this report, municipal securities are debt instruments issued by state and local governments. Municipal securities also include certain types of nondebt instruments (known as municipal fund securities) that include interests in 529 college savings plans. Practices with respect to municipal fund securities are beyond the scope of this report.

[2]Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the United States, June 7, 2012. Municipal securities are bought, sold, and underwritten by securities firms registered as brokers or dealers and by banks registered as municipal securities dealers (sometimes referred to as bank dealers). For purposes of this report, we collectively refer to securities firms and bank dealers that purchase, sell, and underwrite municipal securities as broker-dealers.

[3]In comparison, SEC reported in 2006 that there were 9,428 public companies in the United States with requirements to report information with SEC.

State and local governments account for 80 percent of the total outstanding.[4] Of the remaining 20 percent, corporate conduit borrowers (public and privately held companies) account for approximately 13 percent and nonprofit conduit borrowers (such as schools, health care providers, and nonprofit housing developers) account for approximately 7 percent.[5]

Concerns have been raised about whether investors—particularly retail investors—have access to enough information about municipal securities to make informed investment decisions. Some professional analysts also believe investors may be at heightened risk as states, municipalities, and other entities that issue debt struggle with the aftermath of the recent financial crisis and growing pension obligations. While the federal securities laws generally require certain disclosure in connection with the issuance of securities, Congress exempted municipal securities from the registration and periodic reporting provisions of the federal securities laws, but not the antifraud provisions. Furthermore, SEC and the Municipal Securities Rulemaking Board (MSRB) are not authorized to require issuers of municipal securities to file certain materials.[6] The specific prohibitions differ for each regulator, pursuant to provisions of the Securities Acts Amendments of 1975, generally known as the Tower Amendment.[7]

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directs us to conduct a study and review of the disclosure

[4]Flow of Funds Accounts, June 7, 2012.

[5]Corporate and some nonprofit borrowers access the municipal market through governmental issuers that act as conduits to the market.

[6]SEC is the primary overseer and regulator of U.S. securities markets and administrator of federal securities laws. MSRB is a self-regulatory organization (SRO) created in 1975 with the mission to protect investors, state and local government issuers, other municipal entities, and the public interest by promoting a fair and efficient municipal securities market.

[7]In the Securities Acts Amendments of 1975, Congress prohibited SEC and MSRB from requiring any issuer of municipal securities, directly or indirectly, to file with them prior to the sale of such securities any application, report, or document in connection with the issuance, sale, or distribution of the securities. Congress further prohibited MSRB from requiring any issuer of municipal securities, directly or indirectly, to provide them or a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to the issuer. Pub. L. No. 94-29, § 15B(d), 89 Stat. 97 (1975) (codified at 15 U.S.C. § 78*o*-4(d)).

required to be made by issuers of municipal securities.[8] This report addresses (1) the extent to which information currently provided on municipal securities is useful and the extent to which existing regulation reflects principles for effective disclosure, and (2) options for improving the information issuers disclose to investors of municipal securities, and the related benefits and challenges of these options.

To describe the extent to which information is useful for investors and the extent to which existing regulations reflect principles for effective disclosure, we reviewed SEC and MSRB rules, SEC and MSRB staff reports for improving disclosures, and comment letters submitted to SEC regarding its study of the municipal securities market. We reviewed disclosure information in the Electronic Municipal Market Access (EMMA) system, the official central repository for disclosures about municipal securities. We compared disclosure regulations with principles for effective disclosure from the International Organization of Securities Commissions (*Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities*) and SEC's Plain English Handbook. We reviewed independent and academic studies on the usefulness of disclosure information, and data on municipal securities defaults from independent research firms and rating agencies to understand the risks to investors of municipal securities. We worked through the American Association of Individual Investors to identify and interview 12 retail investors with diverse investment experience with municipal securities. For more perspectives of individual investors, we reviewed transcripts of SEC hearings on the state of the municipal securities market held in 2010 and 2011 and reviewed a study conducted for SEC on the usefulness of SEC-mandated disclosure documents. We also conducted a case study of 14 issuances and made observations about EMMA and the usefulness of the disclosures from the individual investors' points of view. We also interviewed institutional investors (including representatives of eight investment companies), professional analysts, an independent research firm, and groups representing market participants, including broker-dealers, bond lawyers, and municipal advisors. We interviewed staff of federal and state regulators, self-

[8]Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §976, 124 Stat. 1376, 1924 (2010). The act also requires us to examine the municipal securities market, a requirement that we completed in a separate report. See GAO, *Municipal Securities: Overview of Market Structure, Pricing, and Regulation*, GAO-12-265 (Washington, D.C.: Jan. 17, 2012).

regulatory organizations (SRO), and associations, including SEC, MSRB, the Financial Industry Regulatory Authority (FINRA), and the North American Securities Administrators Association.[9]

To identify options for improving the information issuers disclose to investors, we reviewed securities laws, regulations, and guidance. We also reviewed SEC and FINRA examination manuals for SEC Rule 15c2-12, which establishes requirements for the underwriters of municipal securities, and reviewed data on examinations that found violations of the rule.[10] Furthermore, we surveyed experts and groups representing issuers and other market participants, such as municipal advisors, broker-dealers, and professional analysts. We used a nonprobability sampling method to identify and select experts by obtaining referrals from other market participants, experts, and regulators. Although our results are not generalizable, our survey covered a diverse group of experts and market participant groups with broad and differing perspectives. We administered the survey to 26 experts and 29 market participant groups and received responses from 21 experts and 21 groups. To identify the benefits and challenges of these options, we interviewed issuers in three groups representing (1) large and frequent issuers, (2) small and infrequent issuers, and (3) conduit issuers. To provide information about options for improving disclosure information and related benefits and challenges, we also drew on the interviews we conducted with investors, regulators, and market participants.

We conducted this performance audit from June 2011 to July 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I provides a more detailed description of our scope and methodology.

[9]FINRA is an SRO that regulates 98 percent of the broker-dealers that trade municipal securities. NASAA is a membership organization representing state securities agencies.

[10]For the text of SEC Rule 15c2-12, *see* 17 C.F.R. § 240.15c2-12.

Background

SEC and MSRB are the primary entities that have authority at the federal level with respect to disclosure to investors in municipal securities. In the context of municipal securities, SEC interprets and enforces the federal securities laws, including by adopting rules and enforcing antifraud provisions; maintaining regimes for the registration, compliance, inspection, and education of broker-dealers, investment advisers, and municipal advisors; and providing general educational materials for investors about investing in municipal securities.[11] SEC also oversees MSRB and FINRA. MSRB maintains an online repository of information (that is, EMMA) to promote market transparency, for example, by providing access to primary market and continuing disclosures and information about trade pricing.[12] MSRB also provides educational materials to investors and issuers of municipal securities. MSRB regulates brokers, dealers, municipal securities dealers, and municipal advisors in the municipal securities market by adopting rules governing their conduct, which are subject to SEC approval. However, MSRB does not have authority to enforce these rules or examine entities for compliance with these rules. Rather, SEC, FINRA, and bank regulators enforce MSRB rules and conduct compliance examinations.[13]

The Tower Amendment prohibits SEC and MSRB from directly requiring state and local governments to submit information to them prior to sale. Specifically, SEC and MSRB cannot require issuers to file any information

[11]Section 15B(e)(4)(A) of the Exchange Act, as amended by the Dodd-Frank Act, defines the term municipal advisor to mean a person (who is not a municipal entity or an employee of a municipal entity) that (1) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues, or (2) undertakes a solicitation of a municipal entity. According to SEC, the statutory definition of a municipal advisor is broad and includes persons who traditionally have not been considered to be municipal financial advisors. Pursuant to the Dodd-Frank Act, SEC has issued a proposed rule requiring the registration of municipal advisors with SEC, which includes an interpretation of the term municipal advisor.

[12]Disclosure required in the primary market, where these securities are issued, consists of official statements. Continuing disclosure is information provided in the secondary market, where these securities are bought and sold after issuance.

[13]FINRA does not have its own rulemaking authority over broker-dealers' municipal securities activities, but enforces MSRB rules for securities firms and bank regulators enforce MSRB rules for bank dealers. SEC enforces MSRB rules for all securities firms and bank dealers, and for municipal advisors, which may be integrated into or independent of broker-dealers.

with them prior to any sale, and MSRB also cannot require issuers to provide them or investors with any information either pre- or postsale. Furthermore, the Securities Act of 1933 exempts the securities that state and local governments issue from registration with SEC. Securities of state and local governments also are exempt from the periodic disclosure requirements of the Exchange Act of 1934. According to a 1975 Senate report, congressional reasons for the decision to continue to limit direct regulation of issuers when the 1975 amendments to the securities acts were enacted included respect for the rights of state governments to access the capital markets, concerns about the costs of regulation for state and local government issuers, and the perceived lack of abuses in the municipal market that would justify such an incursion on the states' prerogatives.[14]

While federal regulators are prohibited from directly requiring issuers to file presale information on municipal securities, SEC has adopted rules—applicable to broker-dealers acting as underwriters—that relate to primary market and continuing disclosures.[15] More specifically, using its authority over broker-dealers and its broad authority to prevent fraud in connection with the offer, purchase, or sale of securities, SEC adopted Rule 15c2-12 in 1989. The rule established disclosure requirements related to municipal securities in response to the need SEC found for increased transparency.[16] This rule and accompanying guidance obligates underwriters of municipal securities to obtain and review issuers' official statements (typically prepared by issuers or their advisors) and provide

[14]*See* S. Rep. No. 94-75 (1975).

[15]With limited exceptions, state and local governments issue bonds through a broker-dealer that underwrites, or sells, their bonds in a public offering to investors. In 2011, 157 broker-dealers underwrote municipal bonds and the 5 largest underwriters accounted for about 60 percent of par value issued, according to MSRB. MSRB calculated market share for long-term issues and excluded private placements and remarketing of variable-rate bonds.

[16]According to a 1993 SEC staff report, SEC adopted Rule 15c2-12 in response to disclosure deficiencies highlighted in the 1983 default of the Washington Public Power Supply System, which was the largest payment default in municipal bond history at the time. They also cited concerns that official statements were not being made available to investors at initial offerings. See SEC, Division of Market Regulation, *Staff Report on the Municipal Securities Market* (September 1993).

them to investors.[17] In addition, the rule was amended in 1995 to require underwriters to reasonably determine that issuers have entered into a written continuing disclosure agreement for the benefit of municipal securities holders to provide (1) annual financial information and operating data of the type included in the official statement and when and if available, audited financial statements, and (2) notices of certain material events. Beginning in 2009, issuers have been obligated by the agreement to provide the continuing disclosure information and data to EMMA (either directly or by engaging a third-party dissemination agent to submit such information and data on their behalf). For a comparison of key federal disclosure requirements for publicly offered municipal and corporate securities, see appendix II.

Investors access disclosure information in EMMA at no cost through a website maintained by MSRB, which created the system in 2008 primarily to benefit retail investors, also known as individual investors.[18] Documents available in EMMA include official statements (that is, information provided to investors at the initial offering) that underwriters must submit. EMMA also makes available postsale information submitted by issuers or their dissemination agents, including the annual reports of financial information, notices of certain events, and certain other categories of information that issuers may voluntarily provide. The events that issuers (or other obligated persons) must agree to provide notices of include principal and interest payment delinquencies; unscheduled draws on debt service reserves reflecting financial difficulties; and bankruptcy,

[17]An "official statement," which municipal securities underwriters are required to obtain and review, consists of information about the terms of the proposed offering, financial and operating data material to an evaluation of the offering, a description of the secondary market disclosure undertaking to which the issuer agreed, and information on any failure to comply with any previous secondary market disclosure undertaking in the previous 5 years. 17 C.F.R. § 240.15c2-12(f)(3).

[18]EMMA may be accessed at http://emma.msrb.org.

insolvency, receivership and similar events.[19] MSRB allows issuers to voluntarily submit to EMMA on a continuing basis any other types of financial, operating, or event-based information, including (but not limited to) information about bank loans, quarterly or monthly financial information, consultant reports, and capital or other financing plans. According to MSRB, users may conduct searches of issuances on EMMA using one or more of the following parameters: Committee on Uniform Security Identification Procedures (CUSIP) number, issuer name, issue description, obligated person name, state, maturity date, date of issuance, interest rate, and ratings. EMMA provides additional parameters to search for continuing disclosure documents and other information available through EMMA, including trade information.

