[Bond Case Briefs]

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Regulatory

[Lawmakers Threaten SEC with Ultimatum on MCDC.]

WASHINGTON — A bipartisan House duo is threatening the Securities and Exchange Commission, warning it must further ease the Municipalities Continuing Disclosure Cooperation initiative for dealers before the Sept. 10 deadline for participation or they will step in with legislative action.

Reps. Steve Stivers, R-Ohio, and Kyrsten Sinema, D-Ariz., delivered the ultimatum to SEC chairman Mary Jo White in an Aug. 28 letter obtained by The Bond Buyer.

The pair of lawmakers told White that the MCDC, which allows both issuers and underwriters to get favorable settlements by voluntarily reporting instances in the past five years in which they sold or underwrote bonds with materially misleading official statements, is causing confusion and needs to have its deadlines and financial penalty structure changed again before the dealer self-reporting deadline just after midnight Sept. 9.

The SEC announced the MCDC in March and amended it July 31 after weeks of near constant requests from various muni market groups and Stivers to do so. The changes included pushing the issuer and borrower reporting deadline back to Dec. 1, and introducing a tiered approach to financial penalty caps for dealers based on the gross revenues of the firms.

Those changes mostly drew approval from the issuers, but dealer groups and some issuers said having different reporting deadlines would only increase tension between an underwriter and an issuer, who effectively report on each other under the MCDC initiative, if one reports a transaction and the other does not.

Stivers and Sinema told White that extending the deadline for dealers would improve the program. "There is simply no justification for separate reporting deadlines," the lawmakers wrote. "Giving dealers additional time to communicate with their issuer clients before self-reporting violations would promote cooperation and help ensure consistency in self-reports."

The legislators are also pushing the SEC to adopt a civil penalty structure based on the revenues of either a firm's muni bond underwriting business or its muni business in general, rather than its overall size. The high-level cap of $500,000 should remain in place, Stivers and Sinema wrote.

"Penalties based on the sizes of firms' municipal securities business would help ensure that fines are proportional to firms' footprints in the municipal market," they told the SEC.

The lawmakers closed their letter with the threat of action if the SEC does not address their concerns soon, and requested a response by Sept. 5.

Michael Decker, co-head of municipal securities at the Securities Industry and Financial Markets Association, said that SIFMA is glad to see Stivers and Sinema getting involved. Decker echoed the concerns in the Stivers/Sinema letter, saying that some firms want to participate but might not beat the clock. "Some firms are concerned they're not going to be able to review all their transactions by the reporting deadline," he said.

Stivers has been very active on muni issues and has benefited from $10,000 of SIFMA campaign contributions during the 2014 election cycle, records show.

It is unlikely that Congress would be able to act prior to the MCDC underwriter deadline. Though Decker said there is interest among lawmakers, legislation would have to be introduced and passed by both the Republican-controlled House and Democrat-controlled Senate before also getting a prompt signature from President Obama.

THE BOND BUYER
BY KYLE GLAZIER
AUG 29, 2014 12:28pm ET

Munis in Limbo Awaiting Clarity on Bank Liquidity Regulations.

Yesterday the Fed and other regulators announced a new rule detailing what easy-to-sell investments big banks need to hold in reserve in case of a crisis. When it came to deciding if municipal bonds should be eligible for this category of so-called high-quality liquid assets, regulators basically punted. Munis aren't eligible for now, but Fed Governor Daniel Tarullo went to the trouble of releasing a separate statement saying that while most muni bonds "are not sufficiently liquid to serve the purposes of HQLA in stressed periods," regulators are still "working on ideas" to figure out how some munis could eventually be considered for inclusion in the HQLA club.

The announcement didn't cause any real drop in muni-bond prices, but analysts say munis could suffer in the long run if they're not eventually granted HQLA membership.

"The potential impact of this decision is difficult to assess but none of it is good for the municipal bond market," writes J.R. Rieger, global head of fixed income at S&P Dow Jones Indices, today. "Discouraging banks from buying or holding municipal bonds most likely will have the consequence of reducing the liquidity of certain municipal bonds normally pursued by the banking community."

Chris Mauro, head of U.S. municipals strategy at RBC Capital markets, says most investment-grade munis, particularly those of regular muni-bond issuers, ought to qualify, and fears the issue will hang over the market for a while. From Mauro today:

[W]e believe that the blanket exclusion of munis from the definition of HQLAs would have negative long-term implications for the municipal market, potentially dampening demand and liquidity for the asset class. Additionally, it could have the effect of reducing the amount of bank liquidity available to fund credit and liquidity support for Variable Rate Demand Note (VRDNs) programs, bank direct purchase programs, and tender option bond programs…. [W]e fear that the proposed new rule will award the HQLA designation to only a narrow slice of the municipal market….

While we are encouraged by the regulators openness to discuss including municipals as an HQLA, we are worried that the final ruling may extend beyond the January 1, 2015 effective date of the LCR rule, thus introducing an added element of uncertainty to the municipal market.

September 4, 2014, 4:44 P.M. ET

By Michael Aneiro

NAST, NASACT Make 11th Hour Appeal on Munis to Regulators.

WASHINGTON — State treasurers and financial officers are urging federal banking regulators to identify quantitative liquidity standards or characteristics that would allow at least some municipal securities to qualify as high-quality liquid assets in a rule to be released on Wednesday.

"It is unreasonable to treat an entire asset class of securities in the same way, as securities of different issuers will have different characteristics," the National Association of State Treasurers and the National Association of State Auditors, Comptrollers, and Treasurers warned the Treasury, Federal Reserve Board, and Federal Deposit Insurance Corporation said in an Aug. 29 letter. "A more reasonable approach would be for the rule to identify quantitative liquidity standards or characteristics that should be met in order for that particular security to be defined as an HQLA."

Excluding munis from the definition of HQLA will increase borrowing costs for state and local governments, reduce liquidity for and increase volatility of the muni market, and put muni issuers at a disadvantage to foreign governments in accessing the U.S. capital markets, the two groups warned the regulators.

The liquidity coverage ratio [LCR] rule that is due out on Wednesday would implement Basel III regulations. It would require large banks to maintain a certain ratio of HQLA to total net cash outflows. The idea is that the banks would then be able to easily and immediately convert those assets to cash during a period of liquidity stress.

But press reports stating the rule will not classify most or any munis as HQLA have caused issuers, rating agencies and dealers alike to raise concerns like those NAST and NASACT wrote about in their letter last week.

The two groups argued that muni bonds are low-risk, high-volume securities with transparent pricing and that they are readily marketable. Because of this, they argued, there is no reason to adopt a rule that will adversely impact the market.

Fed chair Janet Yellen told a Senate panel in July that munis did not approve to be liquid enough to qualify as HQLA.

But the groups told banking regulators: "We believe the proposed LCR rule will (1) increase borrowing costs for municipal issuers; (2) reduce market liquidity and increase volatility; and (3) disadvantage U.S. municipalities relative to foreign governments in accessing the U.S. capital markets, which NAST believes is not only unjustifiable but against the broader policy interests of the United States."

Dealer groups and lawmakers have also weighed in on the need to allow muni bonds to be HQLA. Citigroup Inc. managing director and senior municipal strategist George Friedlander predicted that bank appetite for bonds would shrink if munis are not HQLA under the rule. Banks have been major drivers of the market, and their holdings of munis have grown sharply since 2009.

More important, if munis are excluded as HQLA, then during periods of liquidity stress, if a bank's liquidity coverage ratio is constrained, it would not be able to provide any support or any marginal demand to the municipal securities market., thereby inducing additional market stress, Citi said in a research paper released last week.

THE BOND BUYER
BY KYLE GLAZIER
SEP 2, 2014 1:24pm ET

Fed Will Consider Adding Municipal Debt as Quality Asset.

WASHINGTON—States and localities that raise cash in the $3.7 trillion municipal bond market moved closer to winning a reprieve Wednesday after regulators agreed to consider allowing banks to use certain types of municipal debt to satisfy a new post-crisis financing rule.

Banking regulators on Wednesday finalized safeguards to require that banks hold enough liquid assets such as cash or Treasury notes to fund their operations for 30 days if other sources of funding aren't available. Under the final rules, municipal securities issued by states and localities won't count as "high-quality liquid assets," meaning such securities wouldn't qualify for use under the new funding requirements.

Still, the Federal Reserve, which helped craft the rules with two other agencies, opened the door to eventually including at least some municipal securities. Federal Reserve Gov. Daniel Tarullo said he expects the central bank to reconsider the issue in response to evidence that some state and local debt is frequently traded and may be "comparable to that of the very liquid corporate bonds" that qualify as high-quality liquid assets.

The market for municipal debt is vast, with roughly 60,000 borrowers and 1.2 million individual bonds. Only a relatively small number of the bonds—from large states and cities such as California and New York—see their securities frequently traded, according to industry experts. That is partly because the features of the market, including the tax-exempt status of most securities, encourage most investors to hold their bonds until maturity.

The Fed's decision to reconsider whether to fully exclude municipal securities was first reported last week by The Wall Street Journal.

States and localities have warned excluding their securities could cause banks to retreat from the municipal market in which they have increasingly become an important player, with four of the largest U.S. banks alone holding some $100 billion of such debt, according to consulting firm Municipal Market Advisors. State Treasurers and other officials say their costs to finance roads, schools and bridges could jump if banks retreat from the market—costs that will ultimately be borne by taxpayers.

"The exclusion of municipal bonds is wholly unjustified, so the commitment to adopt a subsequent rule that brings at least some of them under the tent is welcome," said Tom Dresslar, a spokesman for California Treasurer Bill Lockyer. "But any future rule should not be stingy in welcoming munis. It should be generous."

Mr. Dresslar added municipal bonds meet every criterion the agencies established to define high quality liquid assets. "Continued statements from staff and regulators that there's only a small slice of munis that might qualify as HQLA do not comport with the facts," he said.

The Fed stressed any change in treatment for municipal bonds would only apply to a limited number of the securities, given that few are frequently traded. While many securities issued by states and municipalities have low likelihoods of default, “the liquidity characteristics of these securities range significantly, with most securities issued by public sector entities exhibiting low average daily trading volumes and limited liquidity, particularly under stressed economic scenarios,” the Fed staff wrote in a memo released Wednesday.

THE WALL STREET JOURNAL
By ANDREW ACKERMAN

Muni Groups Urge SEC To Require MA Supervision Rule Changes.

WASHINGTON – The Municipal Securities Rulemaking Board failed to address concerns that its proposed municipal advisor supervision rule will be too costly and burdensome, non-dealer MAs told the Securities and Exchange Commission this week.

National Association of Independent Public Finance Advisors counsel Nathan Howard told the SEC in a comment letter that proposed Rule G-44 on supervisory and compliance obligations of municipal advisors, as well as proposed amendments to Rules G-8 on books and G-9 on preservation of records, remain substantively unchanged after it asked MSRB to reduce the burdens.

Rule G-44 would require MAs to establish, implement, maintain and enforce written supervisory procedures designed to ensure compliance with the federal securities laws and rules. It would mark the first time non-dealer MAs have been subject to supervisory requirements under MSRB rules., NAIPFA remains concerned that the burdens of those requirements would drive up costs for issuers and force smaller MAs out of the business altogether.

Meanwhile, Dave Sanchez, a former SEC muni office lawyer who most recently served as general counsel at a dealer firm, suggested some changes he told the commission would help avoid confusion and reduce regulatory burdens. For example, Sanchez wrote, the portion of the proposal requiring “prompt” amendment of written procedures after rule changes should be altered to “within a reasonable time after changes occur in the applicable rules.” That language matches the requirement of the existing G-27 rule governing dealer supervision requirements, and would help reduce confusion for dealer-affiliated MAs who will have to comply with the new rule as well as existing supervision requirements.

The proposal’s revisions to Rules G-8 and G-9 on preservation of records would require MAs to keep and maintain records of their compliance policies for at least five years and records of those responsible for compliance for at least six years after they are no longer in charge of compliance. If the SEC approves the set of proposals, it will be the first of the new MA rules to get the final go-ahead.

Dealer groups largely support the MSRB proposal, but Bond Dealers of America chief executive officer Mike Nicholas told the SEC that the rule still offers too much wiggle room for smaller MAs. The proposal allows small MA firms to take their size into account when designing their compliance programs.

“As the BDA mentioned in our April letter to the MSRB, we believe draft Rule G-44 provides too much flexibility to small firms by allowing [them] to determine and make accommodations for themselves simply because of their size,” Nicholas wrote. “As a result, we requested that the MSRB set forth certain minimum standards that all municipal advisor firms must meet when establishing supervisory and compliance procedures but still allow these firms appropriate flexibility to decide how to implement such procedures."

"We continue to believe that the draft Rule G-44 is biased toward larger firms and that the accommodations smaller firms are allowed to make should be more circumscribed," he continued. Nicholas told the SEC that all implementation of the MSRB's MA rules should be delayed until they are all complete.

The Securities Industry and Financial Markets Association asked for at least six months between approval and implementation.

THE BOND BUYER
BY KYLE GLAZIER
AUG 28, 2014 12:25pm ET

Foley Hoag: Republican State Parties Challenge SEC's Pay-To-Play Rule.

On August 7, 2014, the New York Republican State Committee and Tennessee Republican Party (the "Plaintiffs") filed a civil suit against the Securities and Exchange Commission (the "SEC") seeking to overturn Rule 206(4)-5 under the Investment Advisers Act of 1940 (the "Advisers Act"), commonly referred to as the SEC's "pay-to-play" rule (the "Rule").

Rule 206(4)-5 was approved by the SEC in 2010 as a means to curb perceived abuses resulting from investment advisers making political contributions in order to influence government officials involved in selecting investment advisers to manage public pension fund assets. Under the Rule, investment advisers are prohibited from providing investment advisory services for compensation to a government entity for a two-year period after any covered associate of the adviser makes an impermissible contribution to an official or candidate for an office that has or would have the ability to influence the selection of an investment adviser by such government entity, as well as placing restrictions on activities of an adviser to any government entities from soliciting or coordinating contributions from others. The Rule applies to any investment adviser that is registered (or required to be registered) with the SEC, as well as to certain advisers that operate under an exemption from registration available under the Advisers Act.

In their complaint, the Plaintiffs argue, amongst other grounds for relief, that (i) Congress has delegated authority over campaign contributions exclusively to the Federal Election Commission under the Federal Election Campaign Act of 1970, and thus the SEC is preempted from regulation of this area, and (ii) by forcing investment advisers to choose between exercising their right to make contributions to their preferred candidates and retaining the ability to engage in their professional activities, the Rule creates an impermissible restraint in violation of the First Amendment.

This suit follows a recent SEC settlement in which TL Ventures, an investment adviser to venture capital funds, agreed to pay substantial disgorgement fees in order to settle allegations that it violated the Rule when a covered associate made campaign contributions to mayoral and gubernatorial candidates. The suit also follows the Supreme Court's recent McCutcheon decision, which is cited prominently in the Plaintiff's complaint, which overturned, on First Amendment grounds, rules placing aggregate limits on federal campaign contributions.

We will continue to monitor and provide further updates on this matter as it progresses.

Last Updated: August 27 2014

Article by Robert G. Sawyer and Diana W. Lo

Foley Hoag LLP

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Bank Liquidity Rules Seen Cooling Demand for Bonds: Muni Credit.

Regulatory changes aimed at heading off another financial crisis may curb purchases of municipal bonds by banks, potentially undermining demand from the biggest buyer in the $3.7 trillion market.

The Federal Reserve and the Federal Deposit Insurance Corp. will meet separately on Sept. 3 to consider measures laying out what easy-to-sell assets banks must keep on hand to weather a month-long credit squeeze. A draft of the rules excludes munis, according to a person familiar with the matter, which would give banks less incentive to own state and local debt.

The companies have added more than $200 billion to their muni holdings since the start of 2010, more than any other segment of investor, according to Fed data. The influx has buoyed prices at times when individuals were selling because of speculation that interest rates were set to rise or bets that issuers such as Puerto Rico would struggle to pay their bonds.

“Banks have been large purchasers of municipal bonds, and that’s certainly been helpful in keeping rates low,” said Ben Watkins, director of Florida’s bond-finance division. “Removing banks as one of the demand components will exacerbate the impact in situations where munis have fallen out of favor.”

Crisis Prevention

The new regulations are based on international standards developed by the Basel Committee on Banking Supervision. They’re designed to prevent a repeat of the 2008 credit crisis by ensuring that banks can produce enough cash to operate during times of stress.

The initial proposal, released in 2013 and with a suggested phase-in beginning next year, would allow banks to use securities including Treasuries, foreign-government debt and corporate bonds to satisfy those requirements. The regulators said state and city obligations don’t trade frequently enough to be included.

The FDIC, the Office of the Comptroller of the Currency and the Fed are formulating the rules. The Wall Street Journal reported yesterday that the Fed is considering allowing banks to use some munis toward the requirement, in response to criticism from lawmakers and state officials.

David Barr, an FDIC spokesman; Bryan Hubbard at the OCC; and Eric Kollig at the Fed all declined to comment.

Taxpayers’ Lament

The proposed treatment has riled state and local officials, who say it will boost interest rates on debt sold for projects such as bridges, roads and schools. Officials from Chicago, Los Angeles, New York and Philadelphia were among those who pressed regulators to reconsider. California, the biggest issuer of munis, assailed the plan.

"If the regulators exclude municipal bonds, they will poke a stick in the eye of American taxpayers," said Tom Dresslar, a spokesman for California Treasurer Bill Lockyer. "It will increase their borrowing costs because it will reduce demand for municipal bonds."

Individual investors seeking munis' tax-exemption still dominate local-government bonds. Households own about $1.6 trillion, or 44 percent, directly through brokerage accounts.

Yet since the 2008 credit crisis, banks have become a growing force as demand for other types of loans dimmed.

JPMorgan's Holdings

The institutions have increased their holdings for 18 consecutive quarters since late 2009, even as the overall market shrank in 10 of those periods, Fed data show. As of March 31, banks held $425 billion, about 12 percent of the market, twice the share from four years earlier.

JPMorgan Chase & Co. and Wells Fargo & Co. own the most among the biggest U.S. banks, with $44 billion and $47 billion, respectively, at the end of June, according to regulatory filings. Jessica Francisco, a spokeswoman for JPMorgan in New York, declined to comment, as did Ancel Martinez, a spokesman for San Francisco-based Wells Fargo.

The change probably won't influence JPMorgan's muni holdings because the bank has already planned to exclude the securities from the assets it will use to satisfy the new rules, according to a person with knowledge of the matter who requested anonymity without authorization to speak publicly about the bank's decisions.

Austerity Cushion

While Fitch Ratings has said that the new regulations could lead banks to reduce holdings, a slowdown in municipal issuance may mask the impact.

The market is on pace to shrink for a fourth straight year as local officials stung by the recession's financial strains have been reluctant to take on new projects.

Munis have earned 8 percent this year through Aug. 27, beating corporate bonds and Treasuries, according to Bank of America Merrill Lynch indexes, Yields on benchmark 10-year munis fell to 2.17 yesterday, the lowest since May 2013.

"The supply-demand equation is so out of whack right now that at least in the short-run I don't think it will have much effect," said Justin Land, who helps oversee $3.5 billion of munis at Wasmer Schroeder & Co. in Naples, Florida.

"I don't think banks will necessarily become sellers of muni debt, just because they have a lot of excess capital and are trying to build reserves," he said. "They just may not be the aggressive buyers they've been over the past few years."

The repercussions of the change will become most evident during times of market stress, when banks may be more prone to stay on the sidelines, Citigroup Inc. muni analysts Vikram Rai, Mikhail Foux and George Friedlander said in an Aug. 26 research note.

“We haven’t seen any definitive effect to date, but that doesn’t mean it won’t be felt,” said Watkins, the Florida official. “How that occurs and when that occurs is difficult to predict, but there definitely will be an impact.”

By William Selway

Aug 28, 2014 5:00 PM PT

To contact the reporter on this story: William Selway in Washington at wselway@bloomberg.net

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BDA Submits Comment Letter to MSRB: Draft Rule G-42, on Duties of Non-Solicitor Municipal Advisors.

The BDA submitted a comment letter to the MSRB regarding revised Draft Rule G-42, to establish the core duties of municipal advisors when providing advice on municipal securities transactions and related products.

Revised draft rule G-42 incorporates a number of changes made by the MSRB to the rule text based upon comments received from the industry.

Specifically, BDA’s letter focuses on:

- BDA’s support for the MSRB’s revised approach to principal transactions, with one further request for clarification;
- Review of recommendations and a request that the MSRB provide specific language that permits the use of reasonable policies and procedures in certain instances;
- Reference to Rule G-23 and a desire for further clarification; and
- Allowances for acting as Underwriter for Conduit Issuer and Municipal Advisor for Obligated Person.

You can view the full text of our letter here.

For BDA’s previous letter to the MSRB on draft Rule G-42, click here. For revised draft rule language, you can click here.

BDA Submits Comment Letter to the SEC: Proposed Amendments to MSRB Rule G-3 on Continuing Education Requirements.

The BDA submitted a comment letter to the SEC on a proposed rule change consisting of proposed amendments to MSRB Rule G-3, on professional qualification requirements regarding continuing education.

The final letter focuses on:

- Support for Increased Municipal Securities Training;

- Concerns with Additional Compliance Burden and Duplicative Requirements;
- Concerns with Enforcement of Continuing Education Requirements.

You can find the final letter, as submitted, here.

You can view the MSRB's submission to the SEC in the Federal Register here and BDA's previous letter to the MSRB on the same topic here.

BDA Submits Comment Letter to the SEC: Proposed New Rule G-44, on Supervisory and Compliance Obligations of Municipal Advisors.

The BDA submitted a letter to the SEC on a proposed New Rule G-44, on supervisory and compliance obligations of municipal advisors; proposed amendments to Rule G-8, on books and records; and proposed amendments to Rule G-9, on preservation of records.

The final letter focuses on:

- A Request for Minimum Standards for all Municipal Advisors;
- The Importance of Self-Certification;
- Outsourcing of the CCO Function;
- Concerns with the Implementation Date.

You can view our final letter here.

You can view the MSRB's submission of the proposed new rule to the SEC in the Federal Register here and BDA's previous letter to the MSRB on the same topic here.

Appeals Court Validates FERC Regional Planning Mandate as Reasoned Evolution of the Open-Access Electricity Transmission System.

The Federal Energy Regulatory Commission's (FERC) Order No. 1000 mandate that going forward the high-voltage electric transmission grid be planned and fairly financed regionally by all of its operators and beneficiaries, survived myriad challenges from 45 petitioners in the unanimous August 15 decision of a three-judge panel of the U.S. Court of Appeals for the D.C. Circuit in South Carolina Public Service Authority v. FERC. The rigorous 97-page opinion rejected challenges coming from all directions to the 2011 rulemaking entitled "Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities."

According to the panel, nearly all of the challenges misapprehended Order No. 1000's regional planning mandate. The court repeatedly emphasized that Order No. 1000's mandate is nothing new, but rather the next step in evolving efforts under section 206 of the Federal Power Act to combat undue discrimination. That evolution, the panel explained, began in 1996 when Orders No. 888 and No. 889 required that electricity transmission be "unbundled" from sales and offered via the internet pursuant to open-access tariffs, and 11 years later continued in Order No. 890's directive that a transmission provider standardize how it measures available transmission capacity and open to its customers the process for planning transmission upgrades and expansions.

The panel's decision affirmed FERC's authority to require each of the key elements that FERC prescribed for regional transmission planning. Those elements include:

All public utility transmission providers are required to participate in a regional planning process, and non-public utilities such as cooperative or municipal utilities effectively must also participate pursuant to a reciprocity requirement carried forward from Order No. 888.

The planning process must include procedures for taking into account federal, state and local laws and regulations affecting transmission, such as federal air quality rules and state or local renewable portfolio standards.

Transmission tariffs must be amended to remove provisions that confer on the incumbent transmission provider a right of first refusal to construct, own, and operate new regional transmission, thereby opening the regional process to input, innovation, and investment from non-incumbents and new entrants, subject to state and local restrictions on siting and eminent domain.

A methodology must be added to transmission tariffs for allocating up-front the cost of new regional transmission facilities, consistent with six principles, including a causation principle directing that the allocation be roughly commensurate with the benefits received by those consumers required to pay, and a prohibition on one region allocating costs to its neighbors without their advance consent.

FERC Chairman Cheryl LaFleur promptly praised the panel's decision upholding Order No. 1000 in its entirety as critical for inducing the "substantial investment in transmission infrastructure [needed] to adapt to changes in its resource mix and environmental policies." In its decision the panel noted that the electric industry in 2008 estimated the infrastructure investment needed at $298 billion between 2010 and 2030.

Following FERC's lead, the panel chose not rule at this time on challenges that elements of the regional planning mandate violate the Mobile-Sierra doctrine —eponymously named for two 1956 Supreme Court decisions —which limits FERC's authority unilaterally to alter the terms of bilateral contractual relationships. FERC explained that it would not rule on these challenges in the context of Order No. 1000, but would instead address them in connection with a transmission provider's filing of tariff amendments in compliance with the Order. Mobile-Sierra challenges prosecuted at that time are unlikely to succeed since precedents interpreting the doctrine give the Commission much greater leeway when implementing industry-wide changes to tariffs than when seeking to alter individual contracts.

August 19 2014
Article by Jeffrey D. Watkiss
McDermott Will & Emery

Dealers Warn New Best-Ex Provisions on SMMPs Costly, Burdensome.

Dealers are objecting to new provisions added to the best execution standard the Municipal Securities Rulemaking Board filed with the Securities and Exchange Commission for approval that would increase the information customers have to provide to be considered sophisticated municipal market professionals who are exempt from the standard.

David Cohen, associate general counsel of the Securities Industry and Financial Markets Association said the new provisions "would significantly increase compliance costs and burdens" and would run counter to the MSRB's goal of harmonizing the rule changes with Financial Industry Regulatory Authority rules.

Current MSRB guidance under its Rule G-17 on fair dealing says that for a customer to be an SMMP, the dealer was have "a reasonable basis to believe [it] is capable of evaluating market risks and market value independently in evaluating the recommendations of the dealer." The customer must also "affirmatively indicate it is exercising independent judgment" in evaluating the dealer recommendations.

MSRB referred to this language in the MSRB best execution rule proposal released in February and it is virtually identical to the provisions in FINRA Rule 2111.

To comply with this requirement, dealers typically obtain certificates to this effect from customers, although the rule says the information can be obtained verbally instead of in writing.

The new provisions contained in new Rule G-48 would also require the customer to affirmatively indicate "the transaction price for non-recommended secondary market agency transactions as to which (i) the dealer's services have been explicitly limited to providing anonymity, communication, order matching and/or clearance of functions and (ii) the dealer does not exercise discretion as to how or when the transactions are executed."

The customer must also affirmatively indicate that it has access to "established industry sources" such as the MSRB's EMMA system and rating agency reports as well as "material information."

Sources say dealers will have to get new certificates or verbal indications from customers.

SIFMA and Bond Dealers of America officials said they are still reading the proposal the MSRB filed with the SEC on Wednesday, which includes proposed changes to the board's Rule G-18 on execution of transactions, as well as amendments to its Rule D-15 and G-48 governing SMMPs.

SIFMA is still unhappy with the proposal. "We continue to believe that the current standard is fair and reasonable, that best execution is an equity market standard that is more appropriate when there is a central exchange and is inappropriately applied to over-the-counter markets," Cohen said.