Investors and Market Participants Cited Limitations of Continuing Disclosures

Many market participants told us that primary market disclosure for municipal securities investors is generally useful. However, investors and market participants with whom we spoke frequently cited limitations to continuing disclosure, including the timeliness of annual financial information, the frequency with which information is provided, and incomplete information. Our analysis found that current regulatory requirements for municipal securities disclosure broadly reflect the seven principles of effective disclosure that were developed by the International Organization of Securities Commissions and certain plain English principles developed by SEC. However, regulators and market

[19]SEC Rule 15c2-12 enumerates events for which a notice is to be provided. The following events must be disclosed: (1) principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; (6) rating changes; (7) tender offers; and (8) bankruptcy, insolvency, receivership or a similar event with respect to the issuer or another obligated person. The following events must be disclosed if they are material: (1) nonpayment-related defaults; (2) modifications to rights of security holders; (3) bond calls; (4) the release, substitution, or sale of property securing repayment of the securities; (5) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security; (6) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; and (7) an appointment of a successor or additional trustee, or a change of name of a trustee.

participants indicated that, in practice, limitations exist in the current regulatory scheme. Further, the effect on individual investors of limitations to disclosure is largely unknown.

Investors and Market Participants Most Commonly Cited Timeliness, Frequency, and Completeness as Disclosure Limitations

Many market participants told us primary market disclosure is generally useful for investors and EMMA has improved investor and market participants' ability to access disclosure documents, but investors and market participants have identified limitations to disclosure. According to MSRB officials, participants in the municipal securities market generally acknowledge that primary market disclosure—official statements—contains the material facts an investor needs to know about an issuer and a security.[20] Investors and market participants such as groups representing investment companies, bond lawyers, and broker-dealers also have indicated that the information provided at the time of issuance is comprehensive. Additionally, most market participant groups with whom we spoke said that MSRB's EMMA website has greatly improved public access to disclosure compared with the prior system for obtaining disclosure documents.[21] Several market participants said that having a central repository for disclosure documents has made finding information easier and more efficient. In addition, one market participant noted that EMMA increased access to information by allowing investors to receive disclosures for free.

However, investors and other market participants cited limitations to the information provided in continuing disclosures. The most frequently cited limitations to the usefulness of this information were: the timeliness of annual financial information, the frequency with which issuers and other obligated persons provided information, and the completeness of the information provided in accordance with the continuing disclosure

[20]There are no detailed requirements regarding the content of an official statement. For purposes of SEC Rule 15c2-12, official statements should include a description of the terms of the security, financial or operating data, a description of the secondary market disclosure undertaking to which the issuer agreed, and other information. In addition, information included in the official statement is subject to the antifraud provisions of federal securities laws.

[21]Prior to July 1, 2009, investors could obtain disclosure information and documents from one of the four Nationally Recognized Municipal Securities Information Repositories, in most cases for a fee.

agreement. Individual investors also frequently cited the readability of disclosures as a limitation.

- Timeliness—According to investors and other market participants, issuers release annual financial information too long after the end of their fiscal years for the information to be useful in making investment decisions. A Governmental Accounting Standards Board (GASB) study of audited annual financial reports prepared in accordance with generally accepted accounting principles (GAAP) for state and local governments provided for fiscal years ending in 2006, 2007, and 2008 found that the average time frame for issuing the reports varied by type and size of government. For example, issuance time frames averaged from 126 days after the end of the fiscal year for large special districts to 244 days for small counties.[22] Similarly, according to National Association of State Comptrollers data, in fiscal year 2010 states took an average of 198 days to complete their comprehensive annual financial reports. Also, in our case study of disclosures for 14 securities in EMMA that were issued in 2009, our analysis found that the number of days after the end of the fiscal year in which issuers or obligated persons provided annual financial information to EMMA varied. Annual financial information for a nonprofit hospital system was provided 55 days after the end of a fiscal year, while annual financial information for a general obligation security issued by a school district was provided 257 days after the end of a fiscal year. Several investors and market participants said that filings provided well after the end of the fiscal year limit the information's usefulness. The GASB study found similar sentiments: less than 9 percent of survey respondents—who represented a range of users of financial information—considered information received 6 months after the end of the fiscal year to be very useful.[23] Three market participants further indicated that untimely information was particularly worrisome for investors at a time when state and local governments have been

[22]See Governmental Accounting Standards Board, *The Timeliness of Financial Reporting by State and Local Governments Compared with the Needs of Users* (Norwalk, Conn.: March 2011). The study looked at the length of time it took to issue audited financial reports in compliance with GAAP for all states and a sampling of large and smaller counties, local governments, school districts, and special districts. Governments surveyed were not necessarily municipal securities issuers. Also, the study did not include annual financial information that was prepared using accounting standards other than GAAP.

[23]Users surveyed included municipal bond analysts, legislative fiscal staff, and researchers at taxpayer associations and citizen groups.

facing credit stress. Moreover, evidence indicates that issuers have not always met the time frames by which they agreed to provide annual information. For example, a study by the California Debt and Investment Advisory Commission of certain securities issued in California from 2005 to 2009 found 11 percent filed more than 30 days after the agreed-upon date.[24]

- Frequency—Investors and other market participants also said that receiving financial information annually was not sufficient to monitor the financial condition of an issuer. An individual investor with whom we spoke and a professional analyst both noted that because disclosures generally are provided annually, investors often must learn important information about the current financial condition of an issuer from external sources such as newspaper articles. For instance, the individual investor told us that he may read in the newspaper that a town that issued securities was having budget problems; however, this information would not be disclosed to investors until the financial statements for the fiscal year were released at some point during the following year. A few market participants indicated that obtaining information more frequently was especially important for investors during times of economic stress. Information that investors and other market participants indicated would be useful to receive between annual financial statements included unaudited quarterly financial reports, cash-flow reports, year-to-date budget updates, and tax revenue information. This type of information is not routinely submitted to EMMA on a voluntary basis. According to MSRB data, in 2011 EMMA received 8,290 submissions categorized as quarterly or monthly financial information (which represents 6 percent of all continuing disclosure documents submitted) and 358 submissions categorized as interim, additional financial information, or operating data. Similarly, quarterly or monthly financial information was available in EMMA for 5 of the 14 securities in our case study.
- Completeness—Investors and other market participants said that issuers do not always provide all of the financial information, event

[24]See California Debt and Investment Advisory Commission, *Municipal Market Disclosure: CAFR Filings: A Test of Compliance among California Issuers* (CDIAC No. 11-04). This study tested whether issuers submitted certain annual financial information to EMMA according to the date agreed upon in the underlying continuing disclosure agreement. The study excluded information about the roles and responsibilities of obligated persons in submitting disclosure information. A commission representative told us that 59 of the 1,227 issuances studied were conduit issuances that, by definition, would have had an obligated person other than the issuer.

notices, or other information they agreed to provide in a continuing disclosure agreement for the lifetime of a security. For example, three market participants told us that issuers and obligated persons did not always file the annual financial information that they agreed to provide. Our case study of disclosures for 14 securities in EMMA identified similar issues in a few cases. In particular, our analysis found that 2 securities—a 2009 general obligation security for a small issuer and a 2009 conduit offering with a publicly traded corporation as the obligated person—had no financial or other continuing disclosures as of May 2012. In addition, a few market participants indicated that filings of event notices can be delayed significantly or that event notices may never be filed. For instance, one market participant said that he had noted cases in which issuers failed to report unscheduled draws on debt service or adverse tax opinions. Such lapses in reporting may also go undetected. As one market participant and a FINRA official noted, an investor or regulator may not be able to ascertain if a reportable event had occurred unless an event notice was filed with EMMA. Finally, a few market participants told us that issuers may provide all of the information they agreed to provide for the first few years after a security was issued, but afterwards fail to provide some of the information—for instance, tax data or operating information.

- Readability—Individual investors commonly cited concerns about the readability of disclosure documents.[25] Four of the 12 individual investors with whom we spoke said that disclosure documents were not easy to read or understand. Furthermore, most individual investors with whom we spoke said that they generally had limited time to decide whether to buy a security, leaving them little time to research a security.[26] Several individual investors and market participants said that disclosures were difficult to understand because they contained extensive legal or technical terminology and complex information. In addition, two of the individual investors with whom we spoke noted that the information for which they looked was “buried” in the disclosure documents and not easy to find.

[25]In our case study of securities disclosures in EMMA, we did not systematically analyze the extent to which disclosures were readable because we could not establish objective criteria for identifying readability.

[26]For example, some investors said they need to make quick investment decisions when purchasing municipal securities in the secondary market because securities may be purchased by another investor within 2 hours.

To a lesser extent, investors and other market participants identified additional limitations—including the lack of standardization and limitations of EMMA—to the usefulness of disclosure. Several market participants said that the lack of standardization of disclosure across different issuers impeded their ability to compare issuances. MSRB also stated in a comment letter to SEC in 2011 that many investors have told MSRB that the lack of standardization in disclosure is a problem.[27] MSRB indicated that elements that market participants would like to see standardized included the use of bond proceeds and some basic information, such as the manner of reporting the name of the issuer or other obligated person and information on the source of repayment. Two market participants also told us standardization of accounting methods and the format of disclosures would make disclosures more useful. Also, investors and other market participants described several aspects of EMMA that limited its usefulness. Several market participants noted that the ability to search for issuances was limited, especially if users did not have the CUSIP number for the issuance in which they were interested.[28] Two market participants noted that continuing disclosures sometimes were categorized incorrectly by the issuer at submission to EMMA and one said that issuers may not submit disclosures for all issuances to which they applied.

Current Regulations Broadly Reflect Disclosure Principles but Some Limitations Exist

We compared requirements for continuing disclosure in SEC Rule 15c2-12 and SEC's antifraud authorities with principles for effective disclosure that were developed by an international organization of securities commissions, which included SEC, and certain plain English principles developed by SEC.[29] These principles include allocation of accountability, continuing disclosure obligation, disclosure criteria, dissemination of information, equal treatment of disclosure, timeliness, and use of plain English in official statements (see app. III for the comparison of the

[27]See Michael G. Bartolotta, "Municipal Securities Rulemaking Board's Recommendations for Update of 1994 Interpretive Guidance," MSRB comment letter to SEC, http://www.sec.gov/comments/4-610/4610-69.pdf (Aug. 8, 2011).

[28]A CUSIP number is an identification number assigned to each maturity of an issue intended to help facilitate the identification and clearance of securities.

[29]See International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* (October 2002). See also SEC, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: August 1998).

principles and municipal securities disclosure requirements). We found that current regulations broadly reflect the seven principles of effective disclosure. However, regulators and market participants have indicated that, in practice, limitations exist in the current regulatory scheme, including the areas of enforceability, content, and efficiency. In particular, they noted the following:

- Allocation of accountability—Although security holders may enforce continuing disclosure agreements by bringing suit against the issuer or obligated person, SEC staff told us that they were not aware of any public statements about any such lawsuits having occurred. Also, two market participants noted that market participants other than investors directly holding a security have no remediation should an issuer or obligated person not provide disclosure. SEC and MSRB cannot enforce continuing disclosure agreements. In a comment letter to SEC in 2011, MSRB stated that because Rule 15c2-12 does not impose penalties for noncompliance with continuing disclosure agreements, there is limited accountability for those issuers or obligated persons that do not provide the information.[30] In addition, various regulatory incentives that could encourage issuers to comply with their agreements have limitations, according to regulators and market participants. For example, regulatory requirements to disclose at issuance failure to comply with prior continuing disclosure agreements only may work as an incentive to encourage issuers to make required disclosures if they anticipate issuing a new security in the future. Moreover, SEC staff and two market participants indicated that even if issuers anticipated issuing a future security they might not be sufficiently incentivized to keep up with their disclosure obligations between issuances, as some issuers may only go to market with a new issuance from every 3 to 5 years.[31] There are other reasons why issuers may not keep up with continuing disclosure responsibilities between issuances. A few market participants who work with issuers to help prepare disclosures told us that some issuers face challenges in complying with their continuing disclosure agreements because of a lack of awareness or understanding of their disclosure responsibilities, which members of one market participant group said can be due to

[30]See Michael G. Bartolotta, MSRB comment letter to SEC (Aug. 8, 2011).

[31]SEC Rule 15c2-12 requires that final official statements contain, if applicable, a description of any instances in the previous 5 years in which the issuer or other obligated person failed to comply, in all material respects, with any previous continuing disclosure agreement.

staff turnover and competing priorities in times of budgetary challenges. Two small issuers with whom we spoke said that they do not have staff dedicated to issuing and monitoring debt, which presents a challenge in preparing disclosures.

- Continuing disclosure obligation—As a condition of an underwriting, an underwriter must reasonably determine that issuers or obligated persons have agreed to provide certain information on a continuing basis. However, this requirement is placed on the underwriter, not directly on the issuer of the security. Regulators and market participants have noted that this requirement on the underwriter is inefficient for several reasons. For example, representatives of two market participant groups told us that an underwriter often does not have an opportunity to influence the content of a continuing disclosure agreement before an issuance, although it is the underwriter's responsibility to ensure the agreement specifies that all required information will be provided. Also, FINRA staff noted that should an issuer or obligated person not provide continuing disclosure information after a security is issued, the underwriter has no means to compel them to do so. Furthermore, representatives of two market participant groups and a former regulator have indicated that a disproportionate amount of the regulatory burden for municipal disclosure falls on underwriters. In addition, Rule 15c2-12 does not expressly require underwriters to document how they comply with requirements to reasonably determine that the issuer or obligated person agreed to provide continuing disclosures and that they are likely to comply with their continuing disclosure agreement. SEC staff said that without this documentation, it may be difficult for an underwriter to demonstrate that it met its obligations.
- Timeliness—Although Rule 15c2-12 requires, as a condition of an underwriting, that an underwriter must reasonably determine that issuers or obligated persons have specified a date by which they agreed to provide the annual financial report, it does not specify what that date should be. Therefore, issuers and obligated persons may provide annual financial information months after the close of the fiscal year.
- Use of plain English—Regulations do not require the use of plain English in municipal securities' official statements or other disclosure documents.

SEC recognizes some of these limitations and has taken recent actions to improve the timeliness and completeness of continuing disclosures. Specifically, in June 2010, SEC amended Rule 15c2-12 and issued interpretive guidance to

- specify that event notices be submitted to EMMA in a timely manner not in excess of 10 business days of the occurrence of the underlying event, rather than merely "in a timely manner" as was previously required;
- remove the general materiality condition for determining whether notice of an event is to be submitted to EMMA—thereby, requiring that notification be provided for certain events when they occur regardless of whether they are determined to be material (including principal and interest payment delinquencies, and unscheduled draws on debt service reserves reflecting financial difficulties, among others), while adding separately a materiality condition to select events (including nonpayment-related defaults and bond calls);
- increase the number of events for which notice must be provided;
- remove an exemption from reporting disclosure information for certain variable-rate securities; and
- reaffirm its previous interpretation that underwriters must form a reasonable belief in the accuracy and completeness of representations made by issuers or other obligated persons in disclosures as a basis for recommending the securities, including making a reasonable determination that the issuer will likely provide the continuing disclosure information it agreed to provide.[32]

Effect of Limitations of Disclosure Regulations on Individual Investors Largely Is Unknown

The risk posed to investors by the limitations of disclosure regulations cited by market participants is largely unknown because (1) there is limited information about the extent to which investors use disclosures to make investment decisions, (2) there is limited information about the extent to which disclosure limitations about which investors were concerned actually have occurred, and (3) there is a low incidence of defaults and other characteristics of the municipal market that mitigate investor risk. Nevertheless, SEC and MSRB have continuing concerns about disclosure in the municipal market.

There is limited information about the extent to which individual investors in municipal securities use disclosures to make investment decisions. Regulators and market participants with whom we spoke did not have

[32]The SEC release states that it would be very difficult for an underwriter to make a reasonable determination that an issuer or obligated person would provide information outlined in a continuing disclosure agreement if the underwriter found that the issuer or obligated person had on multiple occasions during the previous 5 years failed to provide continuing disclosure documents on a timely basis.

overall information on the extent to which individual investors in municipal securities rely on disclosures in making their investment decisions. However, anecdotal evidence suggests that individual investors' reliance on disclosures could be limited. For example, 5 of the 12 individual investors with whom we spoke said that they relied solely on their broker-dealers' advice when making an investment decision, while the others said that they conducted their own research into securities. Of the 5 investors who said they relied solely on their broker-dealers' advice, 2 indicated that they did not rely on disclosures because of the difficulty of understanding them. Similarly, a 2008 SEC study of investor usage of disclosure documents for stocks, bonds, and mutual funds found that only 2 percent of investors surveyed cited SEC-mandated disclosure documents—prospectuses and annual reports—as the most important source of investment information.[33] Rather, surveyed investors most frequently cited financial advisors or brokers as the most important source of investment information.[34] Although the SEC study did not focus on municipal securities, some of the investors surveyed also may have invested in these types of securities. More importantly, the study provides a general indication of investors' usage of disclosure documents and other sources of information. Many individual investors with whom we spoke also said that a security's credit rating has been a main factor in making investment decisions. However, several of these investors told us that they have less faith in credit ratings than they did before the financial

[33]The intent of the survey was to measure investor usage of SEC-mandated disclosure documents and satisfaction with plain English elements used in disclosure documents. The study concluded that because investors found disclosure documents to contain too much legal jargon and believed disclosures were too complicated and difficult to understand, investors often relied on a financial advisor or broker to read these documents for them. See Abt SRBI, *Mandatory Disclosure Documents Telephone Survey,* prepared for SEC Office of Investor Education and Advocacy (New York, N.Y.: July 30, 2008).

[34]According to MSRB staff, the information available through EMMA has an indirect, but significant, positive effect on individual investors who purchase municipal securities through broker-dealers. For municipal securities, broker-dealers are obligated under various MSRB rules to use information available through EMMA to (1) provide disclosure of material information to customers at or prior to the time of trade under MSRB Rule G-17, (2) undertake a suitability determination in the case of a recommendation of a municipal securities transaction under MSRB Rule G-19, and (3) provide fair and reasonable pricing of municipal securities transactions with customers under MSRB Rules G-18 and G-30. SEC staff told us that EMMA is an important source of disclosure information for broker-dealers in relation to the advice they provide individual investors.

crisis, potentially making disclosure information a more important factor in their future investment decisions.

There is also limited information on the extent to which events relating to limitations to disclosure cited by investors—such as issuers and other obligated persons failing to submit information or submitting information late—have occurred. MSRB has limited ability to track issuances with missing or late disclosure for several reasons. For example, MSRB reported that in 2011 it received 1,879 required notices of failure to provide annual financial information; however, MSRB staff told us that they could not reliably determine the universe of issuances in EMMA for which annual financial information was required.[35] This is because EMMA did not have the capability to easily or systematically differentiate between securities that should have disclosure submissions and those that are exempt from SEC Rule 15c2-12, according to MSRB staff.[36] In addition, it is difficult for MSRB or others to develop reliable information about issuer compliance with their continuing disclosure agreements for the universe of outstanding issuances because the structure of continuing disclosure obligations can vary by issuance, making compliance with continuing disclosure agreements difficult to systematically identify and track. As a result, there is limited information on the extent of the problems.

The low levels of defaults on municipal securities and other characteristics of the municipal securities market also make it difficult to determine the importance of disclosure documents as a means of investor protection. Long-term default rates associated with rated municipal securities have been less than 1 percent, which is significantly lower than long-term default rates for rated corporate debt securities (see

[35]A notice of failure to provide annual financial information is one of the types of filings that an issuer or other obligated person may make pursuant to Rule 15c2-12's requirement to provide annual financial information. See Municipal Securities Rulemaking Board, *Municipal Securities Rulemaking Board 2011 Fact Book* (Alexandria, Va.: 2012).

[36]MSRB staff said it can be challenging to identify securities subject to Rule 15c2-12 disclosure requirements for a variety of reasons, including the complexity of the exemptions. Prior to 2011, regulations did not require that the underwriter disclose whether the issuance was subject to the rule. Many official statements are submitted to EMMA for securities that are not subject to continuing disclosure requirements.

table 1).[37] In addition, municipal bankruptcy filings historically have been rare compared with bankruptcy filings by businesses. For 1991 through 2009, 177 municipalities filed for bankruptcy. In contrast, more than 49,000 businesses filed for bankruptcy in the 12-month period ending March 31, 2009.[38]

Table 1: Cumulative Average Default Rates for Municipal and Corporate Issuers (in Percentages), as of Year-end 2011

	Standard & Poor's			Moody's Investors Service		
	1 year	5 years	10 years	1 year	5 years	10 years
U.S. municipal issuers	0.02	0.10	0.17	0.01	0.07	0.13
Global corporate issuers	1.57	6.58	9.83	1.61	7.24	11.18

Source: GAO analysis of data from Standard & Poor's and Moody's Investors Service.

Note: Default rates are cumulative average default rates for corporate and municipal debt issuers rated by each rating agency within 1, 5, and 10 years and indicate the estimated likelihood that an issuer with an outstanding rating will default in 1, 5, and 10 years, respectively. Different rating agencies may use different sets of issuers to calculate default rates. We used data from Standard & Poor's and Moody's Investors Service to compare default rates for U.S. municipal issuers and global corporate issuers by each rating agency. We assessed the reliability of these data and found them to be reliable for this purpose.

In addition, state and local government issuers have a strong incentive to meet their payment obligations because issuances of municipal securities

[37]Corporate debt securities that have been registered and whose issuers are subject to the periodic reporting requirements are subject to SEC disclosure requirements. Although default rates in the municipal securities market remain low, they can vary by sector. According to a 2011 report by a rating agency, over the last 30 years, two-thirds of all defaults have been associated with the industrial development, health care, and housing sectors. See Kroll Bond Ratings, *An Analysis of Historical Municipal Bond Defaults: Lessons Learned -The Past as Prologue* (Nov. 14, 2011). In response to these defaults, the market has demanded more frequent disclosure in some cases, according to MSRB staff as well as two market analysts. For instance, three of these sources told us that issuers or obligated persons in the health care sector frequently provide financial information on a quarterly basis. Based on our case study of disclosures, the issuer or obligated person for four of the five issuances from the health care sector provided quarterly or monthly financial information in EMMA.

[38]See Neil O'Hara and Securities Industry and Financial Markets Association, *The Fundamentals of Municipal Bonds,* 6th ed. (Hoboken, N.J.: John Wiley & Sons, 2012): 174-175; and United States Courts, "Bankruptcy Filings Highest Since 2006," May 14, 2010, accessed May 10, 2012, at http://www.uscourts.gov/News/NewsView/10-05-14/Bankruptcy_Filings_Highest_Since_2006.aspx.

constitute an important tool to finance critical projects, and defaults may hinder their ability to issue future securities and may adversely affect other issuers of municipal securities in the surrounding area. Defaulted municipal securities also have a relatively high recovery rate for investors compared to corporate securities, according to two rating agencies—with one reporting a recovery rate of 67 percent for municipal securities compared with 40 percent for corporate securities.[39] Some states also have mechanisms intended to address financial crises, allowing for state intervention into a local government's finances.[40] Finally, 30 states have laws that give holders of general-obligation and certain other securities issued by municipalities within their states first rights to repayment from certain revenue streams, even during bankruptcy.[41]

Nevertheless, SEC and MSRB have expressed continuing concerns about municipal securities disclosure due to individual investors constituting a significant portion of the market, the size of the market, default risk, and incomplete disclosure. SEC staff told us that disclosure by municipal issuers should be improved in general as it relates to the

[39]In the event of default, the bond indenture may provide for recoveries in one of two ways: (1) the borrower may cure the default and resume paying full debt service, or (2) collateral backing the bonds may be liquidated. Debt service payments also may be made by a third-party guarantor. The study includes defaulted securities from January 1980 through October 2002. See David Litvack and Mike McDermott, *Municipal Default Risk Revisited*, Fitch Ratings (New York, N.Y.: June 23, 2003).

[40]Notably, Jefferson County, Alabama, which filed for the largest municipal bankruptcy in U.S. history in November 2011, defaulted on a general obligation bond payment due in April 2012. Prior to the bankruptcy, the state court in Alabama had appointed a receiver for Jefferson County's troubled sewer system, receivership being a potential remedy that some states allow.