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at BDA said, "We are pleased that transactions with SMMPs remain exempted from the proposal and that rule language and supplementary material tailor best-execution obligations to the unique characteristics of the municipal securities market. Further, it seems as if the supplementary material addresses some of the concerns we continue to discuss with our membership including the promotion of reasonable diligence versus a substantive pricing standard as well as allowances in instances where there are limited pricing information. We still need to more closely analyze the proposal and plan to submit comments to the SEC."

The MSRB asked the SEC to make the proposed changes to its Rule G-18 on execution of transactions, which are generally similar to those the MSRB issued in February, to take effect one year after the SEC approves them.

The best execution standard generally would require dealers to use "reasonable diligence" to determine the best market for a security and then buy or sell the security in that market so the resulting price to the customer "is as favorable as possible under prevailing market conditions," the MSRB said.

To meet their due diligence obligations, dealers would have to take into account a list of factors, including the character of the market for the security, the size and type of transaction, the number of markets checked, the information reviewed to determine the current market for the subject security or similar securities, the accessibility of quotations, and the terms and conditions of the customer's inquiry or order.

One MSRB factor does not appear in the Financial Industry Regulatory Authority best-ex rule for corporate bonds — information reviewed to determine the current market for the subject security or similar securities. This factor will help guide the use of reasonable diligence when dealers cannot find quotations for a bond, the MSRB told the SEC in the filing.

The board's action follows recent complaints by some market participants that a best execution rule is not needed because it is very similar to the board' s Rule G-30 on fair prices and commissions.

But the MSRB told the SEC, "While G-30 contains substantive pricing standards, under which dealers must (among other things) use reasonable diligence in determining a security's fair market value, a best execution standard is an order-handling and transaction-execution standard, under which the goal of the dealer's reasonable diligence would be to ascertain among the variety of venues where the municipal security may be executed, the best market for the security."

As proposed in February, broker-dealers would be exempt from the best execution standard in transactions with sophisticated municipal market professionals. SMMPs are institutional investors or individuals with assets of at least $50 million.

The MSRB's revised Rule G-18 would differ from the FINRA rule in another major way, as it does not require dealers to show why it was reasonable to use a broker's broker. The MSRB said it wanted to develop a rule that did not favor any particular market venue over any other.

The MSRB said it received 10 comment letters on its proposed standard and that "many commenters supported the development of an explicit best-execution standard for the municipal securities market."

The National Association of Independent Public Finance Advisors had raised concerns that the rule could create a different "substantive pricing standard" for issuers than for investors. But MSRB said the rule proposal is an "order-handling and transaction execution standard" that would not impact dealer behavior in new issuances.

SIFMA had complained about proposed rule's costs and burdens. The MSRB told the SEC that it "welcomes SIFMA's offer to provide the MSRB reliable empirical data." The board also noted that SIFMA proposed "a highly similar order-handling rule" and said, "It has not been shown that the costs of proposed Rule G-18 would be significantly greater than the costs of SIFMA's proposal."

THE BOND BUYER
BY LYNN HUME and KYLE GLAZIER
AUG 21, 2014 1:43pm ET

GFOA Releases More MCDC Guidance.

SEC Extends MCDC Deadline for Issuers, Tiers Penalty Caps for Underwriters

WASHINGTON – The Government Finance Officers Association has issued a new alert on the Municipalities Continuing Disclosure Cooperation initiative, offering guidance to issuers on how to make use of the extra time they were granted to participate in the program and explaining problems state and local governments face in performing due diligence.

The Securities and Exchange Commission initiative allows both issuers and underwriters to get favorable settlement terms if they voluntarily report, for any bonds issued in the last five years, any time they misled investors about their compliance with their continuing disclosure obligations. The initiative originally set a deadline around midnight Sept. 9 for both issuers and underwriters to participate, but the SEC late last month extended that deadline to Dec. 1 for issuers.

The latest GFOA alert, dated Aug. 19, makes issuers aware of their extra time, urges them to review information from underwriters they've worked with, and warns them to be prepared for the MCDC submissions to contain flaws.

"Issuers should expect errors in the underwriter's findings due to the deficiencies in the data and systems that are being used to conduct these investigations," the alert counsels. "The data available prior to EMMA from the Nationally Recognized Municipal Securities Information Repository system is either not available or seriously flawed. Adding to the confusion is Bloomberg data, which routinely shows the posted date rather than the filing date on its system. Also, filings that were made on EMMA may not contain all relevant CUSIP numbers or the filing may be made under tabs or headings that do not reflect the entire content of the information filed."

GFOA also told its members to be prepared to analyze the materiality of any misstatements or omissions regarding their continuing disclosure compliance, citing a recent National Association of Bond Lawyers paper on MCDC materiality. That paper provided issuers and their attorneys with a framework for conducting an analysis of whether past offering documents included "material misstatements" that they might want to consider reporting under the MCDC.

"Not all failures to file continuing disclosures or material event notices constitute a 'material' misstatement or omission under the federal securities laws," the GFOA alert advises. "For example, failure to file a bond insurer downgrade may not be considered 'material' because this fact was widely reported and common knowledge by investors."

Market participants assume most underwriters will participate in the MCDC and therefore expose the issuers they've worked with to SEC scrutiny. The extra three months given issuers gives them more time to decide if they want to make materiality decisions and dispute underwriters' findings, the GFOA alert states.

GFOA is continuing to urge issuers to use caution when deciding whether or not to participate in the initiative. Although the terms of the MCDC stipulate that the commission's enforcement division will recommend no civil penalties for issuers, they also make clear that individual public officials could still be charged if appropriate. Securities lawyers have also warned that SEC investigators performing a probe in connection with an MCDC submission could find other violations not covered by the initiative and would be free to act on those.

THE BOND BUYER
BY KYLE GLAZIER
AUG 20, 2014 1:38pm ET

MSRB Files Best-Ex Rule With SEC for Approval.

The Municipal Securities Rulemaking Board has asked the Securities and Exchange Commission to approve its proposal to require municipal securities dealers to seek the most favorable price possible when executing transactions for most investors.

The board wants the proposed changes to its Rule G-18 on execution of transactions, which are similar to those the MSRB issued in February, to take effect one year after the SEC approves them.

The best execution standard generally would require dealers to use "reasonable diligence" to determine the best market for a security and then buy or sell the security in that market so the resulting price to the customer "is as favorable as possible under prevailing market conditions," the MSRB said.

To meet their due diligence obligations, dealers would have to take into account a list of factors, including the character of the market for the security, the size and type of transaction, the number of markets checked, the information reviewed to determine the current market for the subject security or similar securities, the accessibility of quotations, and the terms and conditions of the customer's inquiry or order.

One MSRB factor does not appear in the Financial Industry Regulatory Authority best-ex rule for corporate bonds — information reviewed to determine the current market for the subject security or similar securities. This factor will help guide the use of reasonable diligence when dealers cannot find quotations for a bond, the MSRB told the SEC in the filing.

The board's action follows recent complaints by some market participants that a best execution rule is not needed because it is very similar to the board' s Rule G-30 on fair prices and commissions.

But the MSRB told the SEC, "While G-30 contains substantive pricing standards, under which dealers must (among other things) use reasonable diligence in determining a security's fair market value, a best execution standard is an order-handling and transaction-execution standard, under which the goal of the dealer's reasonable diligence would be to ascertain among the variety of venues where the municipal security may be executed, the best market for the security."

As proposed in February, broker-dealers would be exempt from the best execution standard in transactions with sophisticated municipal market professionals. SMMPs are institutional investors or individuals with assets of at least $50 million.

But one market participant said the MSRB would make dealers get a whole new certificate of affirmation from SMMPs that significantly differs from the one dealers get for SMMPs under FINRA's Rule 2111 on suitability. The rule changes proposed in February would have allowed dealers to use the same SMMP certificate that they use to comply with the FINRA rule. Obtaining new certificates will be burdensome, the source said.

The MSRB's revised Rule G-18 would differ from the FINRA rule in another major way, as it does not require dealers to show why it was reasonable to use a broker's broker. The MSRB said it wanted to develop a rule that did not favor any particular market venue over any other.

The MSRB said it received 10 comment letters on its proposed standard and that "many commenters supported the development of an explicit best-execution standard for the municipal securities market."

The National Association of Independent Public Finance Advisors raised concerns that the rule could create a different “substantive pricing standard” for issuers than for investors. But MSRB said the rule proposal is an “order-handling and transaction execution standard” that would not impact dealer behavior in new issuances.

Some dealers remain skeptical of the use of an equities market concept in the muni market. The Securities Industry and Financial Markets Association and others were concerned about the cost of compliance.

The MSRB told the SEC that it “welcomes SIFMA’s offer to provide the MSRB reliable empirical data.” The board also noted that SIFMA proposed “a highly similar order-handling rule” and said, “It has not been shown that the costs of proposed Rule G-18 would be significantly greater than the costs of SIFMA’s proposal.”

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at Bond Dealers of America, said, “We are pleased that transactions with SMMPs remain exempted from the proposal and that rule language and supplementary material tailor best-execution obligations to the unique characteristics of the municipal securities market. Further, it seems as if the supplementary material addresses some of the concerns we continue to discuss with our membership including the promotion of reasonable diligence versus a substantive pricing standard as well as allowances in instances where there are limited pricing information.”

But Giroux added, “We still need to more closely analyze the proposal and plan to submit comments to the SEC.”

THE BOND BUYER
BY LYNN HUME and KYLE GLAZIER
AUG 20, 2014 5:38pm ET

MSRB Seeks Approval to Establish Best-Execution Rule for Municipal Securities.

The Municipal Securities Rulemaking Board (MSRB) today requested approval from the Securities and Exchange Commission (SEC) to establish explicit requirements for municipal securities dealers to seek the most favorable price possible when executing transactions for retail investors. Proposed MSRB Rule G-18 supports the MSRB’s goal of protecting investors and improving the structure and efficiency of the municipal market.

Read the rule filing.

MSRB Pay-to-Play Proposal Would Impact Dealer, Non-Dealer MAs.

WASHINGTON — The Municipal Securities Rulemaking Board’s proposal to extend its dealer pay-t--play rule to include municipal advisors contains provisions that would affect both dealer and non-dealer MAs, market participants said Tuesday.

The draft amendments to the MSRB’s Rule G-37 on political contributions, which the MSRB proposed for public comment Monday, would generally mirror existing dealer and dealer-MA obligations by prohibiting non-dealer MAs from engaging in municipal advisory business with state or local governments for two years after making political contributions to officials who can influence the award of MA business. But the proposal also suggests some changes to the rule affecting all MSRB registrants, tightening regulations in some ways and loosening them up in others.

The proposal, for example, provides for "cross bans" for firms that include both muni advisor and underwriting businesses. But the rule would require a link between a ban on underwriting or MA business and a contribution made to an official with the ability to influence the awarding of that type of business.

Some issuer officials can influence both types of business and a significant contribution to them from a firm or professional from either the dealer or MA side of the firm would subject both sides of the business to a two-year ban. But other issuer officials might only have influence over the MA, or only over the underwriting business. Contributions to those officials would not trigger a ban for the other side of the business.

The rule also takes a new approach to contributions that might come from MAs soliciting business on behalf of other firms, which market participants said could be potentially problematic. Under the proposal, if a contribution is made by a third-party MA or its associated persons, a ban on securities business would apply both to the dealer that hired the firm to solicit MA business and the solicitor.

A dealer generally is prohibited under MSRB Rule G-38 from making payments to a third-party to solicit muni securities business on its behalf. Under the MSRB proposal a dealer could violate G-38 and also be subject to a two-year ban on MA business with a certain issuer under G-37 if it retains an MA to solicit business on its behalf and contributions trigger the ban.

If an MA firm retains a third party MA that makes a significant contribution triggering the ban, the ban would apply both to the MA that retained the solicitor firm as well as the solicitor firm.

Ki Hong, a partner at Skadden, Arps, Slate, Meagher & Flom in Washington, said the provision raises "concerning questions" about how to control the actions of third-party solicitors. A version of this rule, proposed and then withdrawn three years ago, would have subjected only solicitors to the ban, he said.

Dealers groups reacted mostly positively, because they have long said that non-dealer MAs are unfairly able to operate without fear of how their political contributions could affect their business.

"We are pleased that the MSRB is extending Rule G-37 to cover municipal advisors," said Leslie Norwood, associate general counsel and co-head of municipal securities at the Securities Industry and Financial Markets Association. "We are reviewing with our members the other changes the MSRB is proposing for all regulated entities, and look forward to submitting a comment letter."

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at Bond Dealers of America, said the details of how the rule will be enforced will be important.

"We are and have been in favor of establishing a level playing field especially on this issue and we are hopeful this effort on the part of the MSRB accomplishes that," Giroux said. "We will continue to evaluate the rule and plan to submit comments to the MSRB, however, our concern is and remains how this will be enforced."

Nathan Howard, counsel to the National Association of Independent Public Finance Advisors, said the rule needs a close look because of the new approaches it takes.

"NAIPFA has and will continue to support restrictions on practices that have historically harmed the public interest," he said. "This version of the rule, however, appears to contain significant variances from the version that was released in 2011 and, therefore, will require us to carefully review this proposal."

THE BOND BUYER
BY KYLE GLAZIER
AUG 19, 2014 4:13pm ET

MSRB Requests Comment on Extending its Pay-to-Play Rule to Municipal Advisors.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) is requesting comment on draft amendments to Rule G-37, the MSRB's landmark pay-to-play rule for municipal securities dealers, that would extend the rule to municipal advisors. The Dodd-Frank Wall Street Reform and Consumer Protection Act expanded the jurisdiction of the MSRB to include the regulation of municipal advisors and the protection of state and local governments that often rely on these professionals for advice.

"Addressing corruption, or the appearance of corruption, in the awarding of municipal advisory business is a fundamental goal of the MSRB's comprehensive regulatory framework for municipal advisors," said MSRB Executive Director Lynnette Kelly. "Applying our well-established dealer pay-to-play rule to municipal advisors will help ensure that all regulated municipal market entities and professionals are held to the same high standards of integrity."

The MSRB's draft amendments seek to curb pay-to-play activities by municipal advisors and provide greater transparency regarding their political contributions. The draft amendments would, consistent with the existing rule for dealers, generally prohibit municipal advisors from engaging in municipal advisory business with municipal entities for two years if certain political contributions have been made to officials of those entities who can influence the award of business.

Municipal advisors would be required, like dealers under the existing rule, to disclose their political contributions to officials and bond ballot campaigns for posting on the MSRB's Electronic Municipal Market Access (EMMA®) website. Public availability of this information would facilitate enforcement of the rule and promote public scrutiny of political giving and municipal advisory business.

Read the request for comment to view all proposed changes to the existing rule. Comments are due no later than October 1, 2014. The MSRB will host a webinar on the proposed changes on September 11, 2014 at 3 p.m. ET. Register for the webinar.

The draft amendments to Rule G-37 are among several new regulatory provisions for municipal advisors now in development. The MSRB recently filed its proposed municipal advisor supervision and compliance rule for Securities and Exchange Commission (SEC) approval, with comments due to the SEC by August 26, 2014. The MSRB plans to file a proposal for SEC approval to set baseline professional qualification requirements for municipal advisors. The MSRB is continuing to solicit input on its revised draft rule to create core standards of conduct for non-solicitor municipal advisors through August 25, 2014. Additionally, the MSRB plans to seek comment on amending its existing gifts rule for dealers, MSRB Rule G-20, to establish limitations on gifts given by municipal advisors in their professional capacity.

For news and resources on municipal advisor rulemaking, outreach and education initiatives, visit the Resources for Municipal Advisors section of the MSRB's website.

Municipal-Debt Rules Proposed to Ensure Best Price Sought.

U.S. securities regulators are moving to require brokers to seek the best prices available when trading state and local bonds for customers, a step aimed at keeping investors from being shortchanged.

The Municipal Securities Rulemaking Board today asked the Securities and Exchange Commission to approve a new rule that would require traders to use "reasonable diligence" to obtain the most favorable terms available for customers.

The rule would place stricter standards on brokers who trade in the $3.7 trillion municipal bond market, which, unlike the stock market, lacks a centralized exchange. Current regulations require that brokers buy and sell bonds at "fair and reasonable" prices.

"A requirement that dealers seek the best execution of retail customer transactions in municipal securities will have benefits for investors, promote fair competition among dealers and improve market efficiency," the Alexandria, Virginia-based regulator said in its proposal to the SEC.

The move is part of a push by regulators to protect investors who buy and sell municipal bonds. The market is dominated by individual investors who seek tax-free income by buying bonds sold by states, cities and counties, which have little risk of default.

Embedded Fees

This month, the board said it may also force brokers to reveal to their clients what they paid for municipal bonds, which would allow customers to see dealers' profit on the trades. Such fees are typically embedded in the price and aren't currently disclosed.

The SEC in 2012 suggested that the board require brokers to seek the best prices available for customers. The MSRB then proposed the rules this year, and the submission today seeks the SEC's approval to put them in place.

The new regulations would require that brokers gauge prices on electronic platforms from various sources before deciding where customers would get the most favorable prices.

The rule wouldn't apply to institutional investors, such as money-management firms, which are better equipped than individuals to monitor prevailing prices, or individuals with at least $50 million to invest, the board said.

Bloomberg
By William Selway Aug 20, 2014 1:03 PM PT

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SEC Investor Advocate Calls for Municipal Bond Market Reforms.

Securities and Exchange Commission Investor Advocate Rick Fleming called Wednesday for municipal bond market reforms.

Noting three quarters of muni bonds are owned by individual investors directly or indirectly, he said his office will work with the SEC and self-regulatory organizations (including presumably the Municipal Securities Rule Making Board and the Financial Industry Regulatory Authority) to improve disclosures and other protections.

He added a new law may be necessary.

In prepared remarks to the Southwest Securities Conference in Dallas, the investor advocate said he also will look at the cybersecurity efforts of the agency, the exchanges and market participants.

"Hackers and electronic terrorists present a constant threat to the financial security and privacy of investors," said Fleming, explaining his rationale for jumping into this area.

Looking ahead, he promised to advocate new tools to help advisors protect elderly and other clients with declining brain function when advisors suspect financial or other abuse.

Fleming reiterated his call for increased Congressional funding of the SEC through advisor fees so the agency can raise the number of advisors examined from the current 9 percent a year.

Countering objections from House Republicans who have refused to let Congress consider the idea, he acknowledged the idea of a "user fee" sounds a lot like a tax, but advisor trade groups have shown their support of them to improve quality control within the industry.

"A shorter examination cycle won't stop all fraud, but I believe it will allow the SEC to halt these types of activities sooner and will provide a stronger deterrent to advisors who might otherwise succumb to the temptation to steal," he said.

And, as he has said in the past, in the absence of more money, Fleming said requiring advisors to hire third-party consultants to conduct SEC-like examinations could be an alternative to increase protections, though a lesser one.

FINANCIAL ADVISOR
AUGUST 20, 2014 • TED KNUTSON

Pepper Hamilton: Extended SEC MCDC Initiative Deadline Does Little to Lessen Urgency.

The Securities and Exchange Commission (SEC) has recently modified its Enforcement Division's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative in order to encourage as much participation in the program as possible.

Under the Initiative, the SEC has agreed to recommend favorable settlement terms for issuers, obligors and underwriters of municipal securities who voluntarily report materially inaccurate statements made in offering documents regarding prior compliance with continuing disclosure obligations. Issuers, obligors and underwriters can take part in the MCDC Initiative by completing and submitting a questionnaire by the required deadlines. If the SEC determines the violations should be processed under the MCDC Initiative, the SEC will abide by a predetermined schedule of settlement terms that are relatively lenient and include certain remedial measures aimed at ensuring accurate disclosures.

Extended Deadline for Issuers and Obligors Only

To allow issuers and obligors more time to self-report potential violations, the division has extended the deadline from September 10, 2014 to December 1, 2014 (5:00 p.m. EST). For underwriters, the deadline remains unchanged, ending at 12:00 a.m. EDT on September 10, 2014. To encourage greater participation for underwriters, however, the division has implemented a tiered approach that caps civil penalties according to the size of the firm, which is as follows:

- underwriters with 2013 reported total annual revenue more than $100 million – capped at $500,000
- underwriters with 2013 reported total annual revenue between $20 million and $100 million – capped at $250,000
- underwriters with 2013 reported total annual revenue less than $20 million – capped at $100,000.

Limited Guidance on 'Materially Inaccurate'

Since announcing the Initiative, the division has offered little guidance as to what constitutes "materially" inaccurate disclosures. In a recent case that involved a settlement agreement between the SEC and the State of Kansas, the SEC charged that the state made materially misleading statements by failing to disclose that its pension system was significantly underfunded and posed a risk to the repayment of some municipal bonds. Shedding some light on its notion of materiality, the SEC made clear that violations not only result from materially inaccurate statements, but they also involve the failure to disclose material facts, such as facts relating to the issuer's true financial condition; conflicting interests of various parties; how bond proceeds were used or invested; or how the valuation of bond-financed property was determined.

Finally, although the SEC intended its modifications to the MCDC Initiative to promote greater participation, by extending the deadline for issuers and not underwriters, the SEC has increased the potential for conflict between the interests of issuers and those of underwriters. Because the underlying set of facts only concerns whether there was a material misstatement or omission in a final official statement, both the issuer and the underwriter have potential securities law liability. To obtain the favorable settlement terms, each of these parties has to self-report. If one party self-reports first and the other does not, then a problem arises for the non-reporting party in the event that the SEC staff determines that the facts warrant enforcement action.

Failure to Properly Use Proceeds

Post-bond-issuance monitoring, and associated policies and procedures must be in place. Have you determined whether the facility, built with proceeds from tax-exempt bonds, is being leased out for unauthorized commercial purposes, for example, power generation, cell transmission towers, or to softball and basketball leagues? A qualified private activity bond issue can lose its tax-exempt status if a failure to properly use proceeds occurs subsequent to the issue date, which results in sufficient nonqualified use to cause the issue to fail any of the applicable use requirements. Hence, the issue becomes a taxable private activity bond issue. Generally, a failure to properly allocate proceeds occurs when an action is taken which results in the bonds not being used for the qualified purpose for which they were issued. However, with respect to unspent proceeds, a failure to properly use those proceeds may occur as early as the date on which either the issuer or conduit borrower reasonably determines that the bonds will not be expended on the qualified purpose for which they were issued. More than just a tax issue, however, failure to put proceeds to proper use is a material inaccuracy subject to self-reporting under the MCDC Initiative.

Limitations on Acquisition of Land or Other Property

Under section 147(c) of the Internal Revenue Code, a qualified private activity bond will lose its tax-exempt status if 25 percent or more of the net bond proceeds are used directly or indirectly to acquire real property. However, certain exceptions to this rule are available.

Remedial Actions for Nonqualified Use

Treasury regulations provide that certain prescribed remedial actions can be taken to cure nonqualified uses of proceeds that would otherwise cause qualified private activity bonds to lose their tax-exempt status. Such remedial actions can include the redemption or defeasance of bonds and, when the disposition of bond-financed property is exclusively for cash, the alternative use of such disposition proceeds to acquire replacement property within six months of the disposition date. For conduit borrowers, it is important to assess whether you will be able to enter into a closing agreement under the TEB Voluntary Closing Agreement Program (VCAP).

Pepper Points

Despite the deadline extension, issuers and obligors should not relax their sense of urgency. Put appropriate post-issuance monitoring, policies, and procedures in place. From the outset, the SEC has made clear that where an entity could have self-reported under the MCDC Initiative but failed to do so, and the SEC later decides to bring an enforcement action, more severe sanctions and penalties will be targeted. Accordingly, the extended deadline simply offers the opportunity to accommodate a necessarily labor-intensive review process that will require careful attention to detail.

Issuers, obligors and underwriters all would be well-advised to review their compliance obligations in their offering documents through a wider lens. Beyond materially inaccurate statements, the SEC would appear to expect self-reporting of failure to disclose:

- issuer’s true financial condition
- conflicting interests of various parties
- failure to monitor and manage the legal use of tax-exempt bond proceeds
- methodology for valuation of bond-financed property
- any risk that bonds could lose their tax-exempt status, resulting in potential taxable income to bond holders.

Pepper Hamilton LLP
Frank A. Mayer, III , Jonathan L. Levin and Nefertiri R. Sickout
August 18 2014

Best Execution's Role Unclear.

WASHINGTON — Many municipal market professionals are concerned that the Municipal Securities Rulemaking Board’s proposed best execution rule would not be functionally different from the fair pricing obligations that the MSRB and Financial Industry Regulatory Authority already impose on dealers.

The MSRB announced earlier this month that it will very soon seek Securities and Exchange Commission approval of the proposed best-ex rule, a well-known concept that already exists in the corporate market.

The proposed Rule G-18 would require dealers to use “reasonable diligence” when handling orders and executing municipal security trades for retail investors to “obtain a price that is as favorable as possible under prevailing market conditions.” While market participants have expressed general support for many of the MSRB’s concepts, many claim the proposed rule is not that different from existing fair pricing obligations and that it would create new burdensome compliance procedures for no good reason.

Elizabeth Baird, a partner in Bingham McCutchen’s Washington office, said she does not view a best execution rule in the muni market as being distinct from rules requiring fair pricing and prohibiting unfair markups. The MSRB’s Rule G-30 on prices and commissions requires that dealers conduct principal transactions at a price that is “fair and reasonable” and that they also make a “reasonable effort” to obtain a fair price for customers in agency transactions.

Baird said it is unclear what conduct would lead to a violation of the best ex rule, if and when the SEC gives it the go-ahead. The best execution proposal is basically an equities market concept ported over to the bond market so that regulators could appear to be reforming it, Baird said.

“They’re doing it to appease somebody,” she said. “Little by little, they’re making it harder to operate in the municipal bond market.”

The SEC’s 2012 comprehensive report on the municipal market recommended that the MSRB adopt a best execution rule, and the MSRB has said in written materials that the rule would strengthen and support existing obligations.

Most dealers believe they already abide by the MSRB’s best execution concept, sources said, but have concerns about how FINRA examiners will assess their compliance. The MSRB proposal includes a list of factors similar to those listed under the FINRA corporate best ex rule that could be used to determine if a dealer used “reasonable diligence,” including what information the firm reviewed before the transaction and the terms and conditions of the customer’s inquiry of the dealer.

Nathan Howard, an attorney who is counsel to the National Association of Independent Public Finance Advisors, said his group has argued that the rule would establish a “substantive pricing standard” because if best execution is applicable in a primary issuance then dealers will have to provide the “best price” to issuers while merely offering a “fair price” to investors. The MSRB said in its proposal that the rule would not be a substantive pricing standard, but rather an “order-handling and transaction-execution standard.”

“If the MSRB is correct, and the rule doesn’t create a substantive pricing standard, then I would agree, it is not necessary since it will not have a substantive impact on pricing,” Howard said. “However, this would seem contrary to the ‘provide the customer the most favorable price possible’ comment contained within the initial release.”

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said the proposal creates a higher standard than the current obligations in terms of what it will require from dealers' policies and procedures. SIFMA previously floated its own execution standard to the MSRB, calling it "execution with diligence."

"The current execution standard is 'fair and reasonable,' which SIFMA believes is the proper standard in light of the structure of the municipal market," Cohen said. SIFMA members believe that 'best execution' is an equity market concept that is inapplicable to the over-the counter markets such as municipal securities."