[41]Whether a particular security has these protections depends on the structure of the financing and the statutory authorization for the security. The authors conducted a 50-state survey of rights and remedies provided by states to investors in municipal bond debt. See James Spiotto, Ann Acker, and Laura Appleby, *Municipalities in Distress? How States and Investors Deal with Local Government Financial Emergencies,* 1st ed. (Chicago, Ill.: James E. Spiotto and Chapman and Cutler LLP, February 2012): 254-255.

primary market and continuing disclosure.[42] In rulemakings, SEC staff have noted concern about the size of the municipal securities market and that, while defaults of municipal securities are rare, they do occur. Furthermore, the significant pressure on state and local government budgets and the diminishment of bond insurance since the recent financial crisis have increased focus on disclosure issues, according to SEC and MSRB staff.[43] MSRB staff noted in 2010 that although the municipal securities market largely weathered the 2008 financial crisis, economic conditions and financial liabilities continued to stress municipal bond issuers. SEC staff also told us that recent SEC enforcement actions highlight risks posed by pension funding obligations.[44] Furthermore, SEC

[42]SEC staff told us that improved disclosure by municipal issuers could benefit individual investors and also may have positive effects on pricing and liquidity. In a previous report on the municipal securities market, we noted that municipal broker-dealers generally determine the prices at which they are willing to trade by making relative assessments of a security's market value. Broker-dealers with whom we spoke identified several factors as relevant to their pricing determinations, including the characteristics and credit quality of the security (which broker-dealers can infer by reviewing information from issuers' financial disclosures posted on EMMA). Broker-dealers stated that their ability to understand the credit risk of a particular security rested primarily on their ability to obtain timely, comprehensive issuer disclosures. We also noted that while MSRB has increased the amount of information available to all investors through its EMMA website—including price information on past trades and issuer disclosures—institutional investors with whom we spoke generally had more resources and expertise to assess prices than individual investors. In particular, they had (1) access to more sources of pretrade price information in the form of offerings and bids provided through their large networks of broker-dealers, (2) access to more user-friendly posttrade information through third-party vendors and their networks of broker-dealers, and (3) more market expertise to help them incorporate other available information. See GAO-12-265.

[43]Bond insurance provides securities with the rating of the bond insurer and guarantees investors timely interest payments and, if the issuers default, the return of principal. According to Thomson Reuters data in the 2006 and 2011 *Bond Buyer Yearbook*, in 2005, nine highly rated bond insurers insured about 57.1 percent of new issue volume (51 percent of newly issued securities). By 2010, there was only one active bond insurer in the market, providing insurance to approximately 6.2 percent of new issue volume (12 percent of newly issued securities).

[44]Some analysts have expressed concern in light of the recent financial downturn about the financial stress placed on state and local governments by pension liabilities. We recently reported that most state and local government pension plans have assets sufficient to cover their benefit commitments for a decade or more. We also found that states and localities have implemented various changes to their pension systems since 2008 that were intended to help improve long-term plan sustainability. However, growing budget pressures will continue to challenge the ability of state and local governments to provide adequate contributions to help sustain their pension plans. See GAO, *State and Local Government Pension Plans: Economic Downturn Spurs Efforts to Address Costs and Sustainability*, GAO-12-322 (Washington, D.C.: Mar. 2, 2012).

and MSRB leadership have publicly voiced concerns about various aspects of the municipal securities market. Examples of their concerns include the following:

- An SEC Commissioner remarked that investors may have trouble understanding the risks associated with increasingly complex structures used by large and small municipalities.[45]
- A former SEC Chairman stated that the opacity of the municipal market was unrivaled and presented a significant threat to the U.S. economy.[46]
- An SEC Commissioner was concerned that investors might not have access to the information they needed to accurately calculate their risks when making investment decisions. She stated at an SEC field hearing on the municipal market in 2010 that municipal market investors were afforded second-class treatment compared with that afforded to investors in other securities because they could not count on receiving accurate and timely financial and other material information about their investments.[47]
- MSRB stated in a comment letter to SEC in 2011 that MSRB received complaints about some issuers' disregard for their continuing disclosure agreements and failure to provide information on time or at all.[48]

Options for Improving Disclosure Involve Potential Benefits and Challenges

Experts and market participant groups we surveyed suggested a number of options for improving municipal securities disclosure. Some of the options would require statutory changes while others could be achieved within existing statutory authority. Each of the suggested options involves trade-offs, and market participants and the regulators' views on the efficacy of the options varied. Our discussion of potential benefits provided to investors and potential costs of implementing these options is limited to the views of survey and interview participants.

[45]See Elisse B. Walter, "Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens," speech at the A. A. Sommer, Jr. Corporate, Securities and Financial Law Lecture (New York, N.Y.: Oct. 28, 2009).

[46]See Arthur Levitt Jr., "Muni Bonds Need Better Oversight," *Wall Street Journal* (May 9, 2009).

[47]See Elisse B. Walter, "Statement at SEC Field Hearing on the State of the Municipal Securities Market," (San Francisco, California: Sept. 21, 2010).

[48]See Michael G. Bartolotta, MSRB comment letter to SEC (Aug. 8, 2011).

Some Options Identified to Improve Disclosure Would Require Statutory Changes

Experts and market participant groups we surveyed suggested some options to improve disclosure that would require statutory changes. While many suggested repealing the Tower Amendment, regulators said it would have no effect on what they could require issuers to disclose. SEC staff said the Securities Act exempts municipal issuers from SEC registration requirements. MSRB does not otherwise have affirmative authority to regulate issuers. They said additional statutory changes would be needed for regulators to implement other options we identified for improving disclosure that included prescribing accounting standards, requiring time frames for annual reporting or more frequent disclosure, and requiring certain conduit borrowers to comply with corporate disclosure requirements.

Many Survey Respondents Suggested Repealing the Tower Amendment, but Regulators Said It Would Have No Effect on Disclosure

Seven of 21 experts we surveyed suggested that Congress repeal the Tower Amendment—provisions that prohibit SEC and MSRB from requiring issuers to file any information with them prior to any sale, and MSRB from requiring issuers to provide them or investors with any information pre- or postsale. Some experts believe that repealing these provisions would allow federal regulators to directly require issuers to provide continuing disclosures, and thereby address concerns about incomplete submissions or failures to meet obligations under continuing disclosure agreements, but SEC and MSRB staff did not agree and said additional changes would be needed for them to directly regulate issuers.

As noted previously, the Tower Amendment prohibits SEC and MSRB from requiring state and local governments to file presale information with them in connection with the issuance, sale, or distribution of municipal securities. MSRB is further limited by a prohibition against requiring any issuer to furnish it or any purchaser or prospective purchaser with any document or report about the issuer, except for documents and information that generally are available from a source other than the issuer. Some industry participants believe the Tower Amendment prohibits any regulation of municipal issuers, while others believe its scope is narrower and addresses only prefiling requirements. SEC staff noted that repealing the Tower Amendment would have no real effect on disclosure because of exemptions under the Securities Act. SEC and MSRB staff agreed that repealing the Tower Amendment would remove a prohibition on requiring issuers to file presale information. However, they said such repeal would have no effect on their ability to establish disclosure requirements for issuers with respect to primary or continuing disclosures. SEC staff told us that the Securities Act provision that broadly exempts municipal securities from SEC's registration requirements means that the registration requirements applicable to

corporate issuers do not apply to municipal securities offerings. In addition, the periodic reporting requirements of the Exchange Act do not apply to issuers of such municipal securities. MSRB does not otherwise have affirmative authority to regulate municipal issuers. As a result, SEC and MSRB staff told us that Congress may need to provide SEC or MSRB with affirmative authority or amend exemptions under federal securities laws to establish disclosure requirements directly on municipal securities issuers.[49]

Four market participant groups we surveyed and others (including issuers) with whom we spoke discussed potential challenges to issuers of expanding regulator authority. They expressed concern over the costs of federal regulation as well as the potential infringement on state and local government rights. According to a market participant group with whom we spoke, an increase in the costs of accessing the market could prohibit some issuers from raising capital in the public market and lead some issuers to pursue other options for raising capital, such as through private bank loans. In addition, a market participant group representing issuers said the basic tenets of federalism and the importance of federal-state comity behind the Tower Amendment were important considerations in weighing potential options for improving municipal disclosure.

While neither SEC nor MSRB had indicated to us they were seeking additional authority to regulate issuers, SEC staff indicated that additional authority would be helpful to improve disclosure by municipal issuers. Staff of each regulator had similar views on how to most appropriately use any additional authority that could be granted to regulate disclosure by municipal issuers.

- First, staff generally agreed that the securities registration regime for public companies would be inappropriate for the municipal securities market. With approximately 50,000 issuers and 1.3 million separate outstanding securities, SEC staff said the additional resources potentially needed to review and declare effective registration statements would be extensive, and an MSRB official said regulating

[49]SEC staff expect to release a staff report on the municipal securities market in 2012 that includes legislative, regulatory, and industry best practices and recommendations to SEC Commissioners for measures to improve primary and secondary market disclosure practices, measures to improve market practices, and associated regulation.

municipal issuers would be beyond MSRB's current resource capabilities.

- Second, SEC and MSRB staff recognize that potential continuing disclosure requirements could have costs for issuers, such as small or infrequent issuers, although limited information exists on the universe of issuers, and issuers that might be affected.
- Third, SEC and MSRB staff told us broad-based or marketwide standardized disclosure would not be favorable for the municipal market. Rather, SEC staff told us disclosure requirements could be principles-based. Principles-based disclosure is an approach that would involve establishing key objectives of good reporting and providing guidance and examples to explain each objective. MSRB staff agreed that disclosure requirements should be tailored, noting that the market is highly diverse in terms of the structure of financings and the issuing community. Staff from both regulators said any disclosure requirements for municipal securities issuers would need to reflect the diversity of issuers as well as the federal interest in investor protection.
- Fourth, SEC and MSRB staff stated that regulation of municipal securities must balance investor protection and intergovernmental comity. For example, SEC staff told us any federal regulation of municipal securities disclosure should be flexible and adaptable, so that regulators could account for issues of comity and other political realities present in the municipal market.

Additional Options for Improving Disclosure Would Require Other Statutory Changes

In addition to repealing the Tower Amendment, many of the experts and market participants we surveyed identified additional options that would require statutory changes. These include prescribing accounting standards and requiring time frames for annual reporting, requiring more frequent disclosure, or requiring certain conduit borrowers to comply with corporate disclosure provisions. According to SEC and MSRB staff, Congress would need to provide SEC or MSRB with authority to implement any of these options.

Prescribe Accounting Standards

Five of 21 experts we surveyed and a market participant group with whom we spoke suggested federal regulators should prescribe accounting standards for the financial information issuers disclose in EMMA. These suggestions included that SEC should be provided authority to prescribe accounting standards or regulators should require issuers to comply with

GAAP for state and local governments.[50] Additionally, three market participant groups suggested regulators should have authority to simplify GAAP standards to more efficiently meet investor needs and reduce compliance costs for issuers. According to MSRB staff, Congress could provide MSRB authority to regulate issuers and authorize accounting standards without needing to repeal the Tower Amendment. According to MSRB staff, without statutory changes, MSRB could use existing authority to prohibit broker-dealers from underwriting new securities without an issuer of such securities committing to follow GAAP or other accounting standards. However, an MSRB official also told us that approach would be less effective than directly regulating issuers, an unreasonable burden on broker-dealers, be difficult to comply with and enforce, and could be viewed as an indirect obligation for issuers.

According to an expert, a market participant group, and SEC staff with whom we spoke, standardized accounting requirements could benefit investors by facilitating comparability of financial information across different issuers and securities, and make annual financial information easier to understand, particularly for individual investors. We previously reported that many industry participants think GAAP-basis financial statements provide a fuller, more transparent picture of a government's financial position than those prepared in accordance with other bases of accounting.[51] Reporting of pension liability is one of the areas that market participants and experts we surveyed said should be improved. Appendix IV provides information on several industry-driven efforts to improve pension liability reporting in municipal securities disclosure documents.

However, according to some interview and survey participants, issuers could face challenges in complying with standardized accounting requirements. According to a market participant group and small and conduit issuers with whom we spoke, as well as 2 of 21 experts we surveyed, complying with complex and changing GAAP standards would be too costly for smaller issuers that may not have full-time accounting staff and lack technical expertise. Some issuers also told us a

[50]GASB establishes GAAP for state and local governments. However, issuers of municipal securities are not required to prepare financial statements according to GAAP.

[51]See GAO, *Dodd-Frank Wall Street Reform Act: Role of Governmental Accounting Standards Board in the Municipal Securities Markets and Its Past Funding*, GAO-11-267R (Washington, D.C.: Jan. 18, 2011).

requirement to follow GAAP would be an unfunded mandate, particularly for small or infrequent borrowers because they would be required to invest in the staff time and expertise to prepare financial statements they would not otherwise prepare.[52] Some issuers also questioned the potential benefits to investors of mandated GAAP compliance, saying that statements that comply with GAAP provide too much irrelevant information to investors.

An MSRB official told us authority to prescribe accounting standards would be more appropriate for SEC, as such authority would be within its regulatory purview because of its oversight of the corporate market.[53] MSRB stated it had neither the expertise nor resources to determine appropriate accounting standards and likely would not support such action. An MSRB official told us that appropriate due diligence and consideration of the balance of benefits and burdens should be conducted before requiring all issuers to comply with GAAP standards because of the significant impact such a mandate could have on issuers. SEC staff told us SEC had not expressed a view on whether SEC should have authority to prescribe accounting standards used in primary and continuing municipal disclosure documents. SEC staff told us it could be desirable to require municipal issuers to use GAAP-basis accounting for their securities offerings, but it may be appropriate to first apply any requirement to the largest and most frequent municipal issuers. In 2009, an SEC Commissioner suggested that legislation could provide SEC with authority to require municipal issuers to use GAAP and recognize the financial accounting and reporting standards of an accounting standard-

[52]Because of the number of issuers—estimated at more than 50,000—our examples only illustrate categories of costs that could affect issuers.

[53]SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies, but has looked to private-sector standard-setting bodies to develop these accounting principles and standards. For example, SEC had recognized the Accounting Principles Board as the authoritative source for GAAP until 1973. Since the formation of the Financial Accounting Standards Board (FASB) in 1973, SEC has designated FASB as the private-sector standard-setter whose accounting principles are recognized as "generally accepted" for purposes of federal laws for public companies. The Sarbanes-Oxley Act of 2002 established criteria that must be satisfied for the work product of an accounting standard-setting body to be recognized as "generally accepted." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 108, 116 Stat. 745 (2002). In 2003, SEC reaffirmed FASB as the private-sector standard setter. Commission Statement of Policy: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Securities Act Release No. 8221, Exchange Act Release No. 47,743 (Apr. 25, 2003).

setting body, such as GASB, as "generally accepted."[54] In a 2010 speech at a securities regulation seminar, the Commissioner identified options for improving municipal securities disclosure that SEC would examine in an ongoing review of the municipal securities market.[55] They included mandating the use of uniform accounting standards, such as GAAP standards.

Require Time Frames for Annual Reporting

Four of 21 experts and 4 of 21 market participant groups we surveyed, and 2 market participant groups we interviewed, suggested that federal regulators should require issuers to submit annual financial statements and operating information on a timely basis. Suggestions included that state and local government issuers should meet a standard of 120 or 180 days, or adhere to the same standard as corporate issuers.[56] Improving timeliness could benefit the market by helping build investor confidence in a particular security or issuer and thereby increase investor demand for municipal securities, according to 3 of the market participant groups and 1 of the experts. In turn, increased demand theoretically could improve pricing and increase liquidity, but to what extent this would be the case is unknown. While SEC requires in Rule 15c2-12, as a condition of an underwriting, that an underwriter must reasonably determine that the issuer or obligated person has agreed in a continuing disclosure agreement to specify the date on which annual financial information will be provided, SEC does not have authority to enforce this aspect of the agreement.

Issuers discussed potential challenges of meeting shorter annual reporting time frames. Large issuers (including states, cities, and a county) told us a dependence on other entities—including component units of government—for information could prohibit entities that satisfy their annual reporting obligation by submitting audited financial statements from completing audited financial statements in shorter time

[54]See Elisse B. Walter, "Regulation of the Municipal Securities Market: Investors Are Not Second-Class Citizens" (New York, N.Y.: Oct. 28, 2009).

[55]See Elisse B. Walter, "Remarks before the Forty-third Annual Regulation Securities Seminar," (Los Angeles, Calif.: Oct. 29, 2010).

[56]Corporate issuers adhere to a 60-, 75-, or 90-day reporting standard based on their size and market capitalization.

frames.[57] A state conduit issuer said some issuers might rely on a state to reconcile Medicare payments after the close of the fiscal year before they could report GAAP-compliant financial statements. In addition, some issuers said a limited availability of auditors of governmental entities could impede issuers from complying with a mandated annual reporting time frame.[58] Some states require their local governments to use state auditors, in which case the local government might have little to no control over the timing of the audit. Other states use private-sector auditors, and several issuers told us that there is a shortage of these auditors. For example, an issuer from Wisconsin noted that major accounting firms have reduced staff resources supporting public-sector audits, and smaller auditing firms also have moved away from government audits.

MSRB staff discussed with us their perspectives on possibly requiring issuers to provide annual financial information on a timelier basis. They said the diversity of the issuer community and significant impediments to implementing such an option would need to be evaluated before putting in place such a requirement. In response to market participant concerns that information needed to make informed investment decisions is stale in many cases, MSRB recently developed features in EMMA that allow issuers, obligated persons, and parties providing disclosure upon their behalf, to voluntarily specify a time frame of 120 or 150 days for submitting annual financial information.

Require Quarterly Reporting

Three market participant groups we interviewed and 1 of 21 market participant groups we surveyed told us federal regulators should require

[57]Component units, according to GASB Statement 14 as amended by Statement 61, are legally separate organizations for which a primary government is financially accountable or other organizations whose relationship with a primary government is such that their exclusion from annual financial statements would be misleading. Both states and smaller units of government have component units. For example, colleges can be component units of states and school districts can be component units of cities or counties. A recent report by a working group from the National Association of State Auditors, Comptrollers, and Treasurers said the majority of state issuers lack control or influence over the preparation or timing of component unit audits. Large issuers told us it would be challenging to compile information from component units in shorter time frames, as primary governments lack supervisory power to require component units to provide financial information within shorter time frames.

[58]By auditors of governmental entities, we mean both government auditors and private-sector auditors of governmental entities.

issuers to disclose unaudited financial information on a quarterly basis in EMMA, similar to requirements for corporate issuers. According to 3 market participant groups, more frequent reporting could help provide investors with more timely, relevant information.

Four of seven large issuers and three of six small issuers told us they posted interim financial information to their websites, including unaudited quarterly financial statements and budget reports. Three other small issuers that produced interim financial reports told us they did not post such information on their websites, but could provide it to investors or others on request. Issuers that already produce interim financial information could face minimal cost to submit it to EMMA. Additionally, members of a market participant group representing issuers said unaudited interim financial information might be easier for issuers to prepare than annual audited financial reports (for issuers that fulfill their annual reporting obligation as agreed in their continuing disclosure agreement by providing audited annual financial statements) and provide investors with more current and relevant information. One market participant group representing issuers told us smaller issuers could have a greater incentive to disclose interim financial information for the benefit of investors out of competitive pressure as more issuers adopted the practice.

However, issuers and a market participant group indicated that a requirement for issuers to provide quarterly information to EMMA could be costly, would involve liability concerns, and could result in a limited presentation of financial information that excludes information on accrued assets and liabilities. Some large, small, and conduit issuers with whom we spoke said preparing interim financial information for EMMA would require additional staff resources and, with governments' limited resources, likely would result in issuers reallocating staff resources from other areas. For example, several large issuers and conduit issuers told us they and others would need to hire additional accounting staff if required to provide standardized quarterly financial reports. Large and small issuers also cited concerns about their liability under SEC's antifraud authority of posting unaudited financial information to EMMA, and a market participant group suggested that issuers would be more willing to disclose interim information if they could disclaim liability from the antifraud provisions of the federal securities laws. SEC staff told us that issuers and others cannot disclaim liability or responsibility for their disclosures under the antifraud provisions. Finally, several large and small issuers with whom we spoke and 1 of 21 market participant groups we surveyed said significant adjustments that some government entities

make only at year-end to meet GAAP requirements would make it infeasible to determine an issuer's financial condition from interim financial reports, as interim information would provide an incomplete picture of an issuer's financial condition.

In a 2010 speech to the Investment Company Institute, the SEC Chairman stated that requiring periodic disclosure of financial information—such as tax revenues, expenditures, tax base changes, or pension obligations—could help improve municipal securities disclosure.[59] Further, MSRB staff told us quarterly disclosure could enable investors to better compare different types of securities, as more information would be available for comparative analyses. In addition, they said more frequent disclosure in theory could increase liquidity and improve pricing, but it would be difficult to determine to what extent, and whether, more frequent disclosure would increase liquidity and improve pricing. MSRB staff told us variation among the issuer community also constitutes a significant barrier to mandating more frequent disclosures. They said a tailored approach would be more effective than a one-size-fits-all requirement for issuers to provide more frequent disclosure information.

Require Certain Conduit Borrowers to Comply with Corporate Disclosure Requirements

Four of 21 experts and 1 of 21 market participant groups we surveyed and several issuers we interviewed said SEC should require corporate borrowers that issue debt in the municipal market to comply with disclosure requirements for corporate issuers because this sector has been responsible for most payment defaults.[60] Although a few sectors of the municipal market with corporate borrower participation provide disclosure beyond that required by Rule 15c2-12, not all do. According to SEC staff with whom we spoke, requiring corporate disclosure of conduit borrowers would require certain statutory action to repeal Securities Act exemptions for certain types of securities; however, the Tower Amendment could remain in place. While the Tower Amendment restricts

[59]See Mary L. Schapiro, "Remarks at Investment Company Institute 2010 General Membership Meeting," speech as delivered by Andrew J. Donohue (Washington, D.C.: May 7, 2010).

[60]Survey respondents and issuers with whom we spoke did not advocate changes to the exemption for nonprofit conduit borrowers.

SEC from requiring prefiling information from municipal securities issuers, the restriction does not apply to conduit borrowers, as they are not municipal securities issuers. Whether a corporate conduit borrower is subject to registration and reporting requirements for public companies would depend on whether the corporate conduit borrower qualified for a specific exemption under the Securities Act.

Two market participant groups and an expert with whom we spoke suggested that applying corporate disclosure requirements to conduit borrowers would provide a risk-based approach to improving disclosure. They said focusing changes of disclosure rules on the highest-risk sectors of the market would improve investor protection in the areas of greatest need. One expert we surveyed said conduit borrowers should be required to provide investors with more information because conduit borrowers benefit financially from reduced interest rates on tax-exempt municipal bonds. The expert said eliminating exemptions for corporate borrowers could provide clarity to investors on what entities issue debt in the municipal market, and could provide investors with access to the same registration and disclosure information that otherwise would be available on the same entities if issuing securities in the corporate market. While eliminating exemptions for conduit borrowers could improve transparency, one small issuer told us there could be some costs to government issuers, as some local governments may be required to assume development costs. Conduit issuers agreed that eliminating exemptions could increase costs to conduit borrowers and cause some to leave the market—in theory, leading to lost economic development opportunities.

SEC staff have recommended that the exemption provided by Section 3(a)(2) of the Securities Act be eliminated for corporate conduit borrowers.[61] In 1994, SEC supported this option, but the current commission has not taken a position on this issue. SEC staff have been examining this issue as part of their ongoing study of the municipal securities market. MSRB staff said market participants reported that

[61]Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Securities Act Release No. 7049, Exchange Act Release No. 33,741, 56 SEC Docket 479 (Mar. 9, 1994). Section 3(a)(2) exempts from registration under the Securities Act certain types of industrial development bonds, which corporate entities typically issue through governmental entities. For the relevant staff reports, see SEC, *Staff Report on the Municipal Securities Market* (Washington, D.C.: Sept. 1993), and *Disclosure and Accounting Practices in the Municipal Securities Market* (Washington, D.C.: Jul. 26, 2007).

municipal securities with conduit borrowers in some sectors have been less compliant with continuing disclosure agreements than other types of municipal securities. They said planned improvements to EMMA could help users identify and track conduit issuances, which could aid conduit borrowers in managing their continuing disclosure obligations or help regulators and investors track securities with conduit borrowers.

Other Options for Improving Continuing Disclosure Could Be Achieved within Existing Regulatory Framework

Experts and market participant groups we surveyed and others with whom we spoke suggested other options for improving disclosure that could be implemented within the existing regulatory framework. These included further improving the functionality of EMMA and strengthening efforts to promote EMMA to issuers and investors. Other options included expanding SEC enforcement activities and improving the readability and usefulness of disclosure information by providing guidance or requiring use of plain English in disclosures.

Improve and Promote EMMA

Six market participant groups with whom we spoke and 4 of 21 experts and 3 of 21 market participant groups we surveyed told us EMMA was a significant improvement from the former system for distributing disclosure, and 2 market participant groups said its usefulness had improved since it was first implemented. Members of a group representing issuers said the system provided issuers greater certainty about their compliance with continuing disclosure agreements, as EMMA allows issuers to verify what information they submitted to the system and where it was posted online. When using the former system, issuers mailed in paper documents and lacked the ability to see whether information was filed or if it had been categorized correctly. They said EMMA had made it easier to more accurately file disclosure information, as it was easier to associate disclosure information with appropriate identifiers (CUSIP numbers).