The SEC would have to approve the MSRB proposal before it could become a rule, and could choose to require changes before doing so.

THE BOND BUYER
BY KYLE GLAZIER
AUG 12, 2014 2:09pm ET

MSRB Gives Tech Fees Back.

WASHINGTON — The Municipal Securities Rulemaking Board announced Tuesday that it will rebate $3.6 million to broker-dealers because it has collected more money in technology fees than the board needs to maintain its systems.

The MSRB will provide rebates to currently active registered firms in amounts equal to the technology fees assessed on their trades during the six months that ended with June 2014, the board announced in a release.

Firms pay $1.00 per sales transaction, and that money goes into a technology renewal fund that the MSRB created in January 2011. That fund has reached a level three times higher than the board needs to update and maintain its hardware and software.

"The technology fund provides the resources required to maintain critical systems relied upon by the municipal securities industry," said MSRB executive director Lynnette Kelly. "However the fund has now reached its targeted level and future technology needs are not projected to exceed funding levels. So it is only fair to return the excess to the entities that paid those fees."

Firms eligible for the rebate will receive an email notification of the amount and whether they will receive a credit against future billings or have the option to receive an electronic payment, the MSRB said. They should receive the rebates before Sept. 30.

As a self-regulatory organization, the MSRB is funded through various fees it assesses on regulated members. The board said it plans to review its funding structure soon.

"The MSRB recognizes that changes to its funding structure may be appropriate to ensure that fees are fair and equitably assessed and distributed," the board said in a release. In the coming fiscal year, the MSRB plans to begin a comprehensive review of fees from dealer assessments, municipal advisors and other sources.

THE BOND BUYER
BY KYLE GLAZIER
AUG 12, 2014 11:32am ET

MSRB Proposes Transparency Changes.

WASHIGNTON — The Municipal Securities Rulemaking Board is asking for comment on proposed changes to its G-14 trade reporting rule, including whether to require dealers to identify conditional trade commitments, which differ from newly issued bonds but are reported at the same time.

The inability to distinguish between CTCs and newly issued bonds has created some confusion among investors.

The MSRB notice, issued Wednesday, touches on a variety of market transparency initiatives that would affect how muni market information is reported and disseminated. Among the proposed new data elements are indicators of both which trades result from CTCs and which transactions are executed through alternative trading systems, as well as other proposals related to the board's goal of building a comprehensive central transparency platform for munis. Comments are due by Sept. 26.

"All of these post-trade data elements would enhance transparency in the municipal securities market," said MSRB executive director Lynnette Kelly. "These proposed changes are among the many steps we are taking to ensure that EMMA continues to evolve in response to changing municipal market practices and technological capabilities."

Conditional trade commitments occur when dealers solicit, accept, and conditionally allocate orders prior to the signing of the bond purchase agreement. The prices agreed upon do not necessarily reflect market conditions at the time of the formal award of the bonds. Because trades cannot officially be executed until the bond purchase agreement is signed and the bonds are formally awarded to the underwriter, conditional commitments appear on EMMA the same day as the day the bonds are issued and initially sold. There is no current means of distinguishing between conditional commitments and bonds sold the first day.

The MSRB proposal would require dealers to identify trade reports resulting from CTCs with a new indicator and report the date and time the CTC was made in a new field on the publicly-available trade reports. All dealers, including those outside the underwriting group, would include the new information on trade reports.

"The CTC indicator, together with the date and time at which the pricing of the commitment was made, would provide important transparency as to whether such price is indicative of current market conditions," the MSRB proposal states. "Further, capturing the date and time that the commitment was formed would enable market participants to discern the sequence of new issue trading as well as to link specific transactions to market conditions as of the time an order was formed."

The MSRB indicated its interest in these transparency steps in a July 2013 concept release, which prompted dealers to warn that providing such information could be burdensome without providing much help to investors.

Leslie Norwood, associate general counsel and co-head of municipal securities at the Securities Industry and Financial Markets Association, said SIFMA supports the MSRB's goals of increased transparency but continues to believe that the cost of a CTC indicator would outweigh any benefit to investors.

"It's going to take a re-write of many back office systems," Norwood said, explaining that existing dealer and bank computer systems would need to be reprogrammed to allow for such an indicator.

Ernesto Lanza, a partner at Greenberg Traurig in Washington and former MSRB deputy director said that the CTC indicator could prove very helpful to investors, but would probably not cause a major shift in market practices.

"The question is how to do it in a way that is not cost-prohibitive or process-prohibitive," he said.

Another new indicator would identify which trades occurred via alternative trading systems. The MSRB already identifies transactions done through a broker's broker, because the broker's broker informs the MSRB. The board does not currently identify trades executed through an ATS, but is proposing to require that trade reports identify if an ATS was used as well as the identity of the ATS.

"Identifying in disseminated transaction information that an ATS was employed should provide for higher quality research and analysis of market structure by providing information about the extent to which ATS' are used and should complement the existing indicator disseminated for transactions involving a broker's broker," the MSRB proposal states.

THE BOND BUYER
BY KYLE GLAZIER
AUG 13, 2014 3:51pm ET

MSRB Requests Comment on Extending its Pay-To-Play Rule to Municipal Advisors.

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on draft amendments to Rule G-37, the MSRB's landmark pay-to-play rule for municipal securities dealers, that would extend the rule to municipal advisors. The Dodd-Frank Wall Street Reform and Consumer Protection Act expanded the jurisdiction of the MSRB to include the regulation of municipal advisors and the protection of state and local governments that often rely on these professionals for advice.

Comments are due no later than October 1, 2014. The MSRB will host a webinar on the proposed changes on September 11, 2014 at 3 p.m. ET. Register for the webinar.

View the regulatory notice.

Read the full press release.

Foley & Lardner: The MCDC Initiative and Recent Modifications.

The MCDC Initiative And Recent Modifications: Window For Issuers And Obligated Persons Now Closes On December 1, 2014, While Underwriters Window Still Set To Close On September 9, 2014

As highlighted in the SEC's 2012 Municipal Market Report, the SEC has expressed significant concern that many issuers have not been complying with their obligation to file continuing disclosure documents and that federal securities law violations involving false statements concerning such compliance may be widespread. Increasingly, the SEC also has been taking enforcement actions under either Section 17(a) of the Securities Act of 1933 and/or Section 10(b) of the Securities Exchange Act of 1934 against issuers or obligated persons (collectively, "Borrowers") for inaccurately stating in final official statements that they have substantially complied with their prior continuing disclosure obligations.

The SEC's Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative"), announced on March 10, 2014, is intended to address potentially widespread violations of the federal securities laws by issuers and obligated persons involved in the offer or sale of municipal securities (collectively, "issuers") and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents. The SEC recently announced certain modifications to the MCDC Initiative. This Alert summarizes those modifications. Reference is made to our first Alert on the MCDC, a copy of which can be obtained on Foley.com.

SEC Enforcement Division Modifies MCDC Initiative

On July 31, the SEC announced two primary modifications to its MCDC Initiative: first, to allow issuers and obligors more time to complete their reporting requirements, the division has extended the deadline for Borrowers — but not underwriters– to self-report potential violations from September 10, 2014 to December 1, 2014; and second, with respect to underwriters, the division has determined to implement a tiered approach to civil penalties based on the size of the firm, in order to encourage smaller underwriters to participate in the initiative.

The deadline for underwriters remains unchanged at September 10, 2014 (actually midnight on September 9th).

The division's tiered approach to the cap on civil penalties for eligible underwriters is as follows:

- For underwriters with 2013 reported total annual revenue of more than $100 million: $500,000
- For underwriters with 2013 reported total annual revenue between $20 million and $100 million: $250,000
- For underwriters with 2013 reported total annual revenue of less than $20 million: $100,000

The SEC also acknowledged difficulties with the NRMSIR filing system that predated the current EMMA system maintained by the MSRB. The division states that parties may use "reasonably available sources of information to make good faith efforts to identify potential violations but may not be able to identify certain violations during the period of the initiative due to the limitations of the pre-EMMA NRMSIR system. Potentially mitigating the lack of certainty due to the inconsistency of filings with the NRMSIRS, the division has stated that it "will consider reasonable, documented, good faith, and documented efforts in deciding whether to recommend enforcement action and, to the extent enforcement action is recommended, in determining relief."

For a variety of reasons, including the SEC's often stated views on the manner in which underwriters may comply with Rule 15c2-12, together with this tiered fee structure, we anticipate that underwriters will take advantage of this self-reporting program and scrutinize a Borrower's prior disclosures and possible failures to comply. We note that some market participants have expressed concern that the tiered cap will encourage even more reporting by underwriters of borderline disclosure failures, thus enhancing the tension created by the "modified prisoner's dilemma" of the original MCDC Initiative.

The two and a half month delay in the reporting deadline for Borrowers, will allow for a greater period of time by such Borrowers to understand potentially material misstatements or omissions that may have been disclosed to the SEC by its underwriter.

The MCDC Initiative

Our recommendations related to initial steps to be taken by a Borrower stated in our first Alert, remain the same. We continue recommend that Borrowers take the following steps to determine whether to opt into the MCDC program:

- Borrowers should first review their Official Statements for the past 10 years to determine what was said about continuing disclosure. Borrowers also should note the underwriters of each series of bonds.
- Borrowers next should review their undertakings to determine the scope of their continuing disclosure responsibilities.
- Borrowers then should review the filings actually made. This review should cover both the (1) timely filing of reports and (2) the substance of the reports (making sure the information furnished is that required to be filed); but also (3) the filing of material event notices.

If a Borrower determines that there is a potentially material misstatement in an Official Statement (for example, the Borrower has not described any failure to comply with a continuing disclosure undertaking), then they should consult with counsel to determine, first, if such misstatement was material, and if so, whether to file under the MCDC.

Notwithstanding the foregoing, we strongly encourage Borrowers to coordinate their review with the underwriters of each series of bonds referenced in (i) above. Because the window for self reporting by underwriters closes before the December 1 deadline applicable to Borrowers, Borrowers will need to understand what action (if any) an underwriter has taken with respect to the Borrower's outstanding disclosures.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Last Updated: August 11 2014

Article by Michael G. Bailey, David Y. Bannard, Laura L. Bilas, Heidi H. Jeffery, Chauncey W. Lever and David B. Ryan

Foley & Lardner

SEC Charges Kansas for Faulty Pension Disclosure.

WASHINGTON — The Securities and Exchange Commission has charged the state of Kansas with violating federal securities laws by failing disclose in bond documents that the state's pension system was significantly underfunded, creating a repayment risk for investors.

According to the SEC order settling administrative proceedings against the state, the Kansas Development Finance Authority raised $273 million through eight series of bonds from August 2009 to July 2010 without disclosing in bond documents that the Kansas Public Employees Retirement System was among the most underfunded state pension systems in the U.S. At the end of the 2008 calendar year, the SEC said in court documents, KPERS had a total unfunded actuarial accrued liability of $8.3 billion and was only 59% funded. The underfunding was not disclosed in the state's annual financial information or in official statements for the series of bond offerings, though KPERS did disclose it in its own annual financials.

That behavior violated the antifraud provisions of Section 17(a) of the Securities Act of 1933, the SEC charged. Part of that section of the law makes it illegal to obtain money by omitting a material fact. The SEC alleged that the materiality of the omitted information is clear because in 2009 the state informed both Standard & Poor's and Moody's Investors Service about the pension fund's 2008 investment losses, and both agencies referenced it in their reports.

"We're pleased that our actions have resulted in improved disclosure of pension liabilities in states that were not making investors aware of a significant repayment risk," said Andrew Ceresney, director of the SEC Enforcement Division. "Investors must be given adequate information to evaluate the impact of pension fund liability on a state's overall financial condition."

The action emerged from a nationwide review of muni bond disclosure that had previously produced similar charges against New Jersey and Illinois. The KDFA had been disclosing in recent bond documents that it was under investigation by, and cooperating with, the SEC. Like the two states charged before it, Kansas agreed to settle the charges by adopting new policies and procedures to "help ensure that appropriate disclosures about pension liabilities are being made in its offering documents." The SEC investigation found that the failure to disclose the liability resulted from "insufficient procedures" and faulty communications between the KDFA and the Kansas Department of Administration, which provided the KDFA with the information for its offering documents.

The remedial measures, which the state has fully implemented, included designating responsible individuals in relevant state agencies, mandating more effective communications among those agencies, the establishment of a disclosure committee, and annual training of key personnel.

"Kansas failed to adequately disclose its multi-billion-dollar pension liability in bond offering documents, leaving investors with an incomplete picture of the state's finances and its ability to repay the bonds amid competing strains on the state budget," said SEC muni enforcement chief LeeAnn Gaunt. "In determining the settlement, the commission considered Kansas's significant remedial actions to mitigate these issues as well as the cooperation of state officials with SEC staff during the investigation."

The KDFA declined to talk about the SEC's action, and the office of Gov. Sam Brownback did not respond to a request for comment.

THE BOND BUYER
BY KYLE GLAZIER
AUG 11, 2014 1:58pm ET

WSJ: Kansas Settles Charges it Hid a Risk to Muni Bonds.

SEC Claimed State Misled Investors by Failing to Disclose Underfunding of Pension System

Kansas has agreed to settle a fraud case in which the Securities and Exchange Commission charged the state misled investors when it failed to disclose that its underfunded pension system posed a risk to the repayment of some municipal bonds.

Kansas officials didn't provide important information about the state's pension system in eight bond offerings totaling $273 million in 2009 and 2010, the SEC had said in a cease-and-desist order. Kansas has since adopted new policies to ensure its finances are more transparent in offering documents, the agency said in a news release Monday. The state neither admitted nor denied any wrongdoing, the agency said. There were no penalties or fines.

The action is the third the SEC has taken against states as part of a nationwide review to determine if municipalities are properly disclosing pension liabilities or other risks to investors, who are predominantly retail, in the $3.7 trillion municipal bond market. New Jersey and Illinois also reached similar settlements with the agency without paying a penalty or admitting wrongdoing, and Kansas began to improve its practices even as the agency began questioning them, the SEC said in a news release.

“We’re pleased that our actions have resulted in improved disclosure of pension liabilities in states that were not making investors aware of a significant repayment risk,” Andrew Ceresney, director of the SEC Enforcement Division, said in the release. “Investors must be given adequate information to evaluate the impact of pension fund liability on a state’s overall financial condition.”

The bonds were issued by the Kansas Development Finance Authority at a time when one study found that Kansas’ pension system for public employees was the second-most underfunded in the U.S., the SEC said. Because of “insufficient procedures and poor communications” between state agencies, that information wasn’t provided to bondholders, who also didn’t learn that the liability posed risks to the repayment of their bonds, the agency said.

In response to the SEC action, Kansas Gov. Sam Brownback said in a statement that such reforms as boosting employer and employee contributions have reduced the projected pension deficit. Jim Clark, secretary of administration, said state officials acted promptly in 2011 to improve transparency in bond offerings.

“The SEC has considered these changes and we are pleased that the SEC did not seek any financial penalties,” Mr. Clark said in a statement. “We remain committed to complying with all disclosure requirements and require training and updating of the policies and procedures annually.”

Cities and states have historically received mixed messages about how seriously to treat pension liabilities, and the SEC has taken the position that understating those liabilities is prohibited, said Matt Fabian, managing director at Municipal Market Advisors. Because investors are growing accustomed to such actions by the SEC, the move was unlikely to roil the market, he said.

“If anything, this should improve market function, because you have prospects for better disclosure in the future,” Mr. Fabian said.

By MARIA ARMENTAL and AARON KURILOFF
Updated Aug. 11, 2014 5:07 p.m. ET

MSRB Requests Comment on Expanding Municipal Securities Trade Data on EMMA.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) is requesting comment from municipal market stakeholders on a proposal to enhance the public availability of municipal securities trade data on the MSRB’s Electronic Municipal Market Access (EMMA®) website.

The MSRB is seeking input on proposed changes to the current system of collecting and disseminating trade data that would expand the data made available on EMMA. Among the proposed new data elements is information about trades in new issues that result from conditional allocations by dealers, information regarding sale transactions by dealers that have long-term marketing agreements with underwriters and information about transactions executed through alternative trading systems. Additionally, the proposed changes include a new indicator for customer trades involving non-transaction-based compensation arrangements. Comments are due no later than September 26, 2014.

"All of these post-trade data elements would enhance transparency in the municipal securities market," said MSRB Executive Director Lynnette Kelly. "These proposed changes are among the many steps we are taking to ensure that EMMA continues to evolve in response to changing municipal market practices and technological capabilities."

The MSRB first articulated plans to develop the next generation of its Real-time Transaction Reporting System (RTRS) in its 2012 long-range plan for market transparency products. The plan called for the incremental development of a new "central transparency platform" on EMMA to provide integrated, real-time trade data to investors and other market participants. Market feedback, gathered through two concept releases and ongoing dialogue with industry members, informed the development of the MSRB's proposed post-trade reporting framework.

As the MSRB advances the proposed framework for post-trade transparency, it will continue engaging in outreach with market participants to gather additional input for the first phase of an incremental approach for collecting and disseminating bid-wanted information and other pre-trade data on EMMA.

Date: August 13, 2014

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MSRB Authorizes Technology Fee Rebate to Firms.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) announced today that it will distribute a discretionary technology fee rebate of $3.6 million to eligible brokers, dealers and municipal securities dealers. The technology fee funds the replacement of and upgrades to MSRB technology systems.

The MSRB established a technology renewal fund in January 2011 to ensure the operational integrity of its information systems and to update associated hardware and software to keep pace with changing technology and market system needs. The technology fee is assessed at $1.00 per transaction for all qualified sales transactions. The fund has been building to a target level of three times annual depreciation on technology capital expenditures.

"The technology fund provides the resources required to maintain critical systems relied upon by the municipal securities industry," said MSRB Executive Director Lynnette Kelly. "However the fund has now reached its targeted level and future technology needs are not projected to exceed funding levels. So it is only fair to return the excess to the entities that paid those fees."

The MSRB will provide rebates to currently active and registered firms equal to the technology fees assessed on trades during the six months ended June 2014. Qualified firms will receive an email notification of their rebate amount and whether they will receive a credit against future billings or have the option to receive an electronic payment. The rebates are expected to be processed before September 30, 2014.

The MSRB recognizes that changes to its funding structure may be appropriate to ensure that fees are fair and equitably assessed and distributed. In the coming fiscal year, the MSRB plans to begin a holistic review of fees from dealer assessments, municipal advisors and other sources.

Date: August 12, 2014
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Deadlines Applicable to Colleges and Universities Approaching for Participation in SEC's Continuing Disclosure Cooperation Initiative.

On March 10, 2014, the Securities and Exchange Commission ("SEC") announced a voluntary self-reporting program for issuers and underwriters of municipal bonds for reporting of inaccurate statements made in offering documents regarding prior continuing disclosure compliance through a program called the Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC initiative").

The MCDC initiative permits issuers and obligated persons, for a limited time only, to self-report misstatements concerning prior compliance with continuing disclosure obligations in an official statement for a municipal bond issue. In exchange, the SEC Division of Enforcement agrees to recommend favorable settlement terms for issuers and obligated persons involved in the offering of those municipal bonds. The Division of Enforcement has warned that it will likely recommend seeking significant financial sanctions against issuers and obligated persons that elect not to participate in the MCDC initiative and that are determined to have made material misstatements in an official statement concerning their prior compliance with their continuing disclosure obligations.

Both underwriters and issuers (a term which includes colleges and universities as obligated persons) can participate in the MCDC initiative by completing a questionnaire and submitting it no later than September 10, 2014 in the case of underwriters, or December 1, 2014 in the case of issuers and obligated persons.

The MCDC initiative potentially applies to all colleges and universities that issued tax-exempt debt during the last five years.

CONTINUING DISCLOSURE

For official statements for bonds issued on behalf of a college or university, institution is considered to be the issuer with responsibility for the various statements in the official statement, including statements concerning its prior compliance with its continuing disclosure obligations. Generally, under SEC Rule 15c-2(12), colleges or universities are required to describe failures to comply with prior continuing disclosure obligations over the last five years.

Since 1993, SEC Rule 15c-2(12) has obligated underwriters to require colleges or universities to enter into continuing disclosure agreements that mandate annual filing of audited financial statements and certain financial and operating data for dissemination to the municipal marketplace.

The obligation to provide continuing disclosure applies to most long-term bond issues with the exception of certain variable rate demand bonds secured by letters of credit.

Under most continuing disclosure agreements, a college or university is required to file its annual financial statements and certain operating and financial data with designated repositories, currently the Municipal Securities Rulemaking Board's Electronic Municipal Market Access ("EMMA") system within 180 days of the end of each fiscal year.

Colleges and universities must also file notices of certain material events. Material events include:

(a) principal and interest payment delinquencies;

(b) non-payment related defaults, if material;

(c) unscheduled draws on any debt service reserves reflecting financial difficulties;

(d) unscheduled draws on credit enhancements reflecting financial difficulties;

(e) substitution of credit or liquidity providers, or their failure to perform;

(f) 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 event notices or determinations with respect to the tax status of the bonds, or other material events affecting the tax status of the bonds;

(g) modifications to the rights of holders of the bonds, if material;

(h) bond calls, if material, and tender offers;

(i) defeasances;

(j) release, substitution, or sale of property securing repayment of the bonds, if material;

(k) rating changes;

(l) any bankruptcy, insolvency, receivership or similar event of the obligor;

(m) the consummation of a merger, consolidation or acquisition involving the obligor or the sale of all or substantially all of the assets of the obligor, 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, if material; and

(n) appointment of a successor or additional trustee or the change of name of a trustee, if material.

Notices of material events are generally required to be filed within ten (10) business days of the occurrence of the material event.

CONTINUING DISCLOSURE COMPLIANCE PROBLEMS

Generally, under SEC Rule 15c-2(12), colleges and universities are required to describe failures to comply with prior continuing disclosure obligations over the last five years. There is a five year statute of limitations for SEC enforcement actions so the MCDC initiative covers potential continuing disclosure compliance misstatements or omissions in official statements published within the past five years.

SEC SETTLEMENT TERMS

Under the MCDC initiative, if the SEC Division of Enforcement concludes that there has been a violation, the SEC settlement would require the college or university to do the following as part of an agreed cease and desist order resolving the SEC proceeding:

- Establish policies, procedures and training regarding continuing disclosure obligations within 180 days;
- Comply with existing continuing disclosure undertakings and bring all prior filings up to date within 180 days of institution of the proceedings;
- Cooperate with any subsequent investigation by the SEC Division of Enforcement regarding the false statements, including the roles of individuals and/or other parties involved (underwriters, financial advisors, attorneys);
- Disclose in a clear and conspicuous fashion the settlement terms in the final official statement for any offering by the college or university within five years of the date of institution of the proceeding; and
- Provide the SEC staff with a compliance certification regarding the applicable continuing disclosure undertakings by the college or university on the one year anniversary of the date of institution of the proceedings.

PRISONER’S DILEMMA

The MCDC initiative creates tension between obligors and underwriters, or what is called a “prisoner’s dilemma.”. Both the college or university and the underwriter are required to self-report any material misstatement or omission in a final official statement concerning prior compliance with continuing disclosure obligations. If one party self-reports and the other does not, a problem arises for the second party if the SEC staff determines that the facts warrant an enforcement action. The MCDC initiative is clear that favorable settlement terms are only available for institutions and underwriters that elect to self-report. The SEC’s Division of Enforcement has stated that it will likely recommend and seek financial sanctions in amounts greater than those available under the MCDC initiative.

Another complication is that the MCDC initiative only applies to institutions and underwriters as entities. Although a college or university may self-report and obtain a settlement under the predetermined terms, the SEC retains the right to seek enforcement action against individuals who may be culpable. This may include individuals working at the college or university, or third parties such as attorneys or financial advisors. This increases the difficulty in deciding whether and what to self-report.

WHAT TO DO

Any college or university that issued tax-exempt bonds in the last five years, it needs to review the statements made in the official statements concerning compliance with prior continuing disclosure obligations over the previous five years. In the case of a bond issue in 2010, this would require examination of continuing disclosure filings from 2005. If prior unreported continuing disclosure violations are discovered – failures to file, late filings, or non-reporting of material events that were not disclosed in an official statement – an analysis needs to be performed as to whether the misstatement or omission was “material.”. “Material” is not defined in securities law or regulations and depends on the overall facts and circumstances of a situation. One factor in this analysis is whether the failure would affect a bondholder's confidence in the institution's covenant to provide ongoing continuing disclosure.

In the first instance, a college or university may make its own determination as to whether or not to self-report certain violations on the grounds that they are immaterial. For difficult cases, the MCDC initiative does provide a second review by the SEC staff. The SEC will review each submission and only recommend taking the predetermined enforcement action if the misstatements or omissions were material. Thus, a college or university may self-report while arguing that the circumstances disclosed are not material and should not result in enforcement action. If, however, SEC staff determines otherwise, the institution is still entitled to accept the sanctions included in the MCDC initiative.

8/11/2014

by Jr.Edwin Kelley, Jr. | Bond Schoeneck & King PLLC

SEC Charges Kansas for Understating Municipal Bond Exposure to Unfunded Pension Liability.

The Securities and Exchange Commission today announced securities fraud charges against the state of Kansas stemming from a nationwide review of bond offering documents to determine whether municipalities were properly disclosing material pension liabilities and other risks to investors. According to the SEC's cease-and-desist order instituted against Kansas, the state's offering documents failed to disclose that the state's pension system was significantly underfunded, and the unfunded pension liability created a repayment risk for investors in those bonds.

According to the SEC's order against Kansas, the series of bond offerings were issued through the Kansas Development Finance Authority (KDFA) on behalf of the state and its agencies. According to one study at the time, the Kansas Public Employees Retirement System (KPERS) was the second-most underfunded statewide public pension system in the nation. In the offering documents for the bonds, however, Kansas did not disclose the existence of the significant unfunded liability in KPERS. Nor did the documents describe the effect of such an unfunded liability on the risk of non-appropriation of debt service payments by the Kansas state legislature. The SEC's investigation found that the failure to disclose this material information resulted from insufficient procedures and poor communications between the KDFA and the Kansas Department of Administration, which provided the KDFA with the information to include in the offering materials.

According to the SEC's order, Kansas has since adopted new policies and procedures to help ensure that appropriate disclosures about pension liabilities are being made in its offering documents. Kansas designated responsible parties in state agencies critical to the disclosure process, mandated closer communication and cooperation among those agencies, established a disclosure committee, and now requires annual training of key personnel.

The SEC press release with a link to the order can be seen here.

SEC Approves MSRB Classification Changes.

WASHINGTON — The Securities and Exchange Commission has approved the Municipal Securities Rulemaking Board's proposal that would simplify its rules on professional designations by limiting the activities of some dealer representatives and eliminating one of its professional designations.

Approved Aug. 1 and effective Sept. 30, the changes alter the MSRB's Rule G-3, on classification of principals and representatives, and makes corresponding changes to Rules G-7 on information concerning associated persons and G-27 on supervision.

The non-controversial changes were supported by dealers, who said MSRB's rules will now be more harmonized with the Financial Industry Regulatory Authority's rules. The Securities Industry and Financial Markets Association was the only group to file comments about the proposed changes with the SEC and they were favorable.