Nevertheless, 6 market participant groups we interviewed and 3 of 21 market participant groups and 2 of 21 experts we surveyed suggested further improvements to EMMA could benefit disclosure.[62] Suggestions for improving EMMA included making it easier for investors to find specific securities, making it easier for investors to determine whether financial information had been submitted, and ensuring that information was

[62]MSRB has issued a long-range plan for further developing the EMMA system, which we discuss later in this report.

properly coded to appropriate categories and securities. According to one market participant group with whom we spoke, further improving EMMA's functionality would reduce the time and level of effort required of EMMA users to understand the significance of the information provided. Two market participant groups representing issuers told us that while EMMA has made it easier for them to manage their investor disclosures and determine whether disclosures are publicly available, additional improvements would further increase the functionality and usefulness of the system. MSRB staff agreed that further improving EMMA would encourage greater issuer discipline in complying with continuing disclosure agreements, because functionality improvements to EMMA could provide investors better access to disclosure information and, in turn, increase investor demand for disclosure in EMMA.

Four of 21 market participant groups we surveyed and 3 others with whom we spoke said regulators could strengthen efforts to educate issuers on their disclosure responsibilities. For instance, three market participant groups we interviewed told us some issuers have not yet submitted information to EMMA because they might not be aware of their disclosure obligations under their continuing disclosure agreements. Regulators discussed with us their efforts to educate issuers about EMMA. MSRB's primary education focus for the first year after launching EMMA was to inform and train issuers on their new obligations to file disclosure information to EMMA. According to MSRB staff, these efforts included providing industry conference presentations, developing webinars, creating a call center to provide support to issuers submitting information to EMMA, and posting a list of frequently asked questions on the MSRB website. While these efforts have continued, MSRB has updated its issuer education focus from introducing EMMA to how to leverage EMMA to communicate directly with investors. In November 2011, MSRB launched a toolkit for state and local government issuers on its website, which included information on making continuing disclosure submissions to EMMA and how issuers can better use the information available on EMMA. While MSRB staff view MSRB's initial issuer education efforts as successful because frequent issuers are aware of EMMA and MSRB received positive feedback from the issuer community, they said additional work was needed to educate infrequent, small issuers.

Four of 21 market participant groups and 1 of 21 experts we surveyed also suggested that regulators could strengthen efforts to improve investor awareness of EMMA, as the extent to which individual investors use EMMA is difficult to ascertain. More specifically, 7 of the 12 individual

investors with whom we spoke did not use EMMA to obtain disclosure information because a few said they were not aware of EMMA and several said they relied on advisors for investment advice and information instead of conducting their own research.

Regulators said they expected investor awareness of EMMA to improve over time, and described the extent of their efforts to make investors aware of EMMA. In 2009, MSRB initiated an education and outreach effort to raise awareness of EMMA among investors and others who act on their behalf, and to promote use of the site by market participants. MSRB has used websites, social media, search engines, print and broadcast media, and public speaking engagements, among other things, to communicate to investors, issuers, and the broker-dealer community about EMMA. MSRB also requires that trade confirmations or other documentation associated with primary market transactions provide notice that primary offering disclosure information (official statements) is available through EMMA. Further, MSRB developed an online education center and in May 2012 launched an investor toolkit on its website. MSRB staff told us they plan to develop focus groups of investors to explore ways to improve EMMA, which could include how to improve investor education efforts. Additionally, SEC, FINRA, and others have promoted EMMA on various websites relevant to investors interested in purchasing municipal securities.

Expand SEC Enforcement Activities

Three of 21 market participant groups and 1 of 21 experts we surveyed, and 3 market participant groups with whom we spoke suggested SEC could expand its enforcement activities using its existing antifraud authorities as leverage to improve issuers' adherence with continuing disclosure agreements. As discussed previously, SEC does not have the authority to directly require issuers to submit continuing disclosure information to EMMA. SEC enforcement actions using its antifraud authority could encourage issuers to comply with their continuing disclosure obligations. For example, one issuer we interviewed said he was careful to comply with the continuing disclosure agreement, as he did not want to risk the city becoming the subject of an SEC enforcement action.

An expert and a market participant group we surveyed, and two market participant groups we interviewed discussed the potential benefits of increased enforcement activity. They said a few high-profile enforcement actions could improve disclosure compliance. For example, representatives of a national group that advises issuers on their disclosures said enforcement actions and interpretive releases were their

main sources of guidance for preparing or advising issuers about disclosure information.

To be held liable under the antifraud provisions, issuers must make a material misstatement or omission in their disclosures or public statements (such as to EMMA or in a speech).[63] SEC has initiated enforcement actions against state and local governments for materially false and misleading disclosures they provided to investors in connection with publicly offered municipal securities. For example, SEC found that the State of New Jersey and the City of San Diego violated antifraud provisions by misstating or omitting material information about the annual funding of their pension obligations, which SEC alleged to be material information on which investors would rely.[64] To strengthen enforcement efforts in the municipal securities market, SEC created a municipal securities and public pensions unit in its Division of Enforcement in January 2010. Initial efforts by the division include identifying market activities that pose the greatest risk to investors and identifying potential violations.

Provide Guidance to Help Standardize Disclosure

Six of 21 experts and 8 of 21 market participant groups we surveyed suggested efforts by regulators to standardize disclosure information could benefit investors by improving the content and readability of disclosure. Their suggestions included that SEC establish disclosure guidance on ways to standardize the organization of information or highlight what information could be important according to the type of security or credit sector. Additionally, an investor suggested regulators develop a one-page template issuers could use to provide information most pertinent to investors, in an easily understood format.

Three of 21 market participant groups we surveyed and a market participant group and an investor with whom we spoke said additional

[63]SEC staff told us that the antifraud provisions of the federal securities laws are broad, and may be utilized against persons (including issuers, local officials, underwriters, and financial advisors) in cases alleging fraudulent statements and omissions in offering documents, annual financial information, other statements, or disclosures made by municipal issuers, and, in some cases, public comments made by officials who make a material misstatement or omission in their disclosures or public statements.

[64]*See In re* New Jersey, Securities Act Release No. 9135 (Aug. 18, 2010); *In re* City of San Diego, Securities Act Release No. 8751, Exchange Act Release No. 54,745 (Nov. 14, 2006).

guidance or templates could improve the readability and comparability of information disclosed in EMMA, improving investors' understanding of the information. Additionally, an expert said such guidance, outlining broad categories of basic information all issuers should provide, would be particularly helpful to small or infrequent issuers that lack the resources needed to maintain an awareness of industry changes in disclosure standards. However, many large, small, and conduit issuers with whom we spoke identified potential challenges to providing standardized information. They said standardized formats could require different information from what is collected and maintained now, requiring changes that could impose additional costs on issuers through increased staff time, hiring additional expertise, and associated opportunity costs. Also, 1 of 21 market participant groups we surveyed was concerned that direct regulation of disclosure content and format by SEC or MSRB could have an adverse effect on the quality of disclosure information. That is, standardized information might provide investors with information that was too general to be useful.

SEC staff said they have been exploring different ideas to assist municipal issuers in improving disclosure as part of the staff's ongoing review of the municipal securities market. For example, SEC staff told us SEC could consider having a role in helping issuers determine what types of information would be useful for investors' decision making. While MSRB had not specifically discussed developing templates for disclosure in its long-range plan for EMMA, staff told us MSRB could consider possible options to help standardize disclosure using its authority over how information gets submitted to EMMA. MSRB staff told us examples could include creating a template for baseline disclosure such as an online form for submitting information to EMMA, or providing guidance or best practices to show patterns of good disclosure and highlight good disclosure practices. Staff also suggested MSRB could consider developing an online library of links to websites with guidance and best practices developed by industry groups and regulators.

Require Use of Plain English

Three of 21 market participant groups and 1 of 21 experts we surveyed suggested federal regulators should require issuers to use plain English when preparing information for submission to EMMA. For example, they suggested issuers use plain language to describe financial information or the implications of event notices.

To some extent, issuers already have been following these practices. Municipal issuers that satisfy their annual reporting obligation (agreed on in their continuing disclosure agreement) by submitting an annual

financial report prepared in accordance with GASB rules provide a management discussion and analysis.[65] Additionally, four of seven large issuers and three of seven conduit issuers with whom we spoke had made efforts to incorporate plain language into their annual financial reports and other financial information they posted to their websites. For example, three of seven large issuers said using plain language was a long-time goal. However, large, small, and conduit issuers with whom we spoke said cost factors, including potential liability under SEC antifraud authority, lack of internal expertise, and complex accounting standards, have made it challenging to summarize or interpret the disclosure information they provide in plain language. Because of these factors, one large issuer told us investors should seek assistance from brokers or financial advisors on interpreting financial disclosure information, rather than relying on issuers to provide plain language or summary information.

MSRB staff told us it would be difficult to enforce a requirement that information provided to EMMA use plain English, given the number and diversity of municipal issuers. They said it would be easier to mandate use of plain English if SEC had direct authority over municipal issuers.

MSRB and SEC Have Been Taking Steps to Address Some Options

MSRB has taken recent actions to improve the timeliness of disclosure of financial information, the frequency of disclosure, and the completeness of disclosure filings through improvements to EMMA with a focus on the system's functionality. Examples of recent improvements include the following:

- Filing date information—MSRB expanded the information underwriters report at the time of an offering to include the date by which issuers agree to provide annual financial information. This information is

[65]GASB Statement 34 established financial reporting standards for state and local governments and established that the basic financial statements and required supplementary information for government entities should include a management discussion and analysis. Among other things, the management discussion and analysis should provide an analysis of the government's overall financial position and results of operations to assist users in assessing whether the government's financial position had improved or deteriorated as a result of the year's activities.

displayed in EMMA, making lapses in annual disclosure more transparent to users.[66]

- Voluntary information—MSRB also developed features in EMMA that allow issuers to submit different types of information on a voluntary basis, including monthly budget updates. Additional changes, which became effective May 2011, permit issuers, obligated persons, and parties providing disclosure on their behalf, to provide to EMMA additional categories of information including specifying a timeframe of 120 or 150 days for submitting annual financial information, indicating use of GAAP as established by GASB or Financial Accounting Standards Board (FASB), or providing a web address (URL) where additional financial information is available.[67] An issuer's agreement to participate in any of these voluntary undertakings would be prominently displayed in EMMA.
- Rating information—MSRB implemented a direct feed to EMMA of ratings information from two of the rating agencies that currently provide ratings on municipal securities.[68] According to MSRB, the rating agencies voluntarily provide ratings information to EMMA, which is updated automatically. Consequently, EMMA users who previously might not have been aware of rating changes affecting their securities could obtain timely and accurate information.

In addition to these recent efforts, in January 2012, MSRB issued its long-range plan for further developing the EMMA system.[69] According to MSRB's long-range plan, planned improvements reflect suggestions MSRB received from market participants and others through such venues as industry roundtables, outreach events, targeted meetings, and

[66]MSRB staff told us that MSRB is prohibited under the Tower Amendment from reviewing disclosure content. Although a recent rule change would enable EMMA users to determine whether an issuer has submitted annual financial information in accordance with its pledge, users determine whether the content of the disclosure is complete. See MSRB Notice 2011-08 (Feb. 7, 2011).

[67]Issuers can indicate voluntary plans to submit to EMMA annual financial information within 120 calendar days after the end of their fiscal year, or as a transitional alternative through 2013, within 150 calendar days after the end of the applicable fiscal year.

[68]MSRB staff told us that MSRB has committed to providing ratings information on EMMA from any nationally recognized statistical rating organization that rates municipal securities, agrees to participate, and makes appropriate arrangements to do so.

[69]See MSRB, *Long-Range Plan for Market Transparency Products* (Jan. 27, 2012), available at http://www.msrb.org/About-MSRB/Programs/Long-Range-Plan-for-Market-Transparency-Products.aspx.

feedback through the EMMA website. MSRB's long-range plan includes improving search capabilities to make it easier for investors to find securities. Planned changes would allow users to find specific securities information using information other than CUSIP numbers, such as keywords, map-based information, or hierarchy-based searches (for example, securities within a given state), and would allow users to conduct advanced searches within disclosure documents. The plan also includes ongoing work with the issuer community to develop additional tools and utilities to help issuers manage their debt portfolios and to promote more comprehensive and timely disclosure. For example, MSRB plans to develop more flexibility for issuers to manage disclosure submissions and their appearance in EMMA. These new EMMA capabilities could enable issuers to compare the disclosure and performance of their securities with their peers' securities. MSRB also plans to continue promoting awareness of EMMA and provide additional online education information for investors, including how to work with advisors, access pricing information, and use EMMA.

SEC's ongoing study of the state of the municipal securities market has focused on a range of issues such as primary and secondary market disclosure practices, financial reporting and accounting, investor protection and education, and market structure (including pretrade price transparency).[70] SEC staff told us one purpose of the study is to identify risks in the market and what types of changes, if any, might be needed, including changes in the quality and timeliness of disclosure information provided to the market. SEC staff expect to release their staff report in 2012, and include legislative, regulatory, and industry best practices and recommendations to SEC Commissioners for measures to improve primary and secondary market disclosure practices, measures to improve market practices, and associated regulation. In addition, the Dodd-Frank Act required SEC to create an Office of Municipal Securities to administer SEC rules for municipal securities brokers and dealers, advisors, investors, and issuers, and to coordinate with MSRB on rulemaking and enforcement actions. SEC has been in the process of hiring an Office of

[70]As part of its review, SEC facilitated three field hearings to gather perspectives on issues facing the municipal securities market, held in-person meetings with some market participant groups, and received public comments. SEC held field hearings in San Francisco, California; Washington, D.C.; and Birmingham, Alabama. We previously reported SEC had planned to hold more field hearings, but was unable to do so because of budget constraints. See GAO-12-265. Instead, staff held a number of "mini muni" meetings, with a variety of municipal securities market stakeholders at SEC's offices.

Municipal Securities director and staff. SEC's fiscal year 2012 budget provides for five full-time staff; however, as of April 2012, the office had three employees.

Agency Comments

We provided a draft of this report to SEC, MSRB, and FINRA for comment. SEC and MSRB provided technical comments, which we incorporated, as appropriate. FINRA did not provide comments on the draft report.

We are sending copies of this report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Public Affairs and Congressional Relations may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix V.



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Director
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Appendix I: Objectives, Scope, and Methodology

The objectives of this report were to (1) examine the extent to which information currently provided on municipal securities is useful and the extent to which existing regulation reflects principles for effective disclosure; and (2) identify options for improving the information issuers disclose to investors of municipal securities, and the related benefits and challenges of these options for investors and issuers.

To describe the extent to which information is useful for investors, we reviewed documents from the Securities and Exchange Commission (SEC) and the Municipal Securities Rulemaking Board (MSRB), including rulemakings, studies, statistical reports, staff reports, and a plan that described various issues concerning municipal securities disclosure. We reviewed the transcripts of SEC hearings on the state of the municipal securities market held in San Francisco, California; Washington, D.C.; and Birmingham, Alabama, on various dates in 2010 and 2011. We also reviewed 45 comment letters submitted to SEC as of January 25, 2012, regarding its study of the municipal securities market. We conducted a case study of disclosure information that we obtained from MSRB's Electronic Municipal Market Access (EMMA) system and made observations about EMMA's ease of use, the completeness of the disclosed information, and the ease with which certain information could be found in the disclosures. As EMMA became the central repository for primary market and continuing disclosures in July 2009, we reviewed 14 issuances that were offered between July and December 2009. The issuances reviewed included 2 issued by small governmental entities (a school district and a fire district), 2 issued by medium-sized governmental entities (a utility district and a city), and 2 issued by large governmental entities (a state and a city education board) for general-obligation debt issuances. One issuance was a general-obligation bond issued for a public hospital. The remaining 7 consisted of conduit issuances for a variety of projects, including an airport, solid waste facility, multifamily housing complex, stand-alone hospital, hospital system, continuing care retirement community, and nursing home. We also reviewed independent and academic studies on the usefulness of disclosure information and default studies from the three largest rating agencies as well as data on municipal securities defaults from an independent research firm to understand the risks to investors of municipal securities. We used data from Standard & Poor's and Moody's Investors Service to compare default rates for U.S. municipal issuers and global corporate issuers rated by each rating agency. We assessed the reliability of these data and found it to be reliable for this purpose. In addition, we worked through the American Association of Individual Investors to identify and interview 12 retail investors with diverse investment experience with municipal

securities. We also interviewed institutional investors (including representatives for eight investment companies), professional analysts, a rating agency, an independent research firm, and groups representing market participants, including broker-dealers, bond lawyers, and municipal advisors. Finally, we interviewed staff of federal and state regulators, including SEC, MSRB, the Financial Industry Regulatory Authority (FINRA), and the North American Securities Administrators Association.

To describe the extent to which the information that issuers must provide reflects principles for effective disclosure, we reviewed federal laws and rules, agency regulations, and interpretive guidance that set forth disclosure requirements related to municipal securities. We reviewed SEC Rule 15c2-12, the primary SEC rule relating to underwriters of municipal securities. We reviewed information on SEC regulations for insider trading and that establish fair disclosure requirements for corporate securities to determine their applicability to municipal securities. We also reviewed SEC's antifraud authorities in the Securities Act of 1933 and the Securities Exchange Act of 1934, as well as provisions of these acts that exempt municipal securities from SEC registration and periodic reporting requirements. In addition, we reviewed MSRB's facility filing on EMMA, which establishes requirements for submitting disclosure information to the system. We compared these requirements with principles for effective disclosure and had two analysts review and come to independent judgments to determine the extent to which disclosure regulations reflected the principles. We used two sources for criteria. First, we used *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* from the International Organization of Securities Commissions.[1] We believed these principles to be appropriate criteria for use in this context because our data collection indicated that continuing disclosure was a key issue for municipal securities disclosure. Although trading of municipal securities in the secondary market is infrequent, trading volume is substantial, indicating the importance of continuing disclosure. We did not use one of the principles—simultaneous and identical disclosure—in our analysis because the principle referred to making disclosures across borders, which is not important for municipal securities because the market is

[1]International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* (October 2002).

largely domestic and the securities do not trade on exchanges. Second, we used SEC's *A Plain English Handbook: How to Create Clear SEC Disclosure Documents*, which sets forth principles for preparing disclosure documents in easy-to-understand language.[2] We believed these principles to be appropriate criteria for municipal securities disclosure because our data collection indicated that readability was an issue for investors and a national organization representing state and local governments had suggested the principles to its members for producing municipal securities disclosure documents.

To identify options for improving the information issuers disclose to investors, we reviewed compliance and enforcement information from SEC and FINRA, including examination manuals for Rule 15c2-12 and MSRB Rule G-32, which set forth broker-dealer requirements for disclosures in connection with primary offerings. We reviewed data on examinations that found violations of the rule, and in certain cases, reviewed examination reports. Furthermore, we surveyed experts and groups representing issuers and other market participants, such as municipal advisors, broker-dealers, and professional analysts. The questions we asked experts focused on the regulation of municipal securities disclosure, whereas the questions we asked market participant groups focused on disclosure practices. This is because our initial interviews with market participant groups illuminated conflicts of interest that made it challenging to discuss options for regulating municipal securities disclosure. We recruited experts with career expertise in the municipal securities market and without obvious conflicts of interest, which we defined as the potential to benefit personally or professionally from the outcomes of our study or with a constituent they might feel the need to satisfy. Surveys for both groups asked for options to improve disclosure. We used a nonprobability sampling method to identify and select experts by obtaining referrals from other market participants, experts, and regulators. Although our results are not generalizable, our survey covered a diverse group of experts and market participant groups with broad and differing perspectives. We administered the survey to 26 experts and 29 market participant groups and received responses from 21 experts and 21 groups. We analyzed options according to what was mentioned most frequently and excluded suggestions that were not based

[2]SEC, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: August 1998).

on a correct understanding of the existing disclosure regime or were beyond the scope of our review. To control for small variations across the suggestions, three analysts reviewed and came to independent judgments to assign suggestions into various categories. To identify the types of benefits and challenges related to suggested options, we interviewed 20 issuers in three groups representing (1) large and frequent issuers, (2) small and infrequent issuers, and (3) conduit issuers. The group consisting of large and frequent issuers included representatives of three states, three large cities, and a county. The group of small and infrequent issuers included representatives of five cities and a county with populations of 500,000 or fewer. The group of conduit issuers included representatives of three state housing finance agencies, three state health and educational facilities agencies, and a state bond bank. The issuers were geographically diverse, and represented entities from: California, Colorado, Florida, Georgia, Kansas, Maine, Maryland, Minnesota, New York, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Washington, and Wisconsin. We also drew on information obtained from our survey and other interviews we conducted with investors, regulators, and market participants.

We conducted this performance audit from June 2011 to July 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Key Federal Disclosure Requirements for Publicly Offered Municipal and Corporate Securities

Table 2 compares key federal disclosure requirements for municipal and corporate securities. The information in the table is organized according to whether requirements apply to primary or secondary market disclosure, with requirements that apply to both presented first.

Table 2: Comparison of Key Federal Disclosure Requirements for Publicly Offered Municipal and Corporate Securities, as of June 2012

Key federal disclosure requirement	Municipal	Corporate
Applicability of antifraud provisions[a]	Yes SEC is authorized to take enforcement actions against any person or entity that violates antifraud provisions.	Yes SEC is authorized to take enforcement actions against any person or entity that violates antifraud provisions.
Use of generally accepted accounting principles	No Issuers are not required to prepare financial statements according to generally accepted accounting principles (GAAP). There are no requirements covering the preparation of financial statements. Nevertheless, we previously reported that all states use GAAP for annual financial statements.[b] Utilization varies among local governments, where cash-basis accounting also is used. Governmental Accounting Standards Board (GASB) establishes GAAP for state and local governments.[c,d] Corporate and nonprofit obligated persons may use GAAP set by the Financial Accounting Standards Board (FASB).	Yes SEC requires U.S. public companies to prepare financial statements according to GAAP. SEC designated FASB as the GAAP standard setter for corporate filers. Auditors must conduct audits in accordance with the standards of the Public Company Accounting Oversight Board.

Key federal disclosure requirement	Municipal	Corporate
Regulatory review	No SEC is not authorized to require municipal issuers to file presale information with SEC prior to the sale of municipal securities.	Yes SEC staff may review a company's filings for various purposes. SEC reviews some registration statements and declares them "effective" if the company satisfies disclosure rules, at which time the company may begin to sell its securities. Sometimes, SEC staff do not review registration statements and declare them effective. Some registration statements are effective automatically. SEC staff selectively review filings, including periodic reports, and provide the company with comments in instances where they believe a company can improve its disclosure or enhance its compliance with applicable disclosure requirements. SEC staff view the comment process as a dialogue with a company about its disclosure. The Sarbanes-Oxley Act of 2002 requires SEC to undertake some type of review of a public reporting company's ongoing disclosure once every 3 years for compliance, and SEC may take enforcement actions.
Disclosure repository	Yes MSRB maintains EMMA (Electronic Municipal Markets Access), an online repository for disclosures.	Yes SEC maintains EDGAR (Electronic Data Gathering Analysis and Retrieval), an online repository for disclosures.
Exemptions	Yes The following types of municipal securities offerings are exempt, in whole or in part, from Rule 15c2-12 if one or more of the following conditions are met:[e] • principal amount is less than $1 million; • maturity is 18 months or less; or • the securities are sold in denominations of $100,000 or more and meet standards for limited distribution. There is a limited exemption from Rule 15c2-12 for offerings of municipal securities of issuers with less than $10 million in outstanding municipal securities.	Yes Federal securities laws provide various exemptions from registration for the following securities or transactions: • offered and sold to residents of one state; • private offerings; or • sold through employee benefit plans. A public reporting company may terminate its periodic reporting obligations based on number of shareholders and asset value, or such obligation may be statutorily suspended.
SEC registration	No The Securities Act of 1933 exempts municipal securities from registration requirements.	Yes Offers and sales of securities must be registered under the Securities Act of 1933 unless an exemption is available.

Key federal disclosure requirement	Municipal	Corporate
Primary offering disclosure	Yes For offerings subject to Rule 15c2-12, the rule requires underwriters to obtain and review an official statement consisting of information about the terms of the proposed offering, financial and operating data that is material to an evaluation of the offering, a description of the continuing disclosure undertaking to which the issuer agreed, and information on any failure to comply with any continuing disclosure undertaking in the previous 5 years. Obligation to provide primary offering disclosure to investors is on the underwriter.	Yes For registered offerings of securities, SEC's requirements include a registration statement and prospectus consisting of information about the issuer, including financial information, the terms of the proposed offering, the most significant risk factors affecting the issuer, and the interests of experts or counsel that advised the issuer, among other things. There are securities offerings that are exempt from registration and therefore exempt from such disclosure requirements. The issuer is obligated to provide primary offering disclosure.
Continuing or secondary market disclosure content requirement	Limited Rule 15c2-12 requires, as a condition to underwriting, an underwriter to reasonably determine that an issuer or obligated person has agreed in writing at offering to provide ongoing notices of certain events and annual financial information and operating data.[f] Agreements are enforceable only by bondholders and other parties to or beneficiaries of the agreement, if any. SEC cannot enforce the terms of the agreement.[g] The underwriter's ability to engage in subsequent offerings is affected by whether the issuer has complied with their continuing disclosure agreements for prior undertakings. The underwriter must reasonably determine that the issuer has agreed to provide certain ongoing disclosure and disclose in the official statement compliance failures with previous undertakings for the previous 5 years.	Yes SEC requires public reporting companies to submit annual audited financial statements and unaudited quarterly financial statements. SEC also requires public reporting companies to file notices of certain current specified events.
Secondary market disclosure format requirement	Limited MSRB requires EMMA submissions in portable document format and to be accompanied by certain indexing information.	Yes SEC requires that information filed on EDGAR to be in plain text or HTML. SEC requires most filers to submit data in an interactive format, XBRL. SEC provides detailed written guidance on the form and content for various filing requirements.