Under G-3, limited representatives are individuals whose activities, with respect to municipal fund securities, may include: underwriting or sales; research or investment advice with regard to underwriting or sales; or any other activities that involve communication, with public investors with regard to underwriting or sales. The newly-approved change restricts the activities of limited representatives exclusively to sales to, and purchases from, customers of municipal fund securities. The MSRB has said this approach is consistent with the approach taken by FINRA. The revised rule also defines the term "sales" to include the solicitation of sales of municipal securities.

The amended rules eliminate the designation of "financial operations principal" under G-3, because FINRA has overlapping FINOP designation requirements, including an exam. The section of G-7 that defines "associated person" has been amended to include limited representatives and to replace the term FINOP with "general securities principal." References to FINOP have been removed from amended rules G-7 and G-27.

THE BOND BUYER
BY KYLE GLAZIER
AUG 5, 2014 11:14am ET

MSRB to Propose New Price Transparency Rule.

WASHINGTON — The Municipal Securities Rulemaking Board plans to request comment on whether it should require dealers to disclose a price rather than a markup as a way of improving muni market transparency for retail investors.

The board made that decision at its quarterly meeting in Chicago last week, MSRB chairman Daniel Heimowitz said in a conference call Tuesday.

The MSRB proposal would be an attempt to address concerns about hidden markups in so-called "riskless principal transactions," when bonds are bought and sold within a short time frame so the dealer has little risk the market will change. But Heimowitz said the board had trouble coming to a consensus on what constitutes a riskless principal transaction, and will be interested in hearing from market participants about whether the disclosure of a reference price could achieve the same goal as disclosure of a markup.

The board would propose a rule that would require a dealer to disclose to its customer, when making a retail-sized sale of $100,000 or less, what the dealer paid for that same security on the same day. The rule would only apply to principal and not agency trades.

There have been increasingly loud calls for dealers to disclose their markups on riskless principal transactions, with Securities and Exchange Commission chair Mary Jo White and Commissioner Michael Piwowar sounding the call in recent weeks. Additionally, Sens. Mark Warner, D-Va. and Tom Coburn, R-Okla., introduced a bill in March that would require that disclosure.

“The MSRB recognizes the importance of a coordinated and workable approach to providing investors with additional information about the market for the securities they trade,” said Heimowitz. “We are committed to publishing a proposal that can be shaped with public input into regulations that address improved transparency.”

The MSRB also will be seeking input on other approaches, including requiring markup disclosure, Heimowitz said.

More imminently, the board will seek SEC approval this month of a best execution rule, something that has long existed in the corporate market but which has been a sticking point for munis until recently. The rule would require dealers to use “reasonable diligence” when handling orders and executing municipal security trades for retail investors to “obtain a price that is as favorable as possible under prevailing market conditions.” The final MSRB draft includes some changes that the board’s executive director, Lynnette Kelly, called “technical” tweaks clarifying the exemption from the rule for transactions involving sophisticated municipal market professionals who need less protection. An earlier draft made it seem as if SMMPs must read the policies and procedures of dealer firms, but the board wants them to only understand that dealers have those policies and procedures, Kelly said.

The board also discussed a slew of municipal advisor rules, Heimowitz said. The MSRB will publish for public comment in the coming weeks a proposal to amend its Rule G-37, its pay-to-play rule for municipal securities dealers, to also cover municipal advisors. The proposal would prohibit MAs from engaging in muni advisory business with state or local governments or their subdivisions for two years if certain political contributions are made to those entities’ officials. The board also agreed to propose applying to MAs its existing rule G-20, governing the giving of gifts by dealers to persons whose employers are engaged in municipal securities activities.

“Establishing appropriate pay-to-play and gift regulations for municipal advisors will help ensure that all regulated municipal market professionals are held to the same standards of integrity,” said Heimowitz. “Uniform rules on pay-to-play activities and gift-giving will serve to effectively and fairly guard against corruption, an appearance of corruption and conflicts of interest in the municipal market.”

The board also plans to ask the SEC to sign off on an earlier proposal to set professional qualification requirements for MAs. The proposal would create two classes of MA professionals, principals and representatives, and require all MA representatives to pass an exam once one becomes available. The draft submitted to the SEC will not be greatly changed from the one offered for comment earlier this year, the MSRB officials said.

THE BOND BUYER
BY KYLE GLAZIER
AUG 5, 2014 4:59pm ET

NABL Paper on MCDC Materiality.

NABL today released a paper on considerations for issuers and obligated persons on the questions of materiality and of self-reporting for the SEC's Municipalities Continuing Disclosure Cooperation Initiative (MCDC). The paper is available here. The paper and the analysis in it will be discussed on NABL's teleconference, "MCDC – Should the Issuer Self-Report." The call will be from 1:00 to 2:30 ET, Wednesday, August 6. Additional lines have become available for the teleconference and will be issued on a first-come, first-served basis to regular NABL members. Email registration requests to registration@nabl.org. Confirmations will be sent by 10AM ET Wednesday, August 6. NABL members who are not registered for the teleconference can listen in with someone who is registered or can listen to the audio recording of the teleconference on NABL's website. The audio recording will be available Thursday, August 7.

A key interpretive issue under MCDC is the meaning of "material" in the context of the Initiative. This document is intended to serve the limited purpose of suggesting a framework to analyze this issue. This document does not address whether a municipal issuer or other obligated person under a continuing disclosure agreement should self-report under the Initiative, as there are numerous factors that are involved in any such determination, but the paper does briefly describe some of the considerations the could go into a decision by an issuer or obligated person to self-report.

The paper is focused on materiality determinations by and self-reporting of issuers. NABL believes that this focus will provide the greatest benefit to its members. Because a determination of materiality is dependent on the unique facts and circumstances in any particular instance, and involves the exercise of judgment informed by experience, different parties may reach different conclusions about what is material with respect to similar facts. Moreover, it can be anticipated that issuers and underwriters will have different perspectives, both regarding what may be material and what should be self-reported, particularly in light of the cap on liability applicable to underwriters and the direct application of Rule 15c2-12 only to underwriters.

MSRB Holds Quarterly Meeting.

Alexandria, VA – The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) held its quarterly meeting July 30 – August 1, 2014 in Chicago, Ill., where it approved the advancement of significant regulatory proposals to enhance the transparency and integrity of the municipal securities market. These proposals include:

- Enhancing disclosure of pricing information for retail investors
- Expanding the availability of pre- and post-trade data on the MSRB's Electronic Municipal Market Access (EMMA®) website
- Establishing rules to curb pay-to-play practices for municipal advisors and the giving of gifts in their professional capacity
- Requiring all municipal advisors to take a professional qualifications exam

Price Transparency

In the MSRB's continued focus on enhancing price transparency for municipal securities investors, the Board developed a proposal regarding disclosure of information by municipal securities dealers to their retail customers to help them better understand some of the factors associated with the costs of their transactions. The proposal focuses on disclosure on customer confirmations of the price of a corresponding dealer transaction in the same security that occurs on the same day as the customer trade. The proposed approach would provide investors with information generally already publicly available on the MSRB's EMMA website but would provide it directly to investors in connection with their transactions so they can independently assess the prices they are receiving from dealers. The proposal, which will be published for public comment this fall, will also broadly seek input on alternative regulatory approaches, including markup disclosure on confirmations for trades that could be considered riskless principal transactions.

The MSRB has previously stated that it is working with the Financial Industry Regulatory Authority as it develops a similar proposal for the corporate bond market. The two regulatory authorities will continue to coordinate their approaches to the extent possible in advance of the public comment process.

"The MSRB recognizes the importance of a coordinated and workable approach to providing investors with additional information about the market for the securities they trade," said MSRB Board Chair Daniel Heimowitz. "We are committed to publishing a proposal that can be shaped with public input into regulations that address improved transparency."

In a related effort on price transparency, the MSRB Board approved a forthcoming request for comment on enhancing its Real-time Transaction Reporting System (RTRS) to collect additional post-trade information for public display on EMMA. MSRB market structure staff also will continue engaging in outreach with market participants to gather additional input for the first phase of an incremental approach for collecting and disseminating bid-wanted information and other pre-trade data on EMMA.

Additionally, the Board agreed to proceed with its proposed rule establishing a "best-execution" standard for transactions in the municipal market, with an exception for transactions with sophisticated municipal market professionals. The MSRB will seek Securities and Exchange Commission (SEC) approval of this first explicit obligation for dealers to use "reasonable diligence" when handling orders and executing municipal security trades for retail investors to obtain a price that is as favorable as possible under prevailing market conditions.

Municipal Advisor Regulation

As part of its ongoing effort to implement a comprehensive regulatory regime for municipal advisors, the Board agreed to publish for public comment a proposal to amend MSRB Rule G-37, the MSRB's landmark pay-to-play rule for municipal securities dealers, to also cover municipal advisors. The proposal would prohibit municipal advisors from engaging in municipal advisory business with municipal entities for two years if certain political contributions have been made to those entities' officials. The rule proposal intends to ensure that the high standards and integrity of the municipal securities market are maintained by municipal advisors.

Similarly, the Board agreed to request comment on applying to municipal advisors its existing rule governing the giving of gifts by municipal securities dealers to persons whose employers are engaged in municipal securities activities, MSRB Rule G-20.

"Establishing appropriate pay-to-play and gift regulations for municipal advisors will help ensure that all regulated municipal market professionals are held to the same standards of integrity," said Chair Heimowitz. "Uniform rules on pay-to-play activities and gift-giving will serve to effectively and fairly guard against corruption, an appearance of corruption and conflicts of interest in the municipal market."

The Board also agreed to seek approval from the SEC on an earlier proposal to set baseline professional qualification requirements for municipal advisors. The Board reviewed the comment letters received on its proposal to create two classes of municipal advisor professionals – representatives and principals – and to require all municipal advisor representatives to take and pass an exam within a year of its availability. The MSRB plans to file its proposed rule with the SEC without significant change.

The professional qualifications rule will be the third new municipal advisor rule filed with the SEC since the SEC's adoption of a final definition of "municipal advisor" in September 2013. Last month, the MSRB filed its proposed supervision and compliance rule for SEC approval. In April 2014, the MSRB implemented a fee for municipal advisor professionals. The MSRB is continuing to solicit input on its revised draft rule to create core standards of conduct for municipal advisors through August 25, 2014.

Other Business

In addition to price transparency initiatives and municipal advisor rulemaking, the MSRB Board discussed and approved the annual operating plan and associated budget for the upcoming fiscal year in support of the organization's strategic goals. Consistent with the MSRB's risk management policy, the Board also reviewed the organization's top risk report, which is the product of the MSRB structured risk management program to strengthen internal control environment and accountability, ensure responsible stewardship of all MSRB assets and generate information to inform strategic and operational decision-making.

Bill Sets the Stage for Riskless Principal Regs.

WASHINGTON — A bipartisan bill quietly introduced in the Senate months ago may serve as a starting point for key discussions among regulators about how to develop rules requiring dealers to disclose markups on "riskless principal" transactions.

The Bond Transparency Act of 2014, sponsored by Sens. Mark Warner, D-Va. and Tom Coburn, R-Okla., was introduced in March. The bill would require dealers to disclose to their customers, in writing, at or before the time of completion of a riskless principal transaction, the amount of the difference between the customer's price and the dealer's price. These transactions have not been formally defined, but are generally understood to mean purchases and sales done almost simultaneously so there is little or no chance that the market could move against the dealer.

The idea of requiring dealers to disclose markups in riskless principal transactions is not new, and was included in the Securities and Exchange Commission's 2012 muni market report. More recently SEC Commissioner Michael Piwowar has called for disclosures of such markups, and SEC chair Mary Jo White has instructed the Municipal Securities Rulemaking Board and the Financial Industry Regulatory Authority to begin work on a framework for that purpose.

The SEC does not need legislative authority from Congress to require markup disclosure, but sources said the introduction of the bill could have prodded the SEC into action.

Warner and Coburn introduced the bill after a column appearing in The Wall Street Journal claimed muni investor's profits were being eaten up by markups.

"When buying or selling shares in a stock, customers are told the commission they pay; it only makes sense that the same occur when trading a bond," Warner told The Bond Buyer. "I am encouraged chair White has made our commonsense, bipartisan idea of bond price transparency a priority and that MSRB and FINRA are moving forward on this. I hope they can move expeditiously to protect investors and strengthen our markets."

The bill does not define riskless principal beyond saying it means the dealer is "acting as principal for its own account" leaving it to the SEC to decide what the appropriate standard should be.

The question for the dealer community is how the regulators plan to define a riskless principal. Were the Warner/Coburn bill to become law, a dealer would have to tell a customer at the time of the transaction what the markup would be. In a speech in Boston last week, Piwowar said that the SEC staff's initial opinion is that a same-day time frame to identify riskless principal transactions would be workable for market participants. Piwowar added that he is looking forward to "seeing further analysis on this issue and hearing from market participants on their views."

David Cohen, a managing director and associate general counsel at the Securities Industry and Financial Markets Association, said the support of the dealer community for the new disclosures and the Bond Transparency Act depends on the riskless principal definition.

"SIFMA believes that the bill is a good starting point for discussion," Cohen said, adding that a trade is only riskless if a dealer has a firm customer order in hand before committing to the trade. Whatever definition of riskless principal the commission decides on, Cohen said, it has to be measurable so that it can be automated.

The MSRB had initial discussions at its board meeting last week on how it will approach the new mandate. White said in June that she wants a disclosure framework in place by the end of the year.

THE BOND BUYER
BY KYLE GLAZIER
AUG 4, 2014 4:07pm ET

NABL Releases Whitepaper on Considerations for Issuers and Obligated Persons on the Questions of Materiality and Self-reporting for the SEC's MCDC Initiative.

Download the Report.

SEC Commissioner's Remarks at the 2014 Municipal Finance Conference.

Remarks At The 2014 Municipal Finance Conference Presented By The Bond Buyer And Brandeis International Business Schooll, SEC Commissioner Michael S. Piwowar, Boston, Massachusetts, Aug. 1, 2014

Thank you, Erik [Sirri], for that kind introduction.

Before I begin I need to take an awkward pause and provide the standard disclaimer that the views I express today are my own and do not necessarily reflect those of the Commission or my fellow Commissioners.

With that out of the way, let me tell you how delighted I am to be here at this excellent conference. I have greatly enjoyed interacting with this wonderful group of academics, practitioners, regulators, and journalists all dedicated to examining the myriad of issues raised by the topic of municipal finance. In particular, it is great to see such a diverse mix of prominent academic researchers interested in this field. People like Dan Bergstresser and John Chalmers, who have made significant contributions to the academic literature on municipal finance over the past several years. People like Jess Cornaggia, who is bringing his expertise in credit ratings to municipal finance. People like Erik Sirri and Kim Cornaggia, who have given their time and talents to serve the public at the Securities and Exchange Commission ("SEC" or "Commission").

On that note, I want to make a pitch to the academics participating in this event to seriously consider coming to the SEC as a visiting academic scholar or economic fellow in our Division of Economic and Risk Analysis ("DERA").[1] The Commission has long benefitted from working with outside experts in academia and industry to strengthen the Commission's foundation of market knowledge. By the end of my speech, I hope you will see that there are a number of exciting research opportunities in municipal finance to pursue at the Commission.

It has been twelve years, almost exactly to the day, since I was first introduced to the municipal securities market. It was my second day on the job as a visiting academic scholar at the SEC. I arrived at the Commission expecting to work on equity market structure issues. My PhD dissertation focused on equity market microstructure, my first published academic journal article focused on equity market microstructure, and my pipeline of market microstructure working papers all focused on the equity markets.

But, my research agenda took an unexpected and serendipitous turn after a brief conversation with SEC Chief Economist Larry Harris. I still remember him asking me: "Did you know that we have a database of every secondary market transaction in the municipal bond market over a one-year period?" "No," I answered. He followed up: "Do you want to work in this area?" Of course, as a young academic with lots of motivation but little quality data, it did not take me long to answer, "Yes." Luckily for me that turned out to be the correct response, because I got the strong impression that had I answered in the negative I might have been fired. Having passed that initial test, I soon found myself sifting not only through municipal bond data, but also gathering data and analyzing transparency initiatives in the corporate bond market. And so began my multi-year exploration of the municipal and corporate bond markets with Larry Harris and fellow SEC economist Amy Edwards.[2]

Our research yielded a number of somewhat surprising conclusions about the municipal bond market. First, municipal bonds do not trade very often. When analyzing trading activity of individual bonds, we needed to calculate the average number of trades per week, not perday. Second, municipal bonds are expensive for retail investors to trade. We found that effective spreads in municipal bonds averaged almost 2% of the price for representative retail-sized trades. In the Fed's current near-zero-interest-rate policy environment, this represents several months of a bond's total annual return. Third, retail-size municipal bond trades are more expensive than institutional-size trades. Unlike in equities, municipal bond transaction costs decrease with transaction size. Fourth, many municipal bonds have several complexity features – e.g., sinking funds, special redemption provisions, credit enhancements – that make valuation more difficult for investors. Secondary municipal bond transaction costs increase with instrument complexity, which suggests that investors and issuers might benefit if issuers could issue simpler bonds.

Each of these conclusions seems to raise more questions than it resolves, which is evidence of the complexity of the municipal securities market. This complexity is one of the reasons I have been fascinated by this market for so long, and continue to seek answers to the many unique questions it generates.

Given what I have just told you about my background and previous work related to the municipal bond market, it is probably not a surprise that one of my first actions as a Commissioner was to gather with SEC staff to discuss improvements for retail investors that could be made in this market. The timing was apt, because the Commission adopted a final municipal advisor definition, which occurred just weeks after I was sworn in.[3] Despite the attention paid to the municipal advisor definition and related efforts aimed at protecting issuers, I knew from my prior work in this space that there remained a number of basic reforms that could be enacted to better serve the retail investors that dominate this market.

As a result, I urged the Director of the SEC's Office of Municipal Securities, John Cross, and his staff to shift their focus from the creation of the municipal advisor regime to potential reforms in the existing municipal securities market structure. As part of this dialogue I encouraged staff to identify areas of "low-hanging fruit" reflecting common sense improvements to the municipal bond market that the entire Commission could support.

While staff worked to develop a proposed set of reforms for the municipal securities market, I publicly advocated for incremental changes to fixed income market structure in a speech this January at the U.S. Chamber of Commerce.[4] As a minority Commissioner, these calls for reform can sometimes fall on deaf ears within the SEC. However, I am pleased that today, rather than continuing to beat the drum for changes that might never see the light of day, I am able to discuss with you concrete steps to improve the municipal bond market that are not only achievable, but are already gaining support. These steps have been thoughtfully developed by SEC staff and are consistent with the changes for which I have been advocating. And in key signs of progress, most of these reforms also recently received the support of Chair Mary Jo White and Commissioner Dan Gallagher.[5] I firmly believe that the common sense reforms I describe today have the momentum behind them to be enacted in the near-term for the benefit of retail investors and the market as a whole.

Riskless Principal Transactions

The first issue that must be addressed in the municipal bond market is the disclosure of markups on riskless principal transactions. This is an area that I specifically referenced in the January speech in which I called for changes in the fixed income market, and there are straightforward reforms that will provide substantial benefits to retail investors.

When retail investors enter into transactions with dealers to purchase municipal securities, those transactions may be executed by dealers either in an agency or a principal capacity. If a dealer completes a municipal security transaction in an agency capacity it must disclose to its customer the commission that it charges for the trade. Yet if the dealer instead chooses to complete the same transaction in a riskless principal capacity, it may disclose to the customer that zero commission was paid on the trade even if a markup or markdown was charged. Thus, under the existing rules, the information received by a customer concerning the compensation paid to a dealer for these two economically equivalent methods of executing the same transaction is vastly different. In effect, the current regulatory environment allows the dealer to hide its compensation from a customer merely by altering the method of execution used. As a result, customers may unknowingly be paying increased transaction costs while believing that their trades have not been subject to any commission payment.

The time has come to require dealers to disclose markups and markdowns on all riskless principal bond transactions on customer confirmations. Retail customers should have the information necessary to fully understand the costs associated with their transactions and to make informed decisions about how they trade municipal securities. In the past, limitations on the data reported for municipal securities transactions may have made it difficult to identify riskless principal transactions, for purposes of compliance with – and enforcement of – a rule requiring disclosure of markups or markdowns on such transactions. These limitations are no longer present in today's market, as pricing data on municipal securities transactions is reported soon after execution. Thus, we already have the data necessary to identify riskless principal transactions. All that remains is to close the current disclosure loophole.

Of course, despite the sufficiency of our current data set for these purposes, the key question that will always arise when discussing the disclosure of riskless principal markups is what time frame should be used to identify relevant transactions? As an initial matter, staff in the SEC's Office of Municipal Securities has indicated a belief that a same-day time frame to identify riskless principal transactions would be both consistent with natural break points in the data and workable for market participants. I look forward to seeing further analysis on this issue and hearing from market participants on their views as we move towards a rule in this area.

When I talk about moving forward on this issue, I am looking squarely in the direction of the Municipal Securities Rulemaking Board ("MSRB") and Financial Industry Regulatory Authority ("FINRA"). The issue of riskless principal markups is common to both the municipal and corporate securities markets, and I strongly encourage both organizations to work together to publish proposed rules for public comment. There will certainly be those who object to such an undertaking, but the time has come for investors to understand the costs associated with their fixed income transactions, and I ask my colleagues at the MSRB and FINRA to push ahead in implementing this much needed reform.

Best Execution

Another part of the municipal securities market structure that is in need of improvement is the standard of execution to which dealers are held. For too long, we have seen a split in the execution standards in the fixed income markets between corporate and municipal bonds, with FINRA applying a best execution standard to corporates, and the MSRB requiring dealers in the municipal space to trade with customers at "fair and reasonable" prices and to exercise diligence. Objections to the application of a best execution standard to municipal securities often cite the complexity of the market and its unique characteristics as reasons for not adopting such a standard. However, it is the inherent complexity of this market – combined with its highly retail customer base – that creates the need for this high standard. Dealers face a wide array of options for fulfilling customer orders in the municipal securities space, from using internal inventory, to seeking out transactions with other dealers, or tapping into the liquidity of an alternative trading system. Each of these methods of execution may at various times benefit a retail customer initiating a specific transaction with a dealer. However, with so many different methods of execution available, it is impossible to verify whether a dealer has executed a transaction based on the best interests of its customer. As a result, it is vital that dealers be subject to a standard of best execution in the municipal securities space in order to provide retail customers with the confidence that they are receiving the best execution available for each transaction into which they enter.

I am pleased that this is an area where we are already seeing positive developments. I commend the MSRB for taking thoughtful and deliberative steps over the past year towards a best execution standard. After first seeking comment on the question of whether to move forward with a proposed best execution rule in August 2013,[6] the MSRB appropriately chose to proceed with a proposed rule that was published for comment in February of this year.[7] I understand that the MSRB is in the process of reviewing the comments submitted and developing a final rule for submission to the Commission. I look forward to receiving such a submission and implementing an effective, workable rule in the near future.

While calling for steady movement towards a best execution standard in the municipal securities market, I am not ignoring the concerns that some market participants have expressed regarding the complexities involved with implementing such a standard, or the unique aspects of the municipal securities market that must be accounted for in any final rule. However, I am confident that these difficulties can be addressed through dialogue between the regulatory community and market participants. In particular, I recognize that many market participants are concerned that how to apply a best execution standard to fixed income markets is already subject to a significant amount of uncertainty in the corporate bond market, where the standard presently exists. These concerns are valid, and reflect the need for further guidance. I know that the MSRB and FINRA are already engaged in a dialogue aimed at providing clarity on this issue through the publication of practical guidance on how to apply a best execution standard in the context of illiquid securities such as certain municipal and corporate bonds. I encourage the MSRB and FINRA to complete this important work, and ask market participants to stay engaged on this issue by working with the MSRB and FINRA to identify key areas where guidance is needed.

Pre-Trade Transparency

A third area of the municipal securities market that stands ready for reform is pre-trade price transparency. Transparency in the fixed income markets is a particular interest of mine. My municipal bond research attributed much of the high cost of trading municipal securities to the lack of transparency in that market. My corporate bond research also addressed transparency by showing that investors benefitted significantly from public dissemination of prices.

The municipal securities market has long suffered from a lack of price transparency, and this deficiency is particularly acute for retail investors. In recent years, however, strides have been made to increase post-trade transparency for municipal securities through the MSRB's Electronic Municipal Market Access ("EMMA") system. This service now provides a wealth of historical pricing information in the municipal securities market in an easy to access format.

While the EMMA system reflects a significant advancement in the overall amount of transparency in the municipal securities market, there is still a significant need for publicly available information regarding pre-trade pricing for these financial products. Retail investors currently have little if any insight into the pricing of their transactions. The little pricing information that exists is typically found on alternative trading systems that provide indicative prices and requests-for-quotes to members, but not to the general public. As a result, the retail investors that make up a significant portion of the municipal securities market are left in the unenviable position of not knowing basic information about the prices at which their securities are likely to transact.

We can do better for retail investors. That is why I support efforts to incrementally increase pre-trade price transparency in the municipal securities market by amending Regulation ATS to mandate the public dissemination of pricing information for certain transactions on significant alternative trading systems.
I use the term "incrementally" in recognition of the difficulty of this task and the need to approach it with care. As with any transparency initiative, there is a risk that shining a light on one portion of the market will cause transaction volume to flee further into the dark. This type of movement could have severely negative impacts in a market like that for municipal securities, which already suffers from a lack of liquidity. However, after talking with relevant SEC staff I believe that we can develop

an approach that will provide valuable pricing information to retail investors without over-burdening the market and pushing liquidity away from the trading venues that participate in a transparency initiative. This approach could start with requiring public dissemination of pricing information for smaller transactions typically entered into by retail investors. By focusing first on the disclosure of these transactions, we can provide retail investors with a wealth of valuable pricing information without harming the ability of other market participants to execute large transactions. This is undeniably a delicate task, but the potential benefit for retail investors is too great for us not to undertake meaningful reforms in this area.

Before leaving the topic of transparency, I would like to briefly circle back to the subject of municipal bond complexity that I mentioned earlier as one of the surprising conclusions from my research. This is an area that continues to puzzle me. Despite the potential benefits of increased standardization for both investors and issuers, municipalities continue to issue exceedingly complex bond offerings. The complexity of these offerings is frequently mentioned as one reason why municipal securities do not trade on exchanges, which would provide pre-trade price transparency to retail investors.

I recognize that municipal issuers face unique legal and tax considerations that can influence the design of municipal securities, and therefore may limit their ability to make offerings as simple as they might desire. At the same time, improvements to liquidity from issuing simpler bonds should result in higher valuations and lower issuance costs. These factors alone should help drive the municipal bond market towards greater standardization rather than into the complexity that we see in current issuances. This contradictory result merits further attention, particularly given the potential for decreased costs, increased liquidity, and increased transparency that could result from greater standardization in the municipal bond market. I look forward to receiving feedback from all interested parties regarding what should be done to address this challenging problem.

MSRB Efforts

It is clear by the nature of the market structure reforms I have outlined that much of the initial work must be undertaken by the MSRB. Given what I have seen of the MSRB during my time as a Commissioner, I have full faith that they are up to the task.

The Dodd-Frank Act ushered in a number of changes at the MSRB, including major changes to its board structure and new responsibilities related to the oversight of municipal advisors. I had the opportunity to meet with the revamped MSRB board in May, and I left impressed by the combined knowledge of its members and their willingness to get into the weeds on the many thorny issues present in the current municipal securities market.

In addition to its board, Lynette Kelly and her staff at the MSRB have done yeoman's work during the past months producing an impressive number of rule proposals. Just this past week, the MSRB submitted a rule filing for approval that would establish supervisory and compliance obligations for municipal advisors.

This recent filing represents the first of many related rule filings to come as the MSRB seeks to get the municipal advisor regime up and running. That is why I am particularly pleased that the MSRB recently hired its first Chief Economist, David Saltiel, to help bolster the economic analysis contained in these rule filings. I look forward to future rule filings from the MSRB and to the positive impacts that will come from Mr. Saltiel's involvement with these proposals.

One final comment I would like to make about the MSRB is to commend it for commissioning Erik Sirri to complete the recently published Report on Secondary Market Trading in the Municipal

Securities Market.[8] Tapping into the expertise of outside academics is an excellent way to bring rigorous economic analysis to bear on regulatory issues that are all too often debated primarily on the basis of competing business models of market participants. Erik's report provides an excellent baseline for further analysis by academics, regulators, and market participants of the secondary market trading practices in the municipal securities market, and it supports the type of data-driven approach to regulation that I believe is most effective in meeting the regulatory challenges of the day.

MCDC Program

I would be remiss if I failed to mention the topic that is probably the biggest cause of anxiety for municipal finance practitioners right now, the SEC's Municipalities Continuing Disclosure Cooperation Initiative ("MCDC Initiative").[9] The stated intention of the MCDC Initiative is to address potentially widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents. The MCDC Initiative is designed to encourage self-reporting of possible violations by placing a cap on the civil penalties for issuers or underwriters that self-report by the September 10, 2014 deadline.

As most of you are probably aware, the Commission issued a press release yesterday announcing certain modifications to the MCDC Initiative. These modifications both extend the deadline for issuers to self-report from September 10, 2014 to December 1, 2014, and create a tiered penalty cap for small- and mid-sized underwriters.
Extending the deadline for issuers until December 1, 2014 is intended to address the difficulty of ensuring that the tens of thousands of issuers across the country – particularly the smaller issuers – are aware of the initiative and each have adequate time to consider whether they should self-report. In addition, the tiered penalty cap responds to feedback indicating that many underwriters may reach the current $500k cap, but that a penalty at that level would impair their ability to conduct business.

Finally, the press release also makes a statement related to the difficulties some market participants have encountered in accessing data from the Nationally Recognized Municipal Securities Information Repository ("NRMSIR") system, which pre-dated EMMA. The press release indicated that enforcement staff would consider "reasonable, good faith, and documented efforts" to investigate potential violations in the NRMSIR, which should alleviate the concerns expressed by some that discrepancies in the NRMSIR might result in failures to properly self-report.
These important changes address many of the issues conveyed to me by market participants, and I applaud the SEC staff for developing tailored modifications based on widespread concerns in the market. The changes should serve as confirmation to market participants that our staff listens to the legitimate concerns expressed and responds in a reasonable manner. To the extent that you identify further issues of concern, I encourage you to continue to raise them with the staff, as they have assured me that they remain ready and willing to discuss your questions and provide clarity wherever possible.

Thank you for your attention.

[1] See Division of Economic and Risk Analysis Opportunities for Economists and Other Experts and Professionals with DERA, available athttp://www.sec.gov/divisions/riskfin/rfemployment.shtml.
[2] See Lawrence Harris & Michael Piwowar, "Secondary Trading Costs in the Municipal Bond Market," Journal of Finance 61, 1361-1397 (2006), available athttp://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2006.00875.x/pdf; Amy Edwards, Lawrence Harris & Michael Piwowar, "Corporate Bond Market Transaction Costs and Transparency," Journal

of Finance 62, 1421-51 (2007), available athttp://onlinelibrary.wiley.com/doi/10.1111/j.1540-6261.2007.01240.x/pdf.
[3] See Press Release, SEC Approves Registration Rules for Municipal Advisors (Sept. 18, 2013), available athttp://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539817759.
[4] See Commissioner Michael S. Piwowar, Remarks before the U.S. Chamber of Commerce,Advancing and Defending the SEC's Core Mission, (Jan. 27, 2014), available athttp://www.sec.gov/News/Speech/Detail/Speech/1370540671978.
[5] See Chair Mary Jo White, Remarks before the Economic Club of New York, Intermediation in the Modern Securities Markets: Putting Technology and Competition to Work for Investors(June 20, 2014), available athttp://www.sec.gov/News/Speech/Detail/Speech/1370542122012; Commissioner Daniel M. Gallagher, Remarks at Municipal Securities Rulemaking Board's 1st Annual Municipal Securities Regulator Summit (May 29, 2014), available athttp://www.sec.gov/News/Speech/Detail/Speech/1370541936387. Commissioner Gallagher also spoke about the need for additional steps to improve the transparency of the accounting for public pensions.
[6] See MSRB Notice 2013-16 – Request for Comment on Whether to Require Dealers to Adopt a "Best Execution" Standard for Municipal Securities Transactions (Aug. 6, 2013),available at http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2013/2013-16.aspx?n=1
[7] See MSRB Notice 2014-2 – Request for Comment on Draft Best-Execution Rule, Including Exception for Transactions with Sophisticated Municipal Market Professionals (Feb. 19, 2014),available at http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-02.ashx?n=1.
[8] See Report on Secondary Market Trading in the Municipal Securities Market (July 2014),available at http://www.msrb.org/msrb1/pdfs/MSRB-Report-on-Secondary-Market-Trading-in-the-Municipal-Securities-Market.pdf
[9] See Municipalities Continuing Disclosure Cooperation Initiative, Division of Enforcement, U.S. Securities and Exchange Commission, available at http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml.

MSRB to Amend Professional Qualification Requirements for Dealers.

Alexandria, VA – In an effort to align municipal securities regulatory requirements with current business practices, the Municipal Securities Rulemaking Board (MSRB) is making certain technical changes to its professional qualification rules for municipal securities dealers.

Among the changes is a revision to MSRB Rule G-3, which establishes professional qualification requirements for dealers, that limits the scope of permitted activities of individuals classified as "limited representatives – investment company and variable contracts products" to include only sales to and purchases from customers of municipal fund securities. The revised rule also defines the term "sales" to include the solicitation of sales of municipal securities. Finally, the amended rule eliminates the Financial and Operations Principal (FINOP) classification and related requirements. Read more about the rule changes.

The changes to MSRB Rules G-3, G-7 and G-27 were approved on August 1, 2014 by the Securities and Exchange Commission and are effective September 30, 2014.

The changes are consistent with the MSRB's ongoing effort to ensure that existing and new regulations function as efficiently as possible and are consistent with those of other regulators, when appropriate.

Date: August 4, 2014

Lawyers: MCDC Changes Foster More Tension.

WASHINGTON – The Securities and Exchange Commission's changes to its disclosure violation self-reporting program are somewhat helpful to issuers but may create further problems in their relationships with underwriters, market participants said.

This was the reaction from lawyers, issuers, and dealer groups to the SEC's July 31 announcement that it is altering its Municipalities Continuing Disclosure Cooperation Initiative to encourage more participation.

The MCDC allows issuers and underwriters to get favorable settlement terms if they voluntarily report, for any bonds issued in the last five years, any time they inaccurately claimed to be complying with continuing disclosure obligations. The modifications include pushing back the deadline to Dec. 1 from Sept. 10, 2014 for issuers and borrowers, but not for underwriters.

"I don't think this is as helpful as the SEC thinks it is," said Teri Guarnaccia, a partner at Ballard Spahr in Baltimore. "The extension is de facto just creating further tension."

Guarnaccia explained that the SEC's decision to alter the MCDC's civil penalties cap for underwriters just further incentivizes the smallest dealers to participate. Originally all underwriters' penalties would be capped at $500,000 under the program, but the new approach bases penalties on a dealer's size. Civil penalties will now be capped at $500,000 for dealers who report total revenue of more than $100 million for fiscal 2013 on their annual audited report; $250,000 if they report fiscal 2013 revenue of between $20 million and $100 million; and $100,000 if they report fiscal 2013 revenues of less than $20 million.

The low caps are a major incentive for the smaller dealer firms, but the MCDC's "prisoner's dilemma" structure means that a dealer can "rat out" an issuer by reporting a misleading transaction, and vice versa. Both sides of the market have said issuers and underwriters need to have an open dialogue about how to proceed on deals they both participated in, but Guarnaccia said that all those conversations still need to take place by the original deadline despite the extension for issuers.

John Grugan, a partner in Ballard's Philadelphia office whose practice focuses on securities litigation, said the changes will not affect the way underwriters analyze what to self-report. Grugan agreed that the change provides little help for potential MCDC participants.

"I think it's a very marginal benefit," he said.

Grugan has cautioned that SEC examinations under the MCDC could easily transform into other enforcement actions, and said potential self-reporters can still face "pretty significant consequences," by voluntarily disclosing past violations.

Ballard issued a client alert pointing out that it is not clear whether issuers and borrowers will benefit from any cease and desist orders announced against underwriters prior to their new self-reporting deadline. The SEC, in its lone MCDC case to date, that charged Kings Canyon Joint Unified

School District with misleading bond investors in a 2010 deal, frustrated some attorneys by not disclosing which missed filings resulted in the cease and desist order.

Ben Watkins, chairman of the Government Finance Officers Association's debt committee and Florida's bond finance director, said the issuer deadline extension is helpful but the failure to extend it for underwriters will result in erroneous reports. Watkins said it is "an extremely heavy lift" for underwriters to go through all their deals before the deadline, and their strong incentive to report will result in errors. Watkins said GFOA is still advising issuers to let underwriters comb the deals and then make a determination with the help of counsel about how to proceed.

Watkins added that it is helpful for the SEC to acknowledge the difficulty of searching the old Nationally Recognized Municipal Securities Information Repository [NRMSIR] system which pre-dated EMMA. The SEC said participants "may use reasonably available sources of information to make good faith efforts to identify potential violations" pre-EMMA.

John McNally, a partner at Hawkins Delafield & Wood in Washington, said the extension for issuers is welcome but that underwriting firms have much more review work to do, perhaps exceeding 1,000 official statements.

"So while some delay for issuers beyond the underwriter deadline is appropriate, it would be good to have seen a three- to six-month extension for the underwriters," he said.

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at Bond Dealers of America, said the change "strains the relationship" between issuers and underwriters, because underwriters cannot be sure what issuers might do in the months after the underwriter deadline. Although that is a concern, BDA is encouraged that a change was made.

"They responded to the industry," Giroux said. "That means something."

THE BOND BUYER
BY KYLE GLAZIER
AUG 1, 2014 2:43pm ET

U.S. SEC's Piwowar Calls for More Price Transparency for Munibonds.

Aug 1 (Reuters) – Retail investors in the $3.7 trillion municipal bond market need better pricing information before trades are executed, a top U.S. securities regulator said on Friday in a speech calling for reforms for the lightly regulated market.

"The municipal securities market has long suffered from a lack of price transparency, and this deficiency is particularly acute for retail investors," Securities and Exchange Commission Republican member Michael Piwowar said in prepared remarks for the Municipal Finance Conference in Boston.

"There is still a significant need for publicly available information regarding pre-trade pricing for these financial products," he said.

Piwowar's comments come as industry-funded regulators are working to craft rules to improve transparency and investor protections for the fixed income market.

The Municipal Securities Rulemaking Board, for instance, is pushing to finalize rules that will require municipal bond dealers to comply with best execution, something that is already required of dealers in the U.S. equities market.

The MSRB will also be taking up proposals first advocated by Piwowar in January. They would require dealers to disclose how much they are compensated for executing so-called riskless principal transactions, or buying securities from their customers and reselling them to other dealers.

Piwowar said Friday that pre-trade price transparency could improve through changes to federal rules governing "alternative trading systems," an electronic marketplace where people can buy and sell securities.

ATS operators for both equities and bonds are not required to disclose pre-trade pricing data.

Piwowar said, however, that some "significant" ATS venues should be required to start publicly disseminating prices for some types of trades.

He added that he believed the rules could be drafted to help shine a light on the market without running the risk of drying up liquidity.

For instance, he said, the SEC could start by only requiring the disclosure of pricing data of small transactions by retail investors. Larger trades, by contrast, could still be protected from full disclosure.

"This is undeniably a delicate task, but the potential benefit for retail investors is too great for us not to undertake meaningful reforms in this area," Piwowar said.

Piwowar, who joined the SEC last year, has been among the most vocal advocates for reforms in the municipal bond market.

Before becoming a commissioner, he once worked at the SEC as an economist studying the bond market. His research found that the high cost of trading in the market was linked to the lack of transparency.

In a June speech, SEC Chair Mary Jo White also threw her support behind numerous reforms for the bond market, saying she feared technology was being leveraged to make the "old, decentralized method of trading" better for dealers, but not for investors.

BY SARAH N. LYNCH

(Reporting by Sarah N. Lynch; Editing by Lisa Von Ahn)

SIFMA Commentary: Regulation of MAs: Bring it On.

On July 1, 2014, the SEC's rule implementing Section 975 of Dodd-Frank, governing the conduct of all municipal advisors, finally became effective. This is almost four years after President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Congress could not possibly have envisioned that it would take seven years from the passage of Dodd-Frank to implement basic regulation over independent municipal advisors bringing fundamental protections to municipal issuers and investors. But that is the current time frame.

Yet some of the baseline rules that all other currently regulated parties are subject to are as long as two to three years away from being fully applied to the previously unregulated non-dealer advisors. These rules include such important standards as: professional qualifications and licensing; disclosure of employment and disciplinary history; limitations on and reporting of political contributions and bond ballot contributions; limitations on gifts and business entertainment; written baseline and supervisory policies and procedures; and role disclosure and conflict of interest disclosure.

In light of the MSRB's dual mission to protect both municipal entities and investors, SIFMA urges the MSRB to interpret MSRB Rule G-17, effective immediately, to apply these specific baseline provisions to municipal advisors.

Moreover, we urge the MSRB to move quickly to adopt a testing regime applicable to non-dealer municipal advisors that is the same as the qualification requirements (the Series 52) currently applicable to dealer municipal securities representatives as defined in MSRB Rule G-3: those individuals whose activities include underwriting, trading or sales of municipal securities; financial advisory or consultant services for issuers in connection with the issuance of municipal securities; research or investment advice with respect to the issuance of municipal securities; and any other activity which involve communications with public investors in municipal securities. The Series 52 qualification examination is a basic competency test on municipal securities and has long covered topics applicable to providing advice to municipal issuers; there is no reason that there needs to be a different test for municipal advisors.

SIFMA and its members supported Section 975 as a means of protecting municipal issuers from unregulated municipal advisors. And while we have strong reservations to some of the provisions promulgated by the SEC in the final rule, we nonetheless believe there are a number of long overdue other important provisions that need to be implemented now. Many SIFMA member firms serve as municipal advisors and were already regulated, and we were in favor of this effort to level the regulatory playing field among dealer municipal advisors and non-dealer/independent municipal advisors.

Issuers, without a doubt, have a vested interest in the regulation of companies providing advice to them. Many municipalities have seen success through partnerships with banks and broker dealers. Each and every day, local financial institutions connect state and local governments with our capital markets to issue debt and secure funding for key projects. Municipal bonds have financed four million miles of roads, half a million bridges, 16,000 airports and 900,000 miles of water pipes. This year alone, state and local governments across the country have accessed over $88 billion in funding through the municipal bond markets.

For over 35 years, MSRB Rule G-17 has served as a minimum standard of fair conduct for dealers. It also contains what has been interpreted to be an antifraud prohibition: requiring regulated parties to "deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

Rule G-17 was expanded in 2011 to specifically apply the MSRB's core fair dealing rule to municipal advisors in the same manner that it applied to dealers. The MSRB argued at the time to the SEC that "[t]he proposed rule change is necessary for the robust protection of investors against fraud". The National Association of Independent Public Finance Advisors (NAIPFA) found these amendments to Rule G-17 to be "appropriate and consistent" with Dodd-Frank.

Seven years is far too long to wait for the establishment of a level regulatory playing field. In the absence of immediate regulatory action by the MSRB, SIFMA urges NAIPFA to adopt these principles as best practices for its members: disclosure of employment and disciplinary history;

limitations on and reporting of political contributions and bond ballot contributions; limitations on gifts and business entertainment; written base line and supervisory policies and procedures; and role disclosure and conflict of interest disclosure. SIFMA also urges the MSRB to move quickly to adopt a testing regime applicable to non-dealer municipal advisors that is the same as the test currently applicable to dealer representatives, the Series 52. There is no reason that there needs to be a different test for municipal advisors.

BY KENNETH BENTSEN, JR.
JUL 31, 2014 8:02am ET

Kenneth E. Bentsen, Jr. is President and CEO of SIFMA.

SEC Extends MCDC Deadline for Issuers, Tiers Penalty Caps for Underwriters.

WASHINGTON — Securities and Exchange Commission officials have modified their program for issuers and underwriters to voluntarily self-report continuing disclosure failures, saying they want to encourage as much participation in the program as possible.

The modifications to the SEC enforcement division's Municipalities Continuing Disclosure Cooperation (MCDC) initiative were announced late Thursday.

The MCDC allows issuers and underwriters to get favorable settlement terms if they voluntarily report, for any bonds issued in the last five years, any time they failed to make accurate continuing disclosures with regard to those bonds.

The modifications include pushing back the deadline to Dec. 1 from Sept. 10, 2014 for issuers and borrowers, but not for underwriters.

"The deadline for underwriters remains unchanged at Sept. 10," the SEC said. Commission officials have pointed out that the deadline is actually, for practical purposes, the end of Sept. 9.

LeeAnn Gaunt, director of the SEC enforcement division's municipal securities and public pensions unit, called the extension "modest but meaningful." She said the division only extended the deadline for issuers and borrowers because they "are not as well positioned as underwriters to respond within the original amount of time allotted." She said also that the division wanted to give issuers time to consult with their underwriters and then make their own decisions about what actions to take.

In addition, the SEC has put in place a tiered approach to capping the civil penalties for underwriters that recognizes smaller firms should have lower penalties. Originally all underwriters' penalties would be capped at $500,000 under the MCDC.

But under this modified approach, penalties for underwriters that self-report disclosure failures would be capped at $500,000 if they report total revenue of more than $100 million for fiscal 2013 on their annual audited report; $250,000 if they report fiscal 2013 revenue of between $20 million and $100 million; and $100,000 if they report fiscal 2013 revenues of less than $20 million.

If the caps are not met, underwriters will have to pay $20,000 per offering of $30 million or less with continuing disclosure failures and $60,000 for offerings of more than $30 million with such failures.

The SEC also said that if disclosure violations are identified by the enforcement division after the expiration of the initiative, the division "will consider reasonable, good faith and documented efforts in deciding whether to recommend enforcement action and, to the extent enforcement action is recommended, in determining relief."

Some issuers and underwriters have complained that if they issued bonds five years back, they have to check their disclosures five years back from that — a total of 10 years ago — and bond documents cannot be easily found that far back. Under the SEC's Rule 15c2-12, for an issuer's bonds to be underwritten, it must disclose in bond offering documents any time during the past five years that it failed to file annual financial and operating information on a timely basis.

Bond Dealers of America said it is pleased that the SEC's enforcement division has listened to its concerns, including about the need for a tired penalty approach. However it said it would have liked the SEC to extend the deadline for underwriters as well as issuers.

"It is very encouraging that the SEC did recognize industry concerns and we hope to continue to keep the working dialogue open between regulators and the industry.

The Securities Industry and Financial Markets Association said it was pleased the SEC extended the deadline for issuers and reduced the ` fines for smaller underwriters, but "disappointed" it did not extend the deadline for underwriters.

"Firms are facing a mammoth task of reviewing nearly 73,000 municipal securities transactions and some need extra time to fully research issuer compliance and discuss potential reports with their issuer and obligor clients."

SIFMA urged the SEC to extend the deadline for underwriters as well.

But Gaunt said it is unlikely the SEC will make further changes to the MCDC initiative.

THE BOND BUYER
BY LYNN HUME
JUL 31, 2014 6:35pm ET

Ballard Spahr: MSRB Seeks Second Round of Comments on Municipal Advisor Conduct Rule.

The Municipal Securities Rulemaking Board (MSRB) recently released a revised draft of Rule G-42 (Draft Rule G-42) following receipt of more than 40 comments on its Initial Draft Rule in January 2014. Rule G-42 regulates standards of conduct and duties of municipal advisors in non-solicitor roles. The deadline for comments on the revised draft is August 25, 2014.

In response to commenters, the MSRB has scaled back or eliminated certain prohibitions and requirements, which should allay concerns expressed about potential heavy-handedness on the part of the MSRB. The proposed rule provides more clarity and guidance regarding conduct of municipal advisors, and allows many to operate in a manner similar to current practice.

The following portions of Rule G-42 and its Supplementary Material were revised or added:

- Duty of Care and Duty of Loyalty

- Disclosure of Conflicts of Interest and Other Information
- Documentation of the Municipal Advisory Relationship
- Recommendations and the Review of Recommendations of Others
- Principal Transactions
- Specified Prohibitions
- Inadvertent Advice

A more detailed explanation of the revisions follows.

Duty of Care and Duty of Loyalty

To allow clients to determine the scope of services and control the engagement with municipal advisors, the MSRB removed the duty of care requirement to undertake a thorough review of the official statement. Additionally, the duty of loyalty requirement to investigate or consider other reasonably feasible alternatives to any recommended municipal securities transaction or financial product has been likewise removed.

Disclosure of Conflicts of Interest and Other Information

Draft Rule G-42 regarding disclosure of conflicts has been revised to require disclosure of material conflicts of interest if such conflicts arise due to compensation being contingent on the size or closing of a transaction. Previously, the Initial Draft Rule required a broader compensation disclosure requirement that many commenters believed would confuse clients. An affirmative disclosure that there are “no known” conflicts is now required.

The requirement to disclose the amount and scope of professional liability insurance has been removed, but such disclosure may still be provided voluntarily or upon request. The municipal advisor must also now disclose any material legal or disciplinary event, including a description of the event, where the client may access the advisor’s most recent Securities and Exchange Commission (SEC) forms on the event, and the date the last form was filed.

Documentation of the Municipal Advisory Relationship

A provision was added to detail the steps that may be taken if a party inadvertently engages in municipal advisory activities or enters into a municipal advisory relationship and does not intend to continue, but seeks a safe harbor to withdraw. See “Inadvertent Advice” below.

Revisions were made to simplify the documentation of compensation required under the Initial Draft Rule. Draft Rule G-42 requires that only the form and basis of any direct and indirect compensation be documented, but the parties may still agree to provide further information. The documentation of the advisory relationship must include any term relating to withdrawal from the relationship and can be amended only if there are material changes or additions.

Recommendations and the Review of Recommendations of Others

Draft Rule G-42 clarifies the provisions on recommendations by the municipal advisor and the municipal advisor’s review of recommendations from other parties. This draft states that if a municipal advisor makes a recommendation of a municipal securities transaction or financial product, or if review of a recommendation of another party is requested by the municipal entity or obligated person client, then the municipal advisor, using reasonable due diligence, must determine whether such action is suitable for the client.

Principal Transactions

The Initial Draft Rule prohibited municipal advisors from engaging in any transaction in a principal role in which the municipal entity or obligated person client is a counterparty. Draft Rule G-42 eliminates the prohibition concerning obligated persons and limits the prohibited principal transactions between a municipal advisor or its affiliates and a municipal entity client to those transactions directly related to the same municipal transaction or financial product on which the municipal advisor is providing advice.

Inadvertent Advice

The MSRB added a provision to Draft Rule G-42 covering municipal advisors who unintentionally engage in municipal advisory activities. Such advisors are not subject to Draft Rule G-42's disclosure and documentation requirements if they promptly provide a disclaimer and other information to a municipal entity or obligated person following the provision of inadvertent advice. Draft Rule G-42 further requires a review of the municipal advisor's supervisory and compliance policies and procedures to ensure they are reasonably designed to prevent such inadvertent advice.

Specified Prohibitions

In response to numerous comments criticizing the excessive fee provisions in the Initial Draft Rule, the Draft Rule G-42 added a list of factors relevant to excessive compensation. Factors include municipal advisor expertise, transaction complexity, types of contingent fees, and time spent on the closing of the transaction or product.

Lastly, various Initial Draft Rule definitions were modified to match those found in the SEC Municipal Advisor Final Rule, and the definition of when the municipal advisory relationship begins and ends was also clarified to require written documentation.

by Teri M. Guarnaccia, Bradley D. Patterson, Tesia N. Stanley, and Christopher A. Lemming

Ballard Spahr's Municipal Securities Regulation and Enforcement Group advises its clients on the latest securities issues in their public finance transactions, including regulatory and enforcement matters of the SEC. We advise issuers in a broad range of public offerings and private placements of municipal securities in the primary and trading activity in the secondary market.

If you have questions about this or for more information, please contact Teri M. Guarnaccia at 410.528.5526 or guarnacciat@ballardspahr.com, Bradley D. Patterson at 801.531.3033 or patterson@ballardspahr.com, Tesia N. Stanley at 801.517.6825 or stanleyt@ballardspahr.com, or Christopher A. Lemming at 202.661.7608 or lemmingc@ballardspahr.com.

Ballard Spahr: Industry Concerns Prompt SEC to Modify MCDC Initiative.

In response to concerns raised by industry participants, the Securities and Exchange Commission (SEC) has made some modifications to its Municipalities Continuing Disclosure Cooperation Initiative (MCDC Initiative). The SEC hopes the MCDC Initiative, announced on March 10, 2014, will encourage self-reporting by municipal securities issuers and underwriters of possible securities law violations arising from misstatements in offering documents about an issuer's prior compliance with its continuing disclosure obligations. A summary of the MCDC Initiative can be found here.

The SEC initially imposed a deadline of September 10, 2014, for all self-reporting under the MCDC Initiative. In view of the substantial burden of analyzing prior disclosures, numerous industry groups—including the Government Finance Officers Association, the Securities Industry and Financial Markets Association, Bond Dealers of America, and the National Association of Bond Lawyers—defense counsel, and U.S. Representative Steve Stivers, among others, raised concerns with the SEC, urging the agency to extend the deadline, limit the broad scope of the MCDC Initiative, and consider its unequal impact on smaller issuers, obligated persons, and underwriters.

Yesterday, the SEC responded in part by undertaking three key modifications. First, although the SEC publicly expressed reluctance to extend the MCDC Initiative deadline, issuers and obligated persons will now have until December 1, 2014 to self-report. The SEC declined to provide this extension to the prior deadline imposed upon underwriters to self-report.

Second, in an effort to encourage smaller underwriters to avail themselves of the MCDC Initiative, the SEC announced a tiered approach to civil penalties imposed on underwriters:

- For underwriters with 2013 reported total annual revenue of more than $100 million, a maximum fine of $500,000
- For underwriters with 2013 reported total annual revenue between $20 million and $100 million, a maximum fine of $250,000
- For underwriters with 2013 reported total annual revenue of less than $20 million, a maximum fine of $100,000

Finally, the SEC recognized the limitations in auditing continuing disclosure compliance prior to the Electronic Municipal Market Access (EMMA) system becoming the single, official repository for continuing disclosure information on July 1, 2009. The former Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) system was a decentralized and unreliable source of continuing disclosure information. If the SEC identifies securities law violations after the MCDC Initiative self-reporting deadline, it stated that it will consider good faith efforts to discover violations that occurred pre-EMMA in determining whether to recommend an enforcement action or the type of relief sought if an enforcement action is undertaken.