Key federal disclosure requirement	Municipal	Corporate
Secondary market disclosure timing requirement	Limited There is no federal requirement to provide annual financial information within a certain time frame after the end of the fiscal year. Rule 15c2-12, however, requires that the date be specified in the written undertaking of the issuer or other obligated person. SEC Rule 15c2-12 requires continuing disclosure agreements to include the provision of certain event notices within 10 business days of the date of occurrence; however, the terms of continuing disclosure agreements are unenforceable by SEC.	Yes Annual financial information must be filed within 45, 60, or 90 days after the end of the fiscal year, depending on the type of issuer. Quarterly financial information must be filed within 45 days after the end of the quarter. Current event notices must be filed within 4 business days of the event date.

Source: GAO summary of SEC and MSRB policies, rules, and regulations.

[a]SEC has authority to enforce statutory provisions and rules that prevent fraud in connection with the offer, purchase, and sale of securities. SEC may hold issuers and others responsible for misstatements or omissions of material information from disclosure.

[b]See GAO, *Dodd-Frank Wall Street Reform Act: Role of the Governmental Accounting Standards Board in the Municipal Securities Markets and Its Past Funding*, GAO-11-267R (Washington, D.C.: Jan. 18, 2011).

[c]GASB was established in 1984 as an operating component of the Financial Accounting Foundation. GASB is recognized by the American Institute of Certified Public Accountants as the body that establishes GAAP for state and local governments.

[d]We previously reported on the role and relevance of GASB in the municipal securities markets. Stakeholders with whom we spoke found GAAP-basis financial statements to be highly useful for assessing the quality of municipal securities compared with other bases of accounting. Examples of utility that they cited included that GAAP-basis statements provided important information on topics such as pensions and postemployment benefit plans, and that the management discussion and analysis section and enhanced disclosures in the notes sections provided context on an issuer's financial position. However, views on the pension information (in particular, the appropriate way to measure and accrue cost for these obligations) have become widely divergent. In addition, GAAP-basis financial statements are complex and expensive to prepare and governments are not always timely in issuing audited financial statements. See GAO-11-267R. In 2009, GASB issued an invitation to comment on pension accounting issues, followed by a preliminary views document in 2010, and two exposure drafts of proposed revised pension accounting standards in 2011. GASB approved its revised pension accounting standards in June 2012. The new standards apply to financial reports of pension plans for reporting periods beginning after June 15, 2013, and to government accounting and disclosure of pension information for fiscal years beginning after June 15, 2014.

[e]SEC Rule 15c2-12 establishes requirements applicable to underwriters of municipal securities.

[f]An obligated person is any person, including an issuer of municipal securities, who is committed by contract or other arrangement to support payment of the obligations on the municipal securities to be sold in an offering. Municipal securities may be issued by a governmental issuer acting as a conduit for the benefit of a private-sector entity or a nonprofit organization. Much of the disclosure for these securities pertains to and is provided by the obligated person. Examples of such obligated persons include not-for-profit hospitals, multifamily housing developers, lessees of airport and port facilities, and companies and persons that are the recipients of the proceeds of municipal securities issued for industrial or economic development projects.

[g]Antifraud provisions of the Securities Act of 1933 and Securities Exchange Act of 1934 prohibit the omission or misrepresentation of material facts in connection with the offer, purchase, or sale of any security, including a municipal security. SEC has used the antifraud provisions to bring enforcement actions against issuers that misrepresented their pension liability in official statements (which also may be looked to as secondary market disclosure for previously issued securities).

Appendix III: Principles of Effective Disclosure Compared with Current Disclosure Regulations for Municipal Securities

We compared requirements for continuing disclosure in the Securities and Exchange Commission's (SEC) Rule 15c2-12 and SEC's antifraud authorities with principles for effective disclosure that were developed by an international organization of securities commissions, which included SEC, and certain plain English principles developed by SEC.[1] We found that the current municipal securities disclosure requirements broadly reflect the seven principles for effective disclosure.

Table 3: Principles of Effective Disclosure Compared with Current Disclosure Regulations for Municipal Securities

Principle	Is this principle reflected in regulation?
Allocation of accountability	Yes
The issuer or obligated person is responsible for compliance with the continuing disclosure obligation.	SEC Rule 15c2-12 requires, as a condition of an underwriting, that an underwriter must reasonably determine that an issuer or obligated person, if any, has agreed to undertake for the benefit of bondholders to provide annual and event information over the lifetime of the security. Federal regulators do not have the explicit and affirmative authority to require issuers to comply with this aspect of the agreement. However, security holders may enforce the terms of the agreement through bringing suit against the issuer or obligated person.
Continuing disclosure obligation	Yes
Issuers or obligated persons should have a continuing disclosure obligation requiring disclosure of all information that would be material to an investors' investment decision.	SEC Rule 15c2-12 requires, as a condition of an underwriting, that an underwriter must reasonably determine that an issuer or obligated person, if any, has agreed to undertake for the benefit of bondholders to provide annual and event information over the lifetime of the security.
Disclosure criteria	Yes
Continuing disclosure of information should be fairly presented, not be misleading or deceptive, and contain no material omission of information.	SEC's antifraud provisions apply to municipal securities and participants in the municipal securities market. SEC has used its antifraud authority to take enforcement actions against municipal issuers for disclosing misleading information about the size of pension obligations.
Dissemination of information	Yes
Under the continuing disclosure obligation, issuers or obligated persons should ensure that full information is promptly made available to the market by using efficient, effective, and timely means of dissemination.	SEC Rule 15c2-12 requires, as a condition to an underwriting, an underwriter must reasonably determine that an issuer or obligated person has undertaken to provide disclosure information on EMMA, which allows for prompt submission to the market.

[1]See International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* (October 2002). See also SEC, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: August 1998). While municipal issuers are not required to follow these principles, we believe the International Organization of Securities Commissions criteria are relevant because our data collection indicated that continuing disclosure was a key issue for municipal securities disclosure. Although trading of municipal securities in the secondary market is infrequent, trading volume is substantial, indicating the importance of continuing disclosure.

Principle	Is this principle reflected in regulation?
Equal treatment of disclosure The information to be disclosed in compliance with the continuing disclosure obligation should not be disclosed to selected investors or other interested parties before it is released to the public. Narrow exceptions include advisors and rating agencies.	Yes Although no federal regulation specifically requires that all disclosure information for municipal securities be shared evenly with all investors, municipal securities, like other securities, are subject to SEC insider trading restrictions. Also, SEC Rule 15c2-12 requires, as a condition to an underwriting, an underwriter must reasonably determine that an issuer or obligated person has undertaken to provide disclosure information on EMMA, which helps ensure equal access to information.
Timeliness Issuers or obligated persons should disclose ongoing information on a timely basis, including: • prompt disclosure of material developments, and • annual information.	Partial SEC Rule 15c2-12 requires that as a condition of an underwriting, an underwriter must reasonably determine that an issuer or obligated person, if any, has agreed to provide notices of certain events within 10 business days and to specify the date on which the annual financial information for the preceding year will be provided. Although the rule requires that a date be specified in the undertaking for the filing of the annual financial information, it does not specify how long after the end of the fiscal year that date should be.
Use of plain English in official statements Official statements should: • use short sentences whenever possible, • use tables or bulleted lists (to present complex information) whenever possible, • use descriptive headings and subheadings, • avoid frequent use of defined terms (including acronyms and shortened names),and • avoid legal and highly technical business terminology.	No There are no regulations requiring the use of plain English in official statements, although some industry guidance recommends this practice.

Source: GAO summary of disclosure requirements for municipal securities.

Note: We compared the regulation of disclosure against principles for effective disclosure derived from two sources: International Organization of Securities Commissions, *Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities* (October 2002) and SEC, *A Plain English Handbook: How to Create Clear SEC Disclosure Documents* (Washington, D.C.: August 1998). We determined that one International Organization of Securities Commissions principle, simultaneous and identical disclosure, was not relevant to the U.S. municipal securities market because these securities are not listed, but traded over-the-counter, and investors predominantly are in the United States. Thus, the concept of listing in multiple jurisdictions largely does not apply.

Appendix IV: Pension Liability Reporting

Investors, a market participant group, and an expert told us that the reporting of pension liability in municipal securities disclosure documents could be improved with changes to accounting standards and financial reporting requirements. For example, several investors told us that Governmental Accounting Standards Board (GASB) standards, to the extent issuers adopted them, did not provide for reporting enough information, such as financial projections, that could help users determine whether an entity will have sufficient resources to cover future financial obligations. Consequently, there are concerns that future pension costs could crowd out an entity's ability to meet scheduled principal and interest payments on its municipal securities.

GASB and the National Association of Bond Lawyers have undertaken various efforts that could increase the amount of information reported on pension and other long-term liabilities, but the viability of certain proposals already has been questioned, and it is too early to determine how issuers will react to recent guidance produced by an industry coalition.

- In November 2011, GASB issued suggestions for broadening the information governmental entities report in annual financial reports to include projections of cash flow and long-term financial obligations (that is, bonds, pensions, other postemployment benefits, and long-term contracts) for a minimum of 5 years beyond the reporting period.[1] GASB issued these suggestions for public comment and anticipated that respondents could be sharply divided on the issue. Two of the seven board members did not agree with the suggestions. They said forward-looking financial information would be subjective, and they questioned the potential costs and benefits to governmental entities of preparing the information. They had concerns that the proposed suggestions could affect the timeliness of audited financial statements and some entities' willingness to report statements

[1]GASB, *Preliminary Views of the Governmental Accounting Standards Board on Major Issues Related to Economic Condition Reporting: Financial Projections*, No. 13-3 (Nov. 29, 2011).

compliant with generally accepted accounting principles, or GAAP (for those entities that can choose whether to comply with GAAP).[2]

- In May 2012, the National Association of Bond Lawyers issued guidance to help issuers provide disclosures about their pension funding in primary offering documents, or official statements.[3] The guidance was approved by a group of 12 national organizations representing municipal securities issuers, underwriters, analysts, institutional investors, accountants, actuaries, and others. The Government Finance Officers Association, which has produced disclosure guidance for its diverse membership of governmental issuers, has indicated it plans to approve best practices based on this guidance by October 2012. However, it is too early to determine what the best practices would encompass or the extent to which issuers would adopt them.
- In June 2012, GASB approved standards that amend accounting and financial reporting on pension plans.[4] Among other changes, these standards made more uniform the methodology used to calculate pension liabilities and costs, require governments to recognize their net pension liability on the balance sheet for the first time, and provide additional historical information about pension funding status. GASB believes the new standards will result in a more faithful representation of the full impact of pension obligations. We reviewed selected comment letters submitted to GASB regarding its proposals to revise its pension accounting standards, issued 1 year earlier in June 2011, and found that views on the pension information (in particular, the

[2]These board members suggested alternatives, including broadening standards for reporting historical information and information about how to obtain the subsequent year's budget. They said this information could provide an indication of the future of a governmental entity and that historical data help users to make conclusions about a government's ability to continue to provide its current level of service.

[3]National Association of Bond Lawyers, *Considerations in Preparing Disclosure in Official Statements Regarding an Issuer's Pension Funding Obligations*, (May 15, 2012). Available at http://www.nabl.org/uploads/cms/documents/pension_funding_obligations_document_5-18-12_b.pdf, as of May 18, 2012.

[4]The revised standards, approved as Statements 67 and 68, replaced previous pension plan reporting standards (Statements 25, 27, and 50). Specifically, Statement 67 revised guidance for the financial reports of most pension plans, effective for periods beginning after June 15, 2013, and Statement 68 established new financial reporting requirements for most governments that provide their employees with pension benefits, effective for fiscal years beginning after June 15, 2014.

appropriate way to measure and accrue cost for these obligations) had become widely divergent.[5]

[5]See GASB, *Accounting and Financial Reporting for Pensions: An Amendment of GASB Statement No. 27*, No. 34-E (June 27, 2011) and *Financial Reporting for Pension Plans: An Amendment of GASB Statement No. 25*, No. 34-P (June 27, 2011).

Appendix V: GAO Contact and Staff Acknowledgments

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