The SEC's decision not to extend the deadline for underwriters will significantly impair the ability of underwriters and issuers or obligated persons to coordinate self-reporting, as underwriters will have to make their final materiality determinations far in advance of issuers and obligated persons. It is also unclear whether issuers and obligated persons will benefit from any cease and desist orders announced by the SEC against underwriters prior to their new self-reporting deadline. Such orders could provide guidance on the types of misstatements and omissions the SEC considers material under federal securities law. However, the SEC's first MCDC Initiative cease and desist order included only a cursory materiality analysis and was vague on the facts underlying the order. A summary can be found here.

To assist market participants in understanding how materiality is proven under federal securities law through market analysis, Ballard Spahr will host a brief webinar on August 7, 2014, at 12:00 p.m. ET, featuring economist Vinita Juneja, Ph.D. Register for the webinar here.

by John C. Grugan, Bradley D. Patterson, William C. Rhodes, Teri M. Guarnaccia, and Tesia N. Stanley

Ballard Spahr's Municipal Securities Regulation and Enforcement Group helps municipal market participants navigate a rapidly evolving regulatory, investigative, and enforcement environment, enabling them to anticipate and address compliance issues and respond effectively to investigations when necessary.

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SEC Enforcement Division Modifies Municipalities Disclosure Initiative.

The Securities and Exchange Commission today announced modifications to its Enforcement Division's Municipalities Continuing Disclosure Cooperation (MCDC) Initiative that will provide greater opportunity for smaller municipal securities underwriter firms and municipal issuers to take advantage of the initiative.

To allow issuers and obligors more time to complete their reporting requirements, the division has extended the deadline to self-report potential violations from September 10, 2014 to December 1, 2014. The deadline for underwriters remains unchanged at September 10, 2014. With respect to underwriters, the division has determined that to implement a tiered approach to civil penalties based on the size of the firm would encourage smaller underwriters to participate in the initiative.

"It is clear that many underwriters and issuers are working diligently to take advantage of the initiative within its time period," said Andrew Ceresney, director of the Enforcement Division. "These adjustments to the program are designed to encourage as much participation as possible, which we expect will ultimately benefit investors by encouraging improved compliance with continuing disclosures by the broadest group of industry participants."

Under the initiative, announced on March 10, 2014, the division agreed to recommend standardized settlement terms for municipal issuers and underwriters who self-report that they have made inaccurate statements in bond offerings about their prior compliance with continuing disclosure obligations under the Securities Exchange Act of 1934. In particular, the division will recommend that the Commission accept settlement terms for eligible underwriters that, among other things, include payment of civil penalties up to specified amounts.

The division's tiered approach to the cap on civil penalties for eligible underwriters is as follows:

- For underwriters with 2013 reported total annual revenue of more than $100 million: $500,000
- For underwriters with 2013 reported total annual revenue between $20 million and $100 million: $250,000
- For underwriters with 2013 reported total annual revenue of less than $20 million: $100,000

Since announcing the initiative, the division has learned that some municipal underwriters and issuers have experienced difficulties in identifying potential violations for periods when filings were made in the Nationally Recognized Municipal Securities Information Repository (NRMSIR) system, which pre-dated the Electronic Municipal Market Access (EMMA) system. The division recognizes that parties may use reasonably available sources of information to make good faith efforts to identify potential violations but may not be able to identify certain violations during the period of the initiative due to the limitations of the pre-EMMA NRMSIR system. If violations are identified by the division after the expiration of the initiative, the division will consider reasonable, good faith, and documented efforts in deciding whether to recommend enforcement action and, to the extent enforcement action is recommended, in determining relief.

Questions regarding the initiative may be directed to MCDCinquiries@sec.gov.

SEC Staff Issues Guidance On Verifying Accredited Investor Status.

Last year, the Securities Exchange Commission (SEC) adopted Rule 506(c) of the Securities Act of 1933 (Securities Act), which, in a major departure from prior securities practice, allowed the use of general solicitation and general advertising (referred to throughout this alert as general solicitation) in connection with unregistered offers and sales of securities; though it must be noted the SEC was compelled to take this step by legislative mandate. The new rule imposed three conditions to the application of the exemption: (1) the purchasers had to be accredited investors; (2) the issuer had to take "reasonable steps" to verify the accredited investor status of the purchasers; and (3) the terms of Securities Act Rules 501, 502(a) and 502(d) had to be observed. We discussed Rule 506(c) in a previous client alert.1

In a recent speech to the 2014 Angel Capital Association Summit, the Director of the SEC's Division of Corporation Finance, Keith Higgins, remarked that "one wonders why the new Rule 506(c) exemption has not caught on more widely with issuers who have long clamored for the general solicitation ban to be lifted."2 Although from September 2013, when Rule 506(c) became available, to March 2014, the SEC saw "almost 900 new offerings conducted in reliance on the exemption, raising more than $10 billion in new capital," issuers still preferred to use "the old 'private' Rule 506 exemption (now called Rule 506(b))," which, "during the same time period, was relied upon in over 9,200 new offerings that resulted in the sale of over $233 billion in securities."3 He observed that some believe that issuers have shied away from the new Rule 506(c) exemption because of the requirement to take "reasonable steps to verify" accredited investor status. Expressing surprise that flexibility in verification approaches countenanced by the rule – which allowed a principles-based approach and provided specified methods for verification as safe harbor alternatives – did not find favor with issuers, he noted that the staff of the SEC's Division of Corporation Finance (Staff) would not be receptive to entreaties to "provide guidance – presumably on a case-by-case basis – confirming that a specified principles-based verification method constitutes 'reasonable steps' for purposes of the rule's requirement" because the "notion of the [S]taff reviewing and approving specific verification methods seems somewhat contrary to the very purpose of a principles-based rule" and because he remained unconvinced of the need for such Staff involvement.4

However, such entreaties have had some effect, for the Staff recently issued guidance related to (1) the "reasonable steps" safe harbors for verifying accredited investor status under Rule 506(c)5 and (2) the accredited investor definition in Regulation D.6 This guidance is further evidence that the Staff should be expected to issue ongoing interpretive guidance on Rule 506(c) as issuers continue to grapple with the rule's requirements.7

The guidance illustrates that the Staff narrowly construes the Rule 506(c) accredited investor verification safe harbors. However, even where a safe harbor is not available, the guidance makes clear that issuers can satisfy the verification requirement under the principles-based verification method. However, under that approach issuers must consider all relevant facts and circumstances and additional verification steps may be necessary where reasonable doubt remains about a purchaser's accredited investor status.

This client alert briefly summarizes the Staff's guidance, which will be of interest to public and private companies and investment funds that seek to rely on Rule 506 for securities offerings, especially those issuers seeking to use general solicitation under Rule 506(c).

Rule 506(c) Accredited Investor Verification Safe Harbors

Background. Rule 506(c)(2)(ii) sets forth non-exclusive and non-mandatory accredited investor verification methods that, if satisfied, serve as safe harbors for issuers who will be deemed to have satisfied the "reasonable steps" verification requirement. The safe harbor verification methods include, among others:

- when verifying a purchaser under the accredited investor annual income test, reviewing any Internal Revenue Service (IRS) form reporting a purchaser's income for the two most recent fiscal years and obtaining a written purchaser representation that he or she has a reasonable expectation of reaching the required income level during the current year (Rule 506(c)(2)(ii)(A)); and
- when verifying a purchaser under the accredited investor net worth test, reviewing specified documentation evidencing the purchaser's assets and liabilities8 dated within the prior three months and obtaining a written purchaser representation that all liabilities necessary to make a determination of net worth have been disclosed (Rule 506(c)(2)(ii)(B)).

As what constitutes "reasonable steps" is a principles-based determination, an issuer that does not satisfy any of the verification safe harbors can still satisfy the reasonable steps requirement using other verification methods.9

The Rule 506(c)(2)(ii)(A) safe harbor is not available where IRS forms for the most recently completed year are not yet available (for example, the purchaser's 2014 IRS forms in an early 2015 offering). However, the Staff believes that an issuer could, under the principles-based verification method, satisfy the verification requirement by:

- reviewing IRS forms that report income for the two years preceding the most recently completed year (in our example, 2013 and 2012); and
- obtaining written purchaser representations that (i) an IRS form reporting the purchaser's income for the most recently completed year is unavailable, (ii) specify the purchaser's income for the most recently completed year and that such amount satisfies the required accredited investor income level, and (iii) he or she has a reasonable expectation of satisfying the requisite income level for the current year.

The Rule 506(c)(2)(ii)(A) safe harbor is not available for a non-U.S. taxpayer. However, the Staff believes that an issuer could, under the principles-based verification method, satisfy the verification requirement by reviewing a purchaser's filed foreign tax forms that report income where the foreign jurisdiction imposes penalties for falsely reported information comparable to the penalties imposed by the IRS.

The Rule 506(c)(2)(ii)(B) safe harbor is not available where an issuer reviews the most recent tax assessment that is available but that is not dated within the prior three months. However, the Staff believes that an issuer could, under the principles-based verification method, satisfy the verification requirement if it uses the most recently available tax assessment when determining whether the purchaser satisfies the net worth test. For example, if the most recent tax assessment shows a value that, after deducting liabilities, the purchaser's net worth substantially exceeds $1 million, it may be sufficient verification that the purchaser has satisfied the net worth test.

The Rule 506(c)(2)(ii)(B) safe harbor is not available where an issuer reviews a consumer report from a non-U.S. consumer reporting agency. However, the Staff believes that an issuer could, under the principles-based verification method, satisfy the verification requirement by reviewing a consumer report from a non-U.S. consumer reporting agency that performs similar functions as a U.S. nationwide consumer reporting agency and taking any other steps necessary to determine the purchaser's liabilities (such as a written purchaser representation that all liabilities have been disclosed).

Where reason for doubt exists, an issuer must take additional verification steps under the principles-based verification method. The Staff provides a cautionary reminder that, unlike under the verification safe harbors, where an issuer relies on the principles-based verification method and has reasonable doubt about a prospective purchaser's accredited investor status after completing the diligence associated with its verification method, "it must take additional verification measures in order to establish that it has taken reasonable steps to verify that the purchaser is an accredited investor." For example, if, in the Staff's example above of an acceptable principles-based verification method based on a review of IRS forms and the purchaser's representations, a purchaser's income for the most recently completed year barely exceeds the threshold income requirement, the specified procedures may not satisfy the verification requirement and more diligence may be necessary.

Accredited Investor Definition

To qualify as an accredited investor, a purchaser must be one of the specified persons or entities set forth in Securities Act Rule 501(a). Purchasers that are natural persons typically qualify under the net worth test10 or the annual income test.11

Under the net worth test, an issuer may include a purchaser's assets in an account or property held jointly with a person who is not the purchaser's spouse. However, such assets may only be included in the net worth calculation to the extent of the purchaser's percentage ownership of the account or property.

Where a purchaser's income is not reported in U.S. dollars, issuers have a choice in the exchange rate they may use to determine if the annual income test is satisfied. Issuers may use either (1) the exchange rate in effect on the last day of the year for which income is being determined or (2) the average exchange rate for that year.

We note that Director Higgins has indicated that this "may be an opportune time for a thorough reexamination of [the accredited investor] definition. After all, it was the condition that only accredited investors would be permitted to purchase the securities offered through a general solicitation that gave many members of Congress the comfort needed to support the elimination of the decades-old ban. …Under the 2010 Dodd-Frank Act, the [SEC] is required to undertake a review of this part of the accredited investor definition four years after the enactment of the Act. The [S]taff is currently conducting this review, which will help inform the [SEC]'s consideration of whether or not to change the definition."12 Issuers and their advisors can thus expect more guidance, if not more rulemaking, as to the accredited investor definition. Stay tuned.

Footnotes

1. Please see our client alert dated July 22, 2013, General Solicitation Permitted in Certain Rule 506 and Rule 144A Offerings; "Bad Actors" Disqualified from Rule 506 Offerings; Other Significant Amendments Proposed to Regulation D.

2. Keith F. Higgins, Director, SEC Div. of Corp. Fin., Keynote Address at the 2014 Angel Capital Association Summit (Mar. 28, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370541320533.

3. Id.

4. See id.

5. See SEC Div. of Corp. Fin., Securities Act Rules Compliance and Disclosure Interpretations (C&DIs), Questions 260.35 – 260.38 (Jul. 3, 2014), available at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#260.35.

6. See SEC Div. of Corp. Fin., Securities Act Rules C&DIs, Questions 255.48 & 255.49 (Jul. 3, 2014), available at http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#255.48.

7. Please see our client alert dated December 20, 2013, SEC Issues Guidance on General Solicitation and Rule 506 Bad Actor Rules.

8. For assets, an issuer must review one or more of the purchaser's bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments or appraisal reports issued by independent third parties. For liabilities, an issuer must review a consumer report from at least one of the nationwide consumer reporting agencies.

9. In this regard, we note that in his address to the 2014 Angel Capital Association Summit, Director Higgins stated that the principles-based approach allowed "issuers and other market participants [to] have the flexibility to think about innovative approaches for complying with the verification requirement of the rule and use the methods that best suit their needs. While the [S]taff may not be in a position at this point to provide guidance on what constitutes 'reasonable steps' under particular circumstances, I also believe the [S]taff will not be quick to second guess decisions that

issuers and their advisers make in good faith that appear to be reasonable under the circumstances." Higgins, supra note 2.

10. Under the net worth test, a purchaser must have an individual net worth, or joint net worth with his or her spouse, of over $1 million, excluding the value of the purchaser's primary residence.

11. Under the annual income test, a purchaser must have (1) in each of the two most recent years, individual income of over $200,000 or joint income with his or her spouse of over $300,000 and (2) a reasonable expectation of reaching the same income level in the current year.

12. Higgins, supra note 2.

Last Updated: July 28 2014
Article by Jeff C. Dodd, Alan Bickerstaff, William Cooper and Edward A. Gilman
Andrews Kurth LLP

MSRB Creates Online Education Center to House Digital Resources About the Municipal Market.

Alexandria, VA – To facilitate access by municipal securities investors, state and local governments and others interested in the municipal market to free, objective educational resources, the Municipal Securities Rulemaking Board (MSRB) today unveiled an online education center on its website at msrb.org. The new MSRB Education Center consolidates videos, fact sheets and a significant library of educational resources previously available elsewhere on the MSRB website and on the Electronic Municipal Market Access (EMMA®) website.

"Education and outreach are fundamental elements of our mission to protect investors and state and local governments," said MSRB Executive Director Lynnette Kelly. "Centralizing all of the MSRB's valuable educational content in a single location will support our efforts to ensure investors and issuers have access to free and objective information they need to make informed decisions in the municipal market."

The MSRB Education Center organizes resources by topic and target audience. It features content about the following topics, among others:

- Features and risks of municipal securities
- Lifecycle of a municipal bond
- 529 college savings plans
- Preparing to invest in bonds
- Buying and selling municipal bonds
- Monitoring municipal securities
- The process of issuing municipal securities
- Issuer disclosure to investors

Quick links to the MSRB Glossary of Municipal Securities Terms and past educational webinars are included in the MSRB Education Center. The MSRB also has added a video library and a fact sheet library to allow users to find all available educational material in a particular format.

In a related enhancement, resources to assist users with navigating the EMMA website and utilizing EMMA tools are now consolidated in a section called EMMA Help at emma.msrb.org. Both EMMA Help and the EMMA homepage offer direct links to the MSRB Education Center for users seeking municipal market education.

Hidden Bond Fees Have Regulators Eyeballing Dealers: Muni Week.

On the afternoon of July 14, a broker bought Illinois bonds for 96.3 cents on the dollar. A little over an hour later, the same bonds were sold to an investor for $1.01, a jump of almost 5 percent.

Did the buyer know how much the trader made? Probably not. Unlike stock brokers, who must report commissions, bond dealers aren't required to disclose their markups. According to one estimate, investors may be overcharged to the tune of $1 billion a year.

That may change.

Securities and Exchange Commission Chairwoman Mary Jo White said last month her agency is working with regulators to require bond dealers to disclose markups when they buy securities to fill a customer's order.

When the Municipal Securities Rulemaking Board meets from July 30 through Aug. 1, it will take a first step toward doing that. The regulator said it will discuss soliciting comments from banks and others on the subject. It's a start, at least.

Would putting investors in the know save them money? It has in the past. Not until 2005 could investors even see where bond prices were trading on any given day. Once they could, they wound up paying less, according to a study released by the board.

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Municipal bond prices rose last week, pushing 10-year (BVMB10Y) yields down 0.09 percentage point to 2.22 percent, according to data compiled by Bloomberg.

Prices have been held aloft by a dearth of supply that's showing few signs of abating. This week, state and local governments are set to borrow $2.3 billion, down from $7.3 billion last week. The volume of deals set for the month is the smallest since February.

Among those borrowing this week: San Antonio, Texas, a city with the top credit rating from Standard & Poor's and Moody's Investors Service, which is raising $231 million. The New Jersey Turnpike Authority is set to offer $206 million of debt.

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The Federal Open Market Committee, which decides the direction of interest-rates, releases the results of its two-day policy meeting July 30.

It's not much of a cliffhanger. With the job market still on the mend, Federal Reserve Chair Janet Yellen told Congress this month that the central bank will keep interest-rates low for a "considerable period." Watch the statement for more clues.

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When unions set a Sunday, July 20, strike date for the Long Island Rail Road, the well-heeled lined up $3,500 helicopter rides home from the Hamptons while New York Mayor Bill de Blasio faced down a kerfuffle over his vacation in Italy.

To everyone but the chopper company's benefit, a strike was averted. Today, the Metropolitan Transportation Authority, which runs the railroad, is meeting to discuss the financial impact of the settlement with its more than 5,000 workers.

Payroll is also on the agenda in Los Angeles today. A city's employee relations board is considering a union effort to scuttle a 2012 law that raised the retirement age and capped post-employment benefits for some city workers. At stake: more than $4 billion the city hoped to save over the next 30 years.

By William Selway Jul 27, 2014 9:00 PM PT

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NABL, Other Groups, Send MCDC Recommendations to SEC .

The National Association of Bond Lawyers (NABL), the Government Finance Officers Association (GFOA), the Securities Industry and Financial Markets Association (SIFMA) and the Bond Dealers of America (BDA) sent a letter on July 23 to the five SEC Commissioners voicing concerns about the SEC's Municipal Continuing Disclosure Cooperative (MCDC) Initiative. The letter requests modifications to the scope and deadline of the initiative "in order to maximize the MCDC's potential to improve disclosure compliance, to increase participation in the initiative, and to provide the most accurate set of responses to the SEC."

The letter requests that the initiative adjust the time frame for the 5-10 year look-back period to cover only those annual filings made after 2009, when EMMA came online. The letter argues that, due to the flawed and unreliable Nationally Recognized Municipal Securities Information Repositories (NRMSIR), "[l]imiting MCDC to annual filings after 2009… will give issuers and underwriters a reliable database to identify instances of potentially material inaccurate statements." "The best way to assess how the industry is meeting its disclosure obligations to investors currently," the letter goes on to say, would be "to evaluate compliance since March 2012" because "the SEC did not notify dealers that maintaining records of due diligence activities is a best practice until March 2012."

In addition to adjusting the scope of the initiative, the groups requested that the SEC extend the deadline from September 9, 2014, to March 10, 2015, arguing that "[t]he current deadline does not provide sufficient time for issuers and underwriters to communicate, coordinate, and compare findings from their separate compliance investigations." The groups believe that "many of the 50,000 issuers around the country are not aware of the MCDC… and the current period of conduct reviews comes at a time when many state and local budget staff is involved with preparing budgets and closing out fiscal years."

The letter to the SEC can be seen here.

MSRB Seeks Approval of First MA Rule.

WASHINGTON — The Municipal Securities Rulemaking Board sought approval Thursday for the first municipal advisor rule the muni industry's self regulator has asked the Securities and Exchange Commission to approve since SEC adopted its final MA rule in September.

Proposed Rule G-44, first floated in February, would require MAs to establish, implement, maintain and enforce written supervisory procedures designed to ensure compliance with the federal securities laws and rules. The proposal also includes proposed revisions to Rules G-8 on books and records and G-9 on preservation of records, which would require MAs to keep and maintain records of their compliance policies for at least five years and records of those responsible for compliance for at least six years after they are no longer in charge of compliance. It would mark the first time non-dealer MAs have been subject to supervisory requirements under MSRB rules.

"With today's rule filing, the MSRB is demonstrating its continued commitment to establish a comprehensive regulatory framework for those professionals who provide certain types of financial advice to state and local governments," said MSRB executive director Lynnette Kelly. "We aim to ensure that municipal entities are protected by robust regulations that appropriately address practices and behaviors that are not consistent with a municipal advisor's duties to its clients."

The rule generated a wide range of responses from market participants, with non-dealer MAs seeking more flexibility for small firms and sole proprietorships and dealer-MAs seeking to implement a baseline standard for all advisors. The MSRB has said it believes the rule strikes an appropriate balance, and the proposed rule does allow firms to tailor their written policies and procedures to be appropriate to their sizes.

The MSRB is in the process of developing and proposing various rules stemming from the SEC's MA rule, which imposes a fiduciary standard on those providing muni-related advice to state or local governments. The MSRB proposed a revised MA conduct rule Wednesday. The SEC must approve any proposal before it becomes final.

THE BOND BUYER
BY KYLE GLAZIER
JUL 24, 2014 5:14pm ET

Muni Groups Make Fresh Push to Limit MCDC.

WASHINGTON — Municipal bond issuers, dealers, and lawyers are making another push to alter the Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation initiative, asking the SEC to narrow the program's scope and delay its deadline by several months.

The Government Finance Officers Association, National Association of Bond Lawyers, Securities Industry and Financial Markets Association, and Bond Dealers of America made their latest effort in a joint letter to all the members of the commission. It asks the SEC to restrict the scope of the controversial self-reporting program to bonds sold since March 2012, and to extend the program's deadline from the end of September 9 to March 10. These represent more ambitious requests; BDA asked last month for an extension only until Dec. 15.

The MCDC allows issuers and underwriters to get favorable settlement terms if they voluntarily report any time in the last five years that they offered bonds without disclosing failures to meet their continuing disclosure agreements they set up under the SEC's Rule 15c2-12. The new joint letter echoes a House floor speech earlier this month in which Rep. Steve Stivers, R-Ohio, hinted at legislative action if the SEC failed to tailor the MCDC more narrowly. All the groups who signed the letter have been pleading their cases to the SEC for months, but the commission has yet to budge.

The MCDC currently requires would-be participants to look back as far as 10 years, because determining if a bond sale five years ago had a misleading official statement could require looking at continuing disclosure for the five years prior to that. EMMA has been the sole central disclosure platform only since 2009, and both issuers and underwriters have said searching the old Nationally Recognized Municipal Securities Information Repositories, or NRMSIRs, is problematic due to the volume of inaccurate information stored there and a number of filings being lost.

"Limiting MCDC to annual filings after 2009, when EMMA came online, will give issuers and underwriters a reliable database to identify instances of potentially material inaccurate statements," the latest letter states. "Further, the SEC did not notify dealers that maintaining records of due diligence activities is a best practice until March 2012. After that date the due diligence practices of the industry changed substantially. The best way to assess how the industry is meeting its disclosure obligations to investors currently is to evaluate compliance since March 2012."

The deadline extension is necessary because the allotted time is not enough to perform time-consuming high-quality reviews, the groups told the SEC.

"Conducting reviews, even reviewing information prepared by underwriters, is resource intensive and the expense was not included in state and local budgets," the letter states. "In addition, some underwriters have turned to outside vendors to conduct reviews, but there are only three such vendors and we understand they are no longer accepting clients because they have reached their capacity."

The letter adds that some issuers would require board approval before participating, another process that could take time.

"Extending the deadline will produce better data on true instances of material noncompliance and provide issuers and underwriters with a meaningful opportunity to evaluate the merits of participating," the letter argues.

There has been only one MCDC settlement so far. The SEC earlier this month charged Kings Canyon Joint Unified School District in California with misleading bond investors in a 2010 deal.

THE BOND BUYER
BY KYLE GLAZIER
JUL 24, 2014 2:26pm ET

MSRB Proposes Revised MA Conduct Rule.

WASHINGTON — The Municipal Securities Rulemaking Board proposed a revised draft rule to establish the core duties of municipal advisors, tweaking some of the provisions that generated the most controversy in January's first draft.

The first draft's prohibition on principal transactions has been revised to apply only to transactions with municipal entity clients, not with obligated persons. Most market participants interpreted the first draft as barring MAs from engaging in any non-fiduciary business relationship running concurrent to the municipal advisory agreement. The revised draft released Wednesday defines the banned principal transactions as limited to those directly related to the subject of the municipal advisor's engagement with the municipal entity client.

It spells out that principal transactions are defined as "acting as a principal for one's own account, selling to or purchasing from the municipal entity client any security or entering into any derivative, guaranteed investment contract, or other similar financial product with the municipal entity client."

And it eliminates requirements that MAs review the official statement for a new bond issuance, disclose information about professional liability insurance, and estimate what they expect their total compensation to be. The new draft rule states that MAs don't have to disclose conflicts of interest or document the advisory relationship if they inadvertently provide advice that would be considered municipal advisory activity. It doesn't offer a "safe harbor" from potential violations of the requirement to register with the Securities and Exchange Commission and the MSRB.

The MSRB is seeking public comment on the revised G-42, and has set an Aug. 25 deadline for market participants to weigh in.

"As the foundation of the MSRB's regulatory framework for municipal advisors, MSRB Rule G-42 will play a central role in achieving the MSRB's mandate to protect municipal entities that engage the services of a municipal advisor," said MSRB executive director Lynnette Kelly. "It is important to us and to the market that we develop a rule that effectively and appropriately provides guidance on the core responsibilities of municipal advisors to their clients. The comments we received on the previous draft have informed a number of changes to the text of the draft, and the MSRB wants to provide an opportunity for market stakeholders to review and comment on these changes."

It wasn't initially clear whether the MSRB would repropose the rule or choose to submit a revised draft for SEC approval, but Kelly confirmed earlier this month that a re-proposal was coming. Chuck Samuels, an attorney at Mintz Levin and counsel to the National Association of Health & Higher Education Facilities Authorities, said the MSRB made the right choice, even though it would have been preferable to get G-42 done before the SEC's registration rule took effect July 1.

"Republishing the draft was inevitable and appropriate given the volume and quality of comments it received and the complexity of the issues," Samuels said. "It's unfortunate the process was not completed before the effective date of obligations, but better to get it right."

Jessica Giroux, senior counsel and senior vice president for federal regulatory policy at the Bond Dealers of America, said the MSRB addressed some of their first draft concerns.

"The BDA appreciates that the MSRB has revised Draft Rule G-42 and that they have incorporated some of the suggested changes made by the BDA and other market participants," Giroux said. "We are also encouraged that the MSRB is releasing the revised draft rule for a second round of comments, allowing the industry yet another opportunity to work pro-actively with the MSRB to ensure the rule is in its strongest form before it becomes final."

While the MSRB addressed the BDA's concerns about an overbroad principal transaction ban and the requirement the inadvertent advice documentation, for example, it didn't address points BDA raised about other issues. BDA favored a requirement to disclose liability coverage and wanted the proposed fiduciary standard to "more appropriately mirror existing fiduciary standards utilized in the legal profession."

Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association, said SIFMA is initially pleased with several aspects of the revision.

"Upon first review, we are encouraged that the MSRB has clarified and narrowed the scope of the principal transaction prohibition," Norwood said. "Further, we support the MSRB's decision to limit the application of the fiduciary duty to municipal entities, and to exempt obligated parties, such as corporations, from this increased standard of protection. SIFMA will be reviewing the final rule in more detail with our members, and we look forward to commenting on the proposal."

Nathan Howard, counsel to the National Association of Independent Public Finance Advisors, said the MSRB appeared to have taken public comments to heart, though the section on inadvertent advice needed closer scrutiny in the coming days.

The MSRB is in the midst of developing other MA regulations, including a competency exam. All of the board's rule proposals are subject to SEC oversight.

THE BOND BUYER
BY KYLE GLAZIER
JUL 23, 2014 3:30pm ET

SEC Finalizes Money Market Fund Rules.

The SEC, by a vote of 3-2, finalized its rules governing money market funds. The rules impose a floating NAV for institutional prime money market funds and allow boards to impose fees and gates if a fund's weekly liquidity level falls below a designated threshold. Government and retail funds are specifically exempted from the floating NAV requirement and will continue trading at a fixed asset value.

Municipal money market funds were not specifically exempted; however, the SEC staff noted that they believe many of these funds will meet the retail definition and therefore not be required to maintain a floating NAV.

BDA In the News: BDA, Broker Dealers Have Constructively Engaged on MA Rule.

The BDA's Mike Nicholas was featured in a Bond Buyer commentary on the constructive manner that broker-dealers have worked with other industry participants to understand and ensure a smooth industry transition to meet the requirements of the the SEC's Municipal Advisor Rule, which went into effect on July 1, 2014.

This commentary was produced with significant membership input and in response to an article published in the Bond Buyer on June 27 entitled, "The Truth About MA Rule Distorted, Said Lawyer Who Worked on it,", which you can find linked here.

You can view the full commentary below.

Since the release of the Securities and Exchange Commission's final municipal advisor registration rule in September 2013, the Bond Dealers of America and its members have dedicated significant efforts and resources to work with regulators, educate issuers and ultimately be prepared to make a successful implementation of the rule.

Given the scope of these efforts, it was frustrating to read the June 30 article in the Bond Buyer, in which a former SEC staffer questioned the role that dealers have played in working to interpret and implement the MA rule.

While much of the BDA's efforts have been directed at clarifying and implementing the rule, the BDA strongly disagrees with comments made in this Bond Buyer article and with the SEC's Office of Municipal Securities with regard to the interpretation of the Dodd-Frank Act.

The intent of Congress in adopting the MA provisions of the Dodd-Frank Act was to regulate unregulated financial advisors, which is why the Dodd-Frank Act clearly and categorically excluded dealers serving as underwriters.

In lieu of remaining consistent with the statutory approach, the SEC adopted an "activities based" rule that requires underwriters to scrutinize each kind of communication they have with issuers and borrowers to determine whether they will become municipal advisors – even in situations in which their clients know full well that they are not their advisors. Setting aside what was a clear categorical exclusion in the Dodd-Frank Act has resulted in a very complex rule and has caused unnecessary and costly confusion, delays in implementation, and financial and operating burdens on the entire municipal bond industry.

Despite this fundamental policy concern, since the adoption of the rule, the BDA and its members have worked, and will continue to work, to understand and implement the rule.

The MA rule represents a fundamental shift in how the municipal markets are regulated. In fact, it took the SEC 778 pages and a couple rounds of Frequently-Asked Questions to articulate and explain the rule.

It is in that vein that we believe that the efforts of the BDA, its members and the entire dealer community have enormously contributed to a smoother and clearer implementation of the MA rule. It is completely inaccurate to portray the dealer community as intentionally seeking to obfuscate the rule. The dealer community was as active as any in trying to understand the meaning of the rule and communicate with the Office of Municipal Securities regarding areas of uncertainty and practical obstacles in the implementation of the rule. BDA has assisted issuers, borrowers and others concerning how the rule would change the manner in which municipal market participants interact with one another. With the implementation of a rule this complex and significant that directly impacts dealers' activities and communications with issuers, this is exactly what the dealer community must do.

We believe that the municipal marketplace and the implementation of the MA rule have been positively impacted as a result of dealers' efforts.

The statements made in the Bond Buyer article stating that the dealer community had intentionally distorted the MA rule for its own interests are completely untrue. One particular statement in the article that some of the "individual dealer communications about the MA rule are so distorted …they could be G-17 violations in and of themselves" is both untrue, disappointing and does nothing to further the process of implementing the MA rule.

Just to list a few of the efforts that BDA and its members have contributed to a successful implementation of the MA rule:

We have met with the SEC's Office of Municipal Securities multiple times and provided several written submissions to identify areas of potential uncertainty as to the application of the MA rule and offered proposed solutions to address those areas of confusion. A number of our suggestions were incorporated into the release by the Office of Municipal Securities of FAQs, which provided interpretative guidance concerning the MA rule.

We have coordinated multiple discussions with our members to allow for dealers to engage in real-world deliberations regarding the operation of the MA rule and to help them understand how their peers were planning to implement the rule. We believe these efforts have significantly helped dealers develop informed, effective and consistent approaches to the implementation of the MA rule.

We have worked with our members to develop guidance concerning how to implement policies and procedures to comply with the MA rule.

We have made efforts to assist issuers and borrowers understand how the MA rule will impact them and have helped our member firms develop communication plans for talking to issuers about the MA rule.

Ultimately the jury is still out on whether the added costs, confusion and complexity resulting from the MA rule, and the potential that issuers may obtain less information, will be matched or exceeded by the MA rule's benefits in protecting issuers. In any case, the BDA and its members will do their best to comply with the rule and to continue to help make it as workable as possible for all market participants.

by Michael Nicholas

MSRB Seeks Approval to Implement Supervision Rule for Municipal Advisors.

Alexandria, VA – In a major milestone in its development of a federal regulatory framework for municipal advisors, the Municipal Securities Rulemaking Board (MSRB) today sought approval from the Securities and Exchange Commission (SEC) of a rule to establish supervisory and compliance obligations for municipal advisors. Proposed MSRB Rule G-44 is the first municipal advisor rule for which the MSRB has sought SEC approval since the SEC's adoption of a final definition of "municipal advisor" in September 2013.

"With today's rule filing, the MSRB is demonstrating its continued commitment to establish a comprehensive regulatory framework for those professionals who provide certain types of financial advice to state and local governments," said MSRB Executive Director Lynnette Kelly. "We aim to ensure that municipal entities are protected by robust regulations that appropriately address practices and behaviors that are not consistent with a municipal advisor's duties to its clients."

Proposed MSRB Rule G-44 is aimed at ensuring appropriate supervision of municipal advisor professionals and compliance with all applicable securities laws. These types of requirements are critical to the prevention and early detection of compliance issues before significant consequences occur. The MSRB has additional rules and professional qualification standards for municipal advisors in various stages of development. The MSRB currently is seeking public comment on a revised draft rule to establish core standards of conduct for municipal advisors. Later this week, the MSRB's Board of Directors will consider comments received and next steps on a draft rule on professional qualifications and testing requirements for municipal advisors.

The Board also is considering draft amendments to the MSRB's existing pay-to-play rule to address the potential for pay-to-play activities by municipal advisors, as well as draft amendments to the its existing gifts rule to establish limitations on gifts given by municipal advisors in their professional capacity. Market participants and other interested persons can stay up to date on the MSRB's municipal advisor rulemaking, outreach and education initiatives by visiting the Resources for Municipal Advisors section of the MSRB's website.

MSRB Requests Comment on Revisions to Draft Rule on Municipal Advisor Standards of Conduct.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today released for public comment a revised draft rule to establish the core duties of municipal advisors when providing advice on municipal securities transactions and related products. The revised draft MSRB Rule G-42 addresses a number of issues raised by commenters on the initial draft rule published in January 2014.

"As the foundation of the MSRB's regulatory framework for municipal advisors, MSRB Rule G-42 will play a central role in achieving the MSRB's mandate to protect municipal entities that engage the services of a municipal advisor," said MSRB Executive Director Lynnette Kelly. "It is important to us and to the market that we develop a rule that effectively and appropriately provides guidance on the core responsibilities of municipal advisors to their clients. The comments we received on the previous draft have informed a number of changes to the text of the draft, and the MSRB wants to provide an opportunity for market stakeholders to review and comment on these changes."

Specifically, the initial draft prohibition on principal transactions has been revised to apply only to transactions with municipal entity clients, not with obligated persons. In addition, to clarify the narrow scope of the prohibition, the revised draft rule defines principal transactions as limited to those directly related to the subject of the municipal advisor's engagement with the municipal entity client. The definition also specifies the types of transactions that are covered.

Among the other key changes to the draft rule is elimination of specified requirements that municipal advisors review the official statement in a new issue transaction, disclose information about professional liability insurance and estimate in relationship documentation their expected total compensation in dollars. These changes reflect commenter feedback, including the view that the client primarily should control the scope of the engagement with its municipal advisor.

The revised draft rule also clarifies a municipal advisor's suitability and related obligations when making recommendations to municipal entity and obligated person clients or reviewing the recommendations of others.

To address potential practical and operational issues, the revised draft rule provides relief from certain disclosure and documentation requirements for anyone who inadvertently provides advice that would be considered municipal advisory activity. However, the new provision does not offer a safe harbor from potential violations of Securities and Exchange Commission (SEC) and MSRB registration requirements and other rules for those providing municipal advisory services.

The MSRB's January 2014 request for comment solicited input on whether the federal fiduciary duty should be extended to apply to municipal advisors that work with obligated persons. The revised draft rule does not extend the fiduciary duty.

Comments are due no later than August 25, 2014. Read the full text of the revised draft rule to view all changes from the January 2014 draft. The MSRB is hosting an educational webinar on the revised core standards rule on August 14, 2014 at 3:30 p.m. ET. Register for the webinar.

The MSRB continues to develop additional rules for municipal advisors.

MSRB Seeks to Implement Revised Continuing Education Requirements for Municipal Securities Dealers.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today filed a revised proposal with the Securities and Exchange Commission to require dealers to provide annual municipal securities training for registered persons who are regularly engaged in or supervise municipal securities activities.

In December 2013, the MSRB requested public comment on draft changes to the "Firm Element Continuing Education" requirement in MSRB Rule G-3. The MSRB modified the proposed new requirement to remove the specified one-hour minimum amount of training. The MSRB also amended the proposal to apply only to registered personnel.

"The rule change we are filing today responds to issues raised during the public comment process while continuing to address the need for firms to focus on the particular training needs of staff responsible for understanding municipal securities products and complying with all applicable requirements," said MSRB Executive Director Lynnette Kelly.

Currently, securities firms are required to offer continuing education to their staff based on the firm's assessment of its overall needs, but there are no existing obligations under MSRB rules to ensure that training on municipal securities is provided to dealer personnel regularly engaged in such activities.

The MSRB requires competency of municipal market professionals and compliance with MSRB rules through professional examinations and continuing education requirements. Separately, the MSRB is in the process of developing a professional qualifications program for municipal advisors. Read more here.

MSRB Rule Changes Draw Support from SIFMA.

WASHINGTON — The Municipal Securities Rulemaking Board's proposal to simplify and harmonize its rules on professional designations has drawn applause from a dealers group.

David Cohen, a managing director and associate general counsel at the Securities Industry and Financial Markets Association, expressed support for the tweaks in a letter filed with the Securities and Exchange Commission Tuesday.

The MSRB's proposal would alter its Rules G-3, on classification of principals and representatives, and would make corresponding changes to Rules G-7 on information concerning associated persons, and G-27 on supervision.

Under G-3, limited representatives are individuals whose activities, with respect to municipal fund securities, may include underwriting or sales; research or investment advice with regard to underwriting or sales; or any other activities that involve communication, with public investors with regard to underwriting or sales. The proposed change would limit the activities of limited representatives exclusively to sales to, and purchases from, customers of municipal fund securities. The MSRB has said this approach is consistent with the approach taken by the Financial Industry Regulatory Authority.

The MSRB is also seeking to eliminate its designation of "financial operations principal" under G-3, because FINRA has overlapping FINOP designation requirements, including an exam.

"The responsibilities and duties of FINOPs pertaining to municipal securities are not unique, and FINRA rules establish general responsibilities and duties for such individuals," the MSRB said in its June filing with the SEC. Cohen said the proposed changes will simplify things for dealers.

"The MSRB is eliminating duplicative licensing requirements," Cohen said in an interview. "It doesn't lessen obligations."

SIFMA was the only group to submit comments on the proposal to the SEC, which has oversight over the MSRB and must approve its rule changes.

The Bond Buyer
BY KYLE GLAZIER
JUL 16, 2014 1:15pm ET

[Rep. Stivers Pushes SEC to Limit MCDC, Warns of Possible Legislation.]

WASHINGTON — A Republican congressman is pushing the Securities and Exchange Commission to limit the scope of its disclosure violations self-reporting program to the last two years, warning that if it does not he and other lawmakers may seek a legislative solution.

Rep. Steve Stivers, R-Ohio, fired the shot across the SEC's bow during House lawmakers' discussion of H.R. 5016, an appropriations bill for the Treasury on Wednesday.

Stivers had prepared an amendment to bill that would not fund the SEC's MCDC's efforts for more than two years. He did not formally offer it, but discussed his concerns about the program on the House floor with Rep. Ander Crenshaw, R-Fla., chair of the Appropriations Committee's financial services panel.

The Municipalities Continuing Cooperation Disclosure initiative allows issuers and underwriters to get favorable settlement terms if they voluntarily report, by the end of Sept. 9, any time in the last five years they offered bonds without disclosing failures to meet their continuing disclosure agreements they set up under the SEC's Rule 15c2-12. But Stivers' amendment would have prevented MCDC settlements for deals taking place before March 19, 2012.

That date coincides with a risk alert issued by the SEC's office of compliance inspections and examinations that detailed the commission's view on an underwriter's obligations under 15c2-12. Though that part of the rule was adopted in 1994, the SEC only began to take enforcement actions in this area since the risk alert.

Market groups including the Government Finance Officers Association, the Securities Industry and Financial Markets Association, and Bond Dealers of America have lobbied the SEC to extend the deadline for MCDC participation and restrict its scope to more recent deals, but the commission has refused to budge. House rules prevent legislating in appropriations bills, but Stivers' amendment would have cut off MCDC funding for violations prior to March 2012.

The House has only 10 working days before the end of the MCDC period because the chamber is not scheduled for legislative business in August. But Stivers told colleagues that he is interested in working with them to make changes to the program if the SEC continues to stick to its guns.

"The states and localities that the SEC is trying to protect do not support this program, and feel it's very punitive," Stivers told Crenshaw, noting that the Government Finance Officers Association supported his amendment. Stivers thanked Crenshaw for being willing to work with him and the House Financial Services Committee on a solution "should the SEC not choose to curtail this program on their own."

"We want to make sure it's fair and equitable to our states and local municipalities," Stivers said.

Crenshaw said making sure a large number of bond deals is in compliance is "a huge undertaking," and told Stivers he looked forward to helping him "find some solutions."

Michael Decker, a managing director and co-head of municipal securities at SIFMA, applauded the action.

"We thank Rep. Stivers for his attention to the issues raised by the MCDC Initiative," Decker said. "We, too, believe it would be appropriate for the SEC to focus the program on transactions that were executed after the SEC's Office of Compliance Inspections and Examinations issued their notice in March 2012 focusing the municipal market's attention on compliance issues covered by the MCDC."

There has been only one MCDC settlement so far. The SEC last week charged Kings Canyon Joint Unified School District in California with misleading bond investors in a 2010 deal. Some market participants have pointed out that Kings Canyon was already under investigation when it consented to participate in the MCDC, so it did not actually self-report.

Bond attorneys have also expressed frustration that the settlement does not specify what disclosure failures the SEC focused on. Muni groups have repeatedly sought SEC guidance on what threshold of failure warrants an MCDC confession, but the commission has been silent on that front.

Stivers has shown an interest in muni market issues before, previously sponsoring legislation and lobbying the SEC to narrowly tailor municipal advisor regulations.

The Bond Buyer
BY KYLE GLAZIER
JUL 17, 2014 4:01pm ET

Bond Fee Disclosures Sought by SEC to End 38-Year Debate.

After a 38-year debate on how to make trading costs for corporate and municipal debt transparent, regulators are making another attempt at forcing dealers to disclose how much they earn on the transactions.

The Municipal Securities Rulemaking Board will discuss a proposal at the end of the month, Executive Director Lynnette Kelly said yesterday, after U.S. Securities and Exchange Commission Chair Mary Jo White asked the regulator to come up with a plan by year end. The new rules would apply to so-called riskless trades, where firms fill client orders rather than use their own money to opportunistically buy.

Regulators are placing a greater emphasis on making sure smaller buyers don't get fleeced when transacting in the corporate- and municipal-bond market that's grown 36 percent since 2008. While stock brokers must tell investors how much they earn, bond dealers have profited from an opaque market where trades are still often completed over the telephone.

"You don't know how many bites out of a yield are taken by the time you're buying a bond," said Marilyn Cohen, who manages $320 million of corporate and municipal bonds as founder of Envision Capital Management Inc. "Here we are in 2014 and we're still talking about this."

Increasing Prices

Individuals are especially in the dark about how much they're paying brokers, Cohen said. Investors pay higher prices than securities firms when they trade U.S. state and local government bonds, according to a study of the $3.7 trillion municipal market released this week by the MSRB.

The price of a municipal bond increased by an average of 1.78 percent when a broker purchased a security from one investor and resold it to another, according to the MSRB analysis of trading from 2003 to 2010. Trades between securities firms, in comparison, increased in price by 0.5 percent.

Concern is mounting that the bond market's antiquated infrastructure will exacerbate losses when sentiment reverses after more than five years of easy-money policies that have suppressed borrowing costs and spurred record demand for debt. Investors have funneled about $978.3 billion into long-term bond mutual funds since the end of 2008, an amount that's greater than Turkey's annual gross domestic product, according to the Investment Company Institute.

While yields are still close to all-time lows, analysts predict they'll climb as the Federal Reserve ends its monthly purchases of Treasuries and mortgage debt later this year and prepares to raise benchmark interest rates.

Drafting Parameters

The SEC is "very focused" on making changes in the bond market's structure in the "next year or two," White said in a June 20 speech. She also said the SEC asked the MSRB and Financial Industry Regulatory Authority to draft parameters for how to force dealers to disclose their commissions.

"We look forward to working with the SEC on these important topics," George Smaragdis, a Finra spokesman, said in an e-mailed statement.

MSRB's Kelly said in a telephone interview yesterday that the two regulators are working together and that “it’s important for there to be regulatory consistency.”

The idea of requiring dealers to disclose commissions on certain bond trades isn’t new. The SEC has proposed rules on three separate occasions that would require dealers to reveal mark-ups on riskless principal trades, and failed to follow through each time.

Majority Support

The agency issued the most recent proposal in 1994, and didn’t adopt the rule in part because regulators were readying the bond-price reporting system now known as the Trade Reporting and Compliance Engine, or Trace, which went into effect in 2002.

Regulators are more confident they’ll follow through this time because a majority of the five-member commission — White and two Republican SEC commissioners, Daniel M. Gallagher and Michael S. Piwowar — have called for requiring disclosure.

In addition, a bipartisan Senate bill introduced in March, sponsored by Senator Mark Warner of Virginia and Senator Tom Coburn of Oklahoma, would require dealers to reveal their mark-ups on transactions with customers who placed an order to buy or sell.

“If you have a commission or a mark-up that is three or four percent, that is one year of interest on a bond in many cases,” Piwowar said in a phone interview. “You can burn your yield up on these transactions. Having it on their confirm would provide another level of transparency.”

Riskless Principal

The main issue of contention is how to determine which trades would be subject to the rule.

Regulators are considering rules that would be dependent on how much time it takes between when a dealer buys and sells a bond. Lobbyists from the securities-brokerage industry are opposed to those parameters, and argue regulations should target trades where firms have client orders in hand when they purchase debt.

“Whether we can get comfortable with this really depends on how the regulators define riskless principal,” said Michael Decker, managing director and co-head of municipal securities for the Securities Industry and Financial Markets Association.

“If they are thinking of riskless principal in terms of how long you as a dealer were exposed to market risk, if it’s less than an hour or less than a day, that in our view is not a riskless principal trade,” he said.

Declining Costs

The lack of information about brokers’ commissions is indicative of the antiquated nature of the $40 trillion U.S. bond market. Corporate-bond trading has been slow to move to electronic platforms, partly because there are thousands of individual bonds that trade relatively infrequently.

While transaction costs have declined after the advent of bond-price reporting systems, investors still typically pay more to transact in these markets than in equities. In the year after the Trace bond-price reporting system was introduced, a study found that $1 billion in commissions were wiped out.

Rules mandating more disclosure of commissions “will probably compress the spreads in terms of how much everyone is making," Envision's Cohen said.

By Lisa Abramowicz and Dave Michaels Jul 17, 2014 2:50 AM PT

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Investors Pay More for Munis than Dealers, MSRB Report Shows.

WASHINGTON — Investors pay more for municipal securities than dealers, particularly when there is more time between trades, according to a long-awaited report commissioned by the Municipal Securities Rulemaking Board.

But market sources said that the report's finding is not surprising and that the report is limited in its results.

Erik Sirri of Babson College in Massachusetts conducted the study, which he has been working on since January 2011. The work analyzed millions of municipal market trades and provides an analysis of the muni market's structure, the price differential between two trades of the same security, and the impact of near real-time trade reporting.

MSRB director of research Marcelo Vieira said that the report provides the MSRB a clear picture of how municipal securities move through the market and the information about the impact of its Real-Time Transaction Reporting System reinforces the importance of price transparency. Many market participants have said for years that the many small, retail customers in the muni market typically pay more for the same securities than either institutional customers or dealers.

Fifty percent of all trades had a trade size at or below $25,000, the study reveals. But the study did not differentiate between institutional and retail customers.

Vieira said the MSRB did not pay Sirri, a former director of the division of trading and markets at the Securities and Exchange Commission, for the study. But the professor does retain the rights to the data and its use in future research.

"This report provides a highly detailed benchmark analysis on secondary market trading from the MSRB, an independent and objective source of information, and the key regulator of the municipal securities market," MSRB executive director Lynnette Kelly said in a release Tuesday. "The MSRB supports the use of data in its oversight of the market and encourages further analysis by others into the intricacies of municipal market trading."

The report examines the four types of "trade pairs" that exist in the market: a dealer purchase from a customer followed by a dealer sale to a customer; a dealer purchase from a customer followed by an inter-dealer trade; an interdealer trade followed by a dealer sale to a customer; and interdealer trade followed by an interdealer trade.

Sirri found that the average basis point spread from a dealer purchasing a muni from a customer and selling it to a customer was 178, compared to 146 for a dealer buying a muni from a dealer and selling it to a customer, 67 for a dealer purchasing a muni from a customer and selling it to another dealer, and 50 for a dealer purchasing a muni from a dealer and selling to a another dealer. The average increase for all transactions was 127 basis points.

“Paired-trade differentials are noticeably higher when trades involve a customer, as opposed to another dealer,” the report concludes. “Using an [interdealer-interdealer] trade pair as a starting point, replacing either side of the trade pair with a customer trade serves to increase the paired-trade differential relative to the [interdealer-interdealer] pair. This is perhaps not surprising if higher costs are associated with identifying and trading with a customer versus another dealer.”

The basis point differentials shrank when Sirri looked only at transactions that took thirty minutes or less between the first trade and second. The overall spread dropped to 80 basis points from 127, and fell to 76 for trades occurring within 14 minutes of each other.

The study also examines the impact of the RTRS. Beginning on Jan. 31, 2005, prices for most trades of municipal securities became available to the public on a near real-time basis, within 15 minutes after trade execution. Prior to that, prices became available the next day.

The study shows that the average basis point change in a trade dropped to 160 in 2006 from 213 in 2003, but had edged up to 208 by 2010. The report points to the 2007 financial crisis as a probable factor in the increase of basis points.

“It reflects the importance of transparency,” Vieira said. “From our perspective, it’s all about transparency.”

The study did not attempt to examine riskless principal trades, or purchases and sales of the same munis at almost the same time which do not expose dealers to market risks. SEC commissioners have said that dealers should be required their markups on these trades.

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said the report contains no surprises. The efforts of Sirri and the MSRB underscore the unique characteristics of the muni market, Cohen said, and the role of dealers in an environment that includes many small trades and some securities that trade very infrequently. Cohen added that the report deals with aggregated data, and that the facts and circumstances of individual trades differ considerably.

“There’s a story behind each trade,” Cohen said. “I think it’s important to take that into consideration.”

Joseph Fichera, chief executive officer of Saber Partners LLC., said the study has to be viewed with some qualifications noted in Sirri’s report. The price change data is not analagous to the formal concepts of “mark ups and mark downs,” and the report was never meant to be used as a measure of whether transactions are fair or not for regulatory purposes. It also doesn’t account for specific circumstances, such as changes in credit worthiness.

“Time is money, inventory is a cost, and dealers have a right to make a profit when making markets, especially over time,” Fichera said.

The Bond Buyer
BY KYLE GLAZIER
JUL 15, 2014 3:35pm ET

[Morrison & Foerster: SEC Staff Provides Rule 506(c) Verification Guidance.]

The SEC Staff recently provided further guidance on the provisions of Rule 506(c) of Regulation D which permit the use of general solicitation and general advertising when sales are made only to accredited investors and the issuer verifies the accredited investor status of the purchasers. The Staff has now clarified certain aspects of the verification process through a series of new Securities Act Rules Compliance and Disclosure Interpretations.

When a purchaser holds assets in an account jointly or holds property jointly with an individual that is not the person's spouse, the Staff has said that the assets in the account or property held jointly can be taken into account for the net worth test set forth in Rule 501(a)(5), but only to the extent of the purchaser's percentage ownership of the account or property (Question 255.49).

The Staff has indicated that in a situation where a purchaser's annual income is not reported in U.S. dollars, the issuer may use either the exchange rate that is in effect on the last day of the year for which income is being determined or the average exchange rate for the year (Question 255.48). If a purchaser is not a U.S. taxpayer and therefore cannot provide an IRS form to report income, the non-exclusive method for verification set forth in Rule 506(c)(2)(ii)(A) would not be available; however, the Staff has said that the principles-based verification method could be utilized where an issuer could reasonably conclude that a purchaser is an accredited investor based on a review of tax forms that report income in a foreign jurisdiction which imposes penalties for falsely-reported information that are comparable to those of the U.S (Question 260.36).

If an issuer is seeking to rely on the non-exclusive method for verification set forth in Rule 506(c)(2)(ii)(A) and thus wants to review the purchaser's income as reported on IRS forms for the two most recent years, but the most recent year is not yet available, it would not necessarily be appropriate for the issuer to then review years prior to the two most recent years. However, the Staff believes that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement under the principles-based verification approach by:

- reviewing the Internal Revenue Service forms that report income for the two years preceding the recently completed year; and
- obtaining written representations from the purchaser that (i) an Internal Revenue Service form that reports the purchaser's income for the recently completed year is not available, (ii) specify the amount of income the purchaser received for the recently completed year and that such amount reached the level needed to qualify as an accredited investor, and (iii) the purchaser has a reasonable expectation of reaching the requisite income level for the current year. (Question 260.35).

With respect to the review of tax assessments for the purposes of determining an accredited investor's net worth under the non-exclusive verification method set forth in Rule 506(c)(2)(ii)(B), the Staff notes that reviewing a tax assessment that is more than three months old would not be appropriate when relying on the verification safe harbor. That said, the Staff believes that an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement of Rule 506(c) under the principles-based verification method, if the issuer uses the most recently available tax assessment when determining whether the purchaser has the requisite net worth (Question 260.37).

Lastly, in reviewing consumer reports for the purposes of determining a purchaser's liabilities under the non-exclusive verification method set forth in Rule 506(c)(2)(ii)(B), the Staff indicates that while a consumer report from a non-U.S. entity would not work for the purposes of the safe harbor, an issuer could reasonably conclude that a purchaser is an accredited investor and satisfy the verification requirement under the principles-based verification method by reviewing s foreign report report and taking any other steps necessary to determine the purchaser's liabilities (such as a written representation from the purchaser that all liabilities have been disclosed) in determining whether the purchaser has the requisite net worth (Question 260.38).

In those interpretation where the Staff noted that an issuer could reasonably conclude that a purchaser is an accredited investor based on the principles-based verification method, the Staff further noted that when the issuer has reason to question the information that is being considered or, depending on the test, the purchaser's net income or net worth, then additional verification measures may be necessary in order to verify that the purchaser is an accredited investor.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

July 14 2014
Article by David M. Lynn
Morrison & Foerster LLP

Drinker Biddle: SEC Resolves First Case Under New Municipalities Continuing Disclosure Cooperation Initiative.

On July 8, 2014, the SEC announced that it had settled charges that a school district in California misled bond investors about its failure to comply with its continuing disclosure obligations under Rule 15c2-12 of the Exchange Act. Pursuant to the Municipalities Continuing Disclosure Cooperation ("MCDC") Initiative, Kings Canyon Joint Unified School District, without admitting or denying the SEC's findings, agreed to entry of an Order (1) finding that it was in violation of Section 17(a)(2) of the Securities Act, (2) requiring it to cease and desist from violating Section 17(a)(2), (3) requiring it to establish written policies and procedures and to conduct periodic training regarding continuing disclosure obligations, and (4) requiring it to cooperate with the Enforcement Division in any subsequent investigation and to disclose the settlement in future bond offering materials. The SEC did not order any disgorgement or civil penalty.

Rule 15c2-12 requires that an underwriter obtain a written agreement from an issuer, for the benefit of bondholders, in which the issuer promises to submit certain financial information on an annual basis. This financial information is usually submitted to appropriate national and state repositories where it is available to the investing public. Notably, a broker-dealer must consider an issuer's failure to disclose such financial information in determining whether to recommend a security and must disclose the failure to provide such financial information to customers. Rule 15c2-12 undertakings must be described in final Official Statements.

According to the SEC, Kings Canyon publicly offered $19 million of municipal bonds in December 2006, $4.5 million of municipal bonds in November 2007, and $6.7 million of municipal bonds in December 2007. The SEC found that Kings Canyon executed 15c2-12 agreements to affirm that it had made continuing disclosures of financial information. The SEC alleged, without specificity, that Kings Canyon failed to submit "some" of the disclosures required by that agreement.

According to the Order, in November 2010, Kings Canyon offered $6.8 million of municipal bonds. The Official Statement for the 2010 offering stated that Kings Canyon "has had no instance in the previous five years in which it failed to comply in all material respects with any previous continuing disclosure obligation …." Again, without providing specifics as to what information Kings Canyon did not disclose, the SEC found that statement to be "untrue."

The SEC concluded that Kings Canyon's inclusion of the "untrue statement" violated Section 17(a)(2). Section 17(a)(2) makes it unlawful "in the offer or sale of any securities … to obtain money or property by means of any untrue statement of material fact or omission to state a material fact necessary in order to make statements made, in light of the circumstances under which they were made, not misleading." Section 17(a)(2) does not require that the SEC prove that a respondent acted with "scienter." Rather, the SEC may establish such a violation by showing that the respondent acted negligently.

The SEC also did not provide significant details about Kings Canyon's negligence. The SEC simply concluded that Kings Canyon reviewed drafts of the 2010 Official Statement that included summary descriptions of previous continuing disclosure agreements and that it subsequently approved the Official Statement. Moreover, the SEC, without discussion, concluded that investors would "attach importance" to Kings Canyon's failure to comply with its continuing disclosure agreements and that the alleged "untrue" statement was therefore material.

The SEC does not refer to any individuals in the settled Order against Kings Canyon. The SEC Order also does not indicate what role the underwriter played in drafting or approving the 2010 Official Statement. Given that the MCDC Initiative was announced on March 10, 2014, it appears that the staff conducted a fairly swift investigation in order to resolve the matter four months later. The undertaking that Kings Canyon cooperate with any subsequent investigation by the Enforcement Division may suggest, as we pointed out in our April 22 post, that the SEC may use issuers' cooperation to pursue individuals. Moreover, it is not out of the realm of reason that the SEC may extend its focus to other participants in municipal securities offerings, such as underwriters and broker-dealers.

Article By:
Mary P. Hansen
Drinker Biddle & Reath LLP
posted on: Friday, July 11, 2014

Overflow Crowd Attends the Muni Bonds 101 Seminar.

On July 2, 2014, the MBFA Coalition held a "Municipal Bonds 101" seminar on Capitol Hill for congressional staff and interested parties focusing on the importance of preserving the present-law treatment of tax-exempt municipal bonds.

The seminar featured a distinguished panel of municipal finance experts from varying backgrounds who explained the benefits of the traditional municipal bond market to staff from key congressional personal and committee offices.

Panelists included:

Ron Bernardi, Principal, President and CEO, Bernardi Securities
Mayor Steve Benjamin, Columbia, South Carolina
Kevin Burke, President and CEO, Airports Council International – North America

The education seminar featured panel presentations, an interactive discussion and fostered a great learning environment for key hill staffers. This "Muni Bonds 101" seminar is the second we've hosted in two years and has proven to be a key component in an ongoing effort by the MBFA Coalition to educate policy makers and staff on the benefits of the municipal market and the negative implications of scaling back or eliminating the tax exemption on municipal debt.

Click here for handouts from the seminar.

For more information on the Municipal Bonds for America coalition, please visit our website: www.munibondsforamerica.org

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GFOA Offers New Guidance on SEC Self-Reporting Program.

WASHINGTON — The Government Finance Officers Association has issued an alert for issuer officials urging them to approach the Securities and Exchange Commission's continuing disclosure self-reporting program cautiously, and advising the group's members that attempts to lobby the SEC for changes to the initiative have been largely unsuccessful.

The GFOA alert released Monday came barely two months before the SEC's Municipalities Continuing Disclosure Cooperation initiative is set to expire Sept. 10. The program allows issuers and underwriters to get lenient settlement terms if they voluntarily self-report their failures to ensure bond offering documents were not false or misleading about their compliance with their continuing disclosure obligations. Issuers would not face civil financial penalties if they participate, but individuals would not enjoy any immunity. Issuers need to take the MCDC "seriously, but exercise caution," the alert states.

"The legal consequences of participating in the MCDC initiative are significant and should be thoroughly evaluated with the assistance of counsel," it advises.

The alert also explains that issuers need not worry about the MCDC if they have not issued bonds in the past five years, the time period covered by the initiative. For issuers who have offered debt in that time period and who are unsure if their official statements might have been inaccurate, the GFOA recommends a review of those offerings with transaction participants in addition to scrutinizing internal files and EMMA filings. If an OS admits to past noncompliance, it is probably not problematic, the GFOA alert states.

"If the information in the official statement describes any instances of prior non-compliance (including instances that may be immaterial), the issuer can probably conclude that it has not misstated compliance and no further investigation is necessary," it explains.

If an issuer official does discover potentially problematic official statements, it should consult counsel about the materiality of the lapse and about the potential advantages and disadvantages of participating in the MCDC, GFOA's alert concludes. Issuers in that situation should also adopt or enhance policies and procedures to prevent future lapses in addition to correcting noncompliance as quickly as possible.

The MCDC has been controversial since it was announced earlier this year, and GFOA debt committee chairman Ben Watkins has publicly expressed strong distaste for the SEC's approach. GFOA is among several industry groups, including the Bond Dealers of America, National Association of Bond Lawyers, and Securities Industry and Financial Markets Association, who have pushed the SEC to make changes to the MCDC.

Many market participants want the deadline extended to December or beyond. GFOA is also seeking clarification on what the SEC would consider to be material for the sake of the MCDC, a term courts have ruled means information a "reasonable investor" would want to know.

SEC officials have indicated that they are unlikely to alter the MCDC, although they have expressed some sympathy for the struggles that both issuers and underwriters have reported experiencing while attempting to find documents on deals that happened before the EMMA system became the muni market's sole transparency database in 2009.

"The initial feedback from the SEC indicated an unwillingness to streamline the MCDC Initiative to improve the efficiency and effectiveness and reduce the uncertainties and burdens being imposed on issuers," the GFOA alert states. "GFOA will continue to press for common-sense changes to modify the MCDC Initiative and focus on constructive ways to improve continuing disclosure compliance."

The Bond Buyer
BY KYLE GLAZIER
JUL 7, 2014 2:02pm ET

SEC Charges California School District with Misleading Investors.

Settlement Is First Under Initiative Targeting Municipal Disclosure

Washington D.C., July 8, 2014 — The Securities and Exchange Commission today charged a school district in California with misleading bond investors about its failure to provide contractually required financial information and notices. The case is the first to be resolved under a new SEC initiative to address materially inaccurate statements in municipal bond offering documents.

The SEC found that in the course of a 2010 bond offering, Kings Canyon Joint Unified School District affirmed to investors that it had complied with its prior continuing disclosure obligations. The statement was inaccurate because between at least 2008 and 2010, the school district had failed to submit some required disclosures. The California school district agreed to settle the charges without admitting to or denying the findings.

Under the Municipalities Continuing Disclosure Cooperation (MCDC) initiative, the SEC's Enforcement Division agreed to recommend standardized settlement terms for issuers and underwriters who self-report or were already under investigation for violations involving continuing disclosure obligations. The 2014 initiative, launched on March 10, expires on September 10.

"The integrity of the municipal securities market requires that issuers carefully comply with all of their disclosure obligations," said Andrew J. Ceresney, director of the SEC's Division of Enforcement. "Our MCDC initiative is one piece of our efforts to ensure that issuers meet their obligations going forward."

LeeAnn Ghazil Gaunt, chief of the SEC Enforcement Division's Municipal Securities and Public

Pensions Unit added, “An important component of the MCDC program is that it provides issuers who were already under investigation the opportunity to accept the standard terms and resolve their enforcement matters in a fair and efficient manner. We are pleased that King’s Canyon has taken advantage of the program and we continue to encourage all eligible issuers and underwriters to do so while the MCDC terms are still available.”

The SEC’s order instituting settled administrative proceedings finds that in three bond offerings between 2006 and 2007, Kings Canyon contractually agreed to disclose annual financial information and notices of certain events pertaining to those bonds. When it conducted a $6.8 million bond offering in November 2010, Kings Canyon was required to describe any instances where it had failed to materially comply with its prior disclosure obligations. In the 2010 offering document, Kings Canyon inaccurately affirmed that there was “no instance in the previous five years in which it failed to comply in all material respects with any previous continuing disclosure obligation.” Because Kings Canyon failed to submit some of the contractually required disclosures relating to the 2006 and 2007 offerings, the November 2010 bond offering document contained an untrue statement of a material fact.

Without admitting or denying the SEC’s findings, Kings Canyon consented to an order to cease and desist from committing or causing any future violations of Section 17(a) of the Securities Act. It also agreed to adopt written policies for its continuing disclosure obligations, comply with its existing continuing disclosure obligations, cooperate with any subsequent investigation by the Enforcement Division, and disclose the terms of its settlement with the SEC in future bond offering materials.

The SEC’s investigation was conducted by Monique C. Winkler and was supervised by Cary Robnett. Both are in the SEC’s San Francisco Regional Office and are members of the Enforcement Division’s Municipal Securities and Public Pensions Unit.

WSJ: SEC in Pact With California School District on Bond Offer.

Kings Canyon Joint Unified School District Allegedly Failed to Provide Some Required Financial Disclosures

The Securities and Exchange Commission said Tuesday it reached a settlement with a California school district on claims the district failed to provide some required financial disclosures during a 2010 bond offering.

The case is the first to be resolved under a SEC initiative to address materially inaccurate statements in municipal bond offering documents, the agency said.

According to the SEC, the Kings Canyon Joint Unified School District had affirmed to investors that it had complied with previous disclosure requirements in the course of a 2010 bond offering. However, the SEC said the school district had failed to submit some required disclosures between at least 2008 to 2010.

The California school district agreed to settle the charges without admitting to or denying the findings. Terms of the settlement include consenting to a cease-and-desist order, adopting written policies related to continuing disclosure obligations and disclosure of the terms of its settlement with the SEC in future bond offering materials.

“The school district is glad they were able to resolve the matter amicably with the SEC,” said Jeffrey Kuhn, defense counsel for the district.

Mr. Kuhn said there were “inadvertent errors in the way they handled things” that have been acknowledged and the district is in the process of adopting policies and procedures so that it won’t happen again.

Under an initiative that began in March, the SEC’s enforcement division agreed to recommend standardized settlement terms for issuers and underwriters who self-report or who were already under investigation for violations involving continuing disclosure obligations. The initiative is set to expire Sept. 10.

By TESS STYNES
July 8, 2014 2:31 p.m. ET

Commentary: Law Brings Muni Advisors under SEC-MSRB Umbrella.

As many state and local governments across the country begin their July 1 fiscal year, a new federal law going into effect is of particular interest to municipal governments that issue bonds. The new law defines the scope of activities of municipal advisory professionals and establishes new requirements for those that provide advice on matters of public finance.

Each of the various financial professionals that work with state and local governments plays a different role and may have relationships that could affect any recommendations they make. The definition of a municipal advisor, established by the Securities and Exchange Commission, together with an associated regulatory regime for municipal advisors, will provide needed oversight of these financial professionals. The Municipal Securities Rulemaking Board is charged with developing a regulatory framework that clarifies and establishes requirements for these roles, responsibilities and relationships of municipal advisors. These “three Rs” are fundamental to understanding why we are here.

First, a bit of history. Congress mandated the creation of a regulatory framework for municipal advisors with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The goal of this framework is to protect state and local governments from the potentially costly consequences of relying on the financial advice of unregulated professionals that may lack sufficient expertise and accountability. Dodd-Frank imposed a federal fiduciary duty on municipal advisors to put the interests of their state and local government clients first, and a comprehensive regulatory framework will establish basic standards for the roles, responsibilities and relationships of municipal advisors.

Dodd-Frank broadly defined the term “municipal advisor” and left it to the SEC to provide additional clarity and guidance on who ultimately is a municipal advisor and must comply with any existing or future regulatory requirements. The SEC provided that guidance in its final registration rule released in September 2013 and effective today.

With certain exceptions, financial professionals who provide advice about municipal financial products or the issuance of municipal securities for an issuer must register with both the SEC and the MSRB and must comply with a broad MSRB requirement to deal fairly with all persons. The MSRB is developing additional rules to govern the conduct and professional qualifications of municipal advisors. The MSRB seeks to ensure that all municipal market participants understand the role of a municipal advisor, an advisor’s responsibilities to its client and the relationships among the various participants in a transaction.

To date, the MSRB has focused on establishing core standards of conduct for municipal advisors, setting supervision and compliance obligations for municipal advisor firms, and creating a professional qualification exam to require municipal advisors to demonstrate a minimum level of competency. The MSRB also plans to revise its rules on pay-to-play practices. Current rules that prohibit pay-to-play by municipal securities dealers will be extended to include municipal advisors.

The MSRB invites extensive participation in the development of its regulatory framework and hosts a number of outreach events and webinars to ensure stakeholders understand developing rules and how to comment. As the municipal advisor regulatory structure continues to evolve, the July 1 effectiveness of the SEC's registration rule signifies a major step forward in bringing all municipal advisors under the regulatory oversight of the SEC and the MSRB. Follow the current status of municipal advisor rulemaking and access free educational resources on the MSRB's website (MSRB.org) in the "Resources for Municipal Advisors" section.

BY DAN HEIMOWITZ
JUN 30, 2014 9:57pm ET

Daniel Heimowitz is Chair of the Municipal Securities Rulemaking Board.

What Governments Need to Know About the New Municipal Advisor Rule.

A new rule about who can give governments financial advice goes into effect Tuesday, but how to apply it is far from resolved.

It's been a confusing road for the creation of a new category of financial advisors who will be regulated by the federal government. So confusing, in fact that the feds delayed implementating the Municipal Advisor Rule by half a year to July 1.

A municipal advisor is a qualified financial professional (such as a banker or financial consultant) who give municipalities advice on financial deals like bond offerings. That person must be registered through the SEC as a municipal advisor and cannot have any other interest in the deal.

Historically, it was common for those orchestrating the transaction to also dish out advice and counsel to the municipality entering. The problem with this model was that while most underwriters or brokers are fair and reasonable, entrusting a financial professional to give advice to a municipality when that professional could potentially benefit a great deal if the municipality enters into the deal creates an inherent conflict interest.

Reaction from bankers and underwriters on how best to cope with the new restrictions on what they can and can't say to their government clients has been varied. (The rule technically goes into effect this week but many institutions have already been operating under its restrictions ahead of time.) An exception does exist that allows underwriters and bankers on a deal to talk with the government about options so long as the government presents in writing that it already has a municipal advisor and it is relying on its advisor's advice. Still, said Mark-David Adams, a bond counsel at Edwards Wildman law firm, some have effectively instituted a gag order.

"Some banks are telling their officers … to absolutely not give any advice flat-out, whatsoever," he said. "It's just set a term sheet, [that says] 'this is what we want, this is what we'll pay for it, have a nice day and good bye.'"

There are gray areas in which those who conduct financial deals for governments can work and issuers can expect most of the underwriters they deal with to operate in this realm. Some additional key exceptions offered by the Municipal Market Advisors include:

1) Underwriters may include recommendations and advice when responding to an issuer's request for proposal if the RFP is about a specific financing and has been advertised either to three reasonably competitive firms or via posting on the issuer's website. The response timeframe off the RFP must also be less than 6 months.

2) While underwriters and other professionals may not provide recommendations or advice to issuers unless an exemption is met, underwriters may talk with the issuer about "general market information." This does not mean underwriters can "express subjective assumptions, opinions, or views [that] constitute a recommendation." But it does mean they can talk about available products and even "information regarding a municipal entity's particular outstanding bonds, such as current market prices and yields, without this information constituting a recommendation."

Adams said many governments are considering whether to retain a municipal advisor on an ongoing basis so as to make it easier for underwriters or bankers to approach a government with a deal that might be good for them (like refinancing debt at a lower interest rate). But that's not a solution that will work for everyone as many governments are used to seeking advice from different people depending on their expertise and the type of deal.

Adams predicted a 6-month growing pains period before governments and financial institutions settle in to the new routine.

"It's probably going to be a little clumsy," he said. "Like someone going out on their first date – it's going to be awkward for a while."

GOVERNING.COM
BY LIZ FARMER | JULY 1, 2014

Bond Dealers Make New Push to Change Disclosure Program.

WASHINGTON — The Bond Dealers of America is making another push for changes to the Securities and Exchange Commission's Municipalities Continuing Disclosure Cooperation initiative after the SEC rejected BDA's earlier requests to narrow the scope of the program and extend its deadline.

The BDA renewed its efforts in a four-page June 30 letter signed by chief executive officer Mike Nicholas and sent to SEC chairman Mary Jo White. The letter repeats an earlier BDA request that the program be extended to Dec. 15 from its current deadline of Sept. 10. The program allows issuers and underwriters to get lenient settlement terms if they voluntarily self-report their failures to ensure bond offering documents were not false or misleading about their compliance with their continuing disclosure obligations,

The letter also reiterates a proposal from the BDA's June 9 letter that issuers and underwriters only have to review bond documents on the Municipal Securities Rulemaking Board's EMMA website to determine their past compliance history, rather than going back into the much less user-friendly Nationally Recognized Municipal Securities Information Repository or NRMSIR system that existed prior to 2009. The letter includes a new request that the civil penalty cap of $500,000 included in the MCDC should be lowered and tiered according to the firm's size. The penalty size is currently pegged to the size of the deal, not the firm, and maxes out at $500,000 for the largest totals.

“The BDA wants our member firms to be able to take advantage of the amnesty program, but in doing so at the $500,000 cap, we fear that it will cause them to face an unduly burdensome financial challenge and should therefore be tiered accordingly,” Nicholas wrote. “We believe that the intent of the commission was to place a reasonable cap on an underwriter’s exposure; however, the $500,000 cap places a disproportionate burden on smaller firms with no associated tangible benefit connected to the initiative.”

The total cost for a dealer who hires an outside vendor to come through the potentially decade-long list of deals searching for potentially misleading official statements could reach $600,000, a penalty a cost that could be staggering for a smaller firm, according to the BDA letter.

A June 30 letter to BDA from LeeAnn Ghazil Gaunt, head of the municipal securities and public pensions unit at the SEC’s Division of Enforcement declined to offer the BDA any relief on either the NRMSIR issue or the time limit. While the SEC struck a sympathetic tone about the increased challenges of searching the NRMSIR system compared to EMMA, the commission appears unwilling to go as far as BDA would like. The latest letter expands on the group’s concerns.

“When dealers review the transactions in which they were involved, they are encountering numerous practical problems with the NRMSIR system that render any review with respect to filings under the NRMSIRs essentially impossible to conduct in a meaningful and reliable way,” the BDA letter states.

These problems include systems that are no longer operational, and one that supplies unreliable information.. Further, Nicholas argues, it is unreasonable for the SEC to make market participants wade through a system that everyone agreed was broken before it was replaced by EMMA.

“The whole point of the EMMA system was to fix what was broken with the NRMSIR system,” the BDA letter states.

The letter closes with a final appeal for a time extension, arguing that the short current deadline will limit the abilities of underwriters and issuers to huddle on their past deals and decide which ones might be eligible under the MCDC. SEC officials have signaled that a deadline extension is unlikely and said that the “modified prisoner’s dilemma” structure of the initiative that pits the interests of underwriters against those of issuers is an important aspect of the MCDC. The BDA also asks for a face-to-face meeting with White or her staff.

The Bond Buyer
BY KYLE GLAZIER
JUL 1, 2014 12:16pm ET

MSRB Marks Milestone in Municipal Market Transparency.

The Municipal Securities Rulemaking Board (MSRB) today marked the fifth anniversary of a pivotal milestone in the transparency of the municipal securities market. On July 1, 2009, the MSRB’s Electronic Municipal Market Access (EMMA®) website became the official, centralized public access point for financial and other continuing disclosures from state and local governments that issue municipal securities, making these documents freely available to investors and the general public for the first time. View a graphic that highlights key events in the evolution of municipal market transparency.

View the full press release.

MSRB Reminder: Resources Available for Municipal Advisors.

The Securities and Exchange Commission's (SEC) final municipal advisor registration rule takes effect today, July 1, 2014. Before engaging in municipal advisory activities, municipal advisors must register with the SEC and the Municipal Securities Rulemaking Board (MSRB). To assist municipal advisors in staying apprised of developing regulatory initiatives, the MSRB regularly updates a dedicated page on its website and provides numerous resources for municipal advisors. Access News and Resources for Municipal Advisors.

Municipal advisors can also sign up to receive regulatory notices and other information from the MSRB. Please note that the primary regulatory contact at each MSRB-registered municipal advisor firm automatically receives regulatory notices from the MSRB.

Firms Withdraw as MAs Ahead of Final Rule.

WASHINGTON — Dozens of firms have withdrawn their registrations as municipal advisors under the new regulatory regime that takes full effect Tuesday, citing a myriad of reasons for avoiding participation in a new era of muni advising.

Beginning July 1, individuals and firms providing advice to state and local governments about the issuance of muni bonds or the investment of muni proceeds or escrows must begin registering under the Securities and Exchange Commission's permanent MA regime. More than 1,100 MAs temporarily registered with the commission, including major broker-dealer firms, single-proprietor advisory firms, lawyers, and other professionals. But by the eve of the rule's final effective date, many of those temporary registrants had decided not to remain registered as MAs.

"I haven't really been doing municipal advisory work, said Alexis Jackson, president of A.A. Jackson & Associates in Stone Mountain, Ga. Jackson, a lawyer and finance consultant, said she registered as an MA early in the regime because she had a client that wanted to do a tax-exempt deal. She said a subsequent change in the lending market led her to withdraw her registration in 2011, before the SEC's final rules were unveiled, because that one deal she registered for was scuttled.

Other market participants also indicated that they are no longer active in markets that would require them to be registered MAs. Peter Kvam, manager of investments and compliance at Healthcare Community Securities Corporation in New York, said his firm was one which decided to play it safe by registering rather than risk the consequences of practicing as an unregistered MA. Although the final rules have not been effective, MAs have already been required to register under a temporary regime and have been subject to a fiduciary duty and fair play rules.

"We took the conservative approach," Kvam said.

The company decided to withdraw earlier this year because it no longer carries 529 college savings plans, the only aspect of its business that it felt might trigger any obligation under the MA regime.

Other market participants said they simply decided not to get into the municipal advisory game after all.

“Not something I wanted to do right now,” said Mallory Factor, a manager at Caelus Consulting, which solicits business for investment firms.

Nathan Howard, an attorney who works with municipal advisors, said the many withdrawals are the result of guidance that has made it more clear who is likely to be an MA in the view of the SEC staff. In recent months, the SEC has published two sets of interpretive guidance in the form of “frequently asked questions.” That guidance explained that firms could be exempted from having to register as MAs under some circumstances, including if an issuer had retained its own independent MA, if the firms were responding to a legitimate request for proposals, or if they were offering certain types of advice permissible for their professions. Bond lawyers, for example, would not have to register as MAs as long as they do not cross the line from providing traditional legal services to providing professional financial advice or holding themselves out to be financial experts.

The recent withdrawals are reflective of the broad registration exemptions granted by the SEC that are set to take effect on July 1, which will allow many firms to provide advice without triggering any fiduciary duty obligations,” Howard said. “The withdrawals are also resulting from the growing number of firms who have determined to cease their municipal advisory business either due to prospective costly regulation or an increase in acquisition activity.”

Some market observers continue to predict that large numbers of MAs, particularly smaller sole proprietorships, are likely to fold up shop rather than deal with the fees, tests, and other requirements imposed by the still-growing MA regulatory regime. Although the MA rule is ultimately just one small piece of the 2010 Dodd Frank Act and the SEC rule is now final, the Municipal Securities Rulemaking Board is still in the process of writing rules which will dictate the behavior of muni advisors. Of central concern to dealer and non-dealer MAs alike is the MSRB’s proposed Rule G-42 on the duties of non-solicitor municipal advisors, which is undergoing revision. While the law says that MAs have a fiduciary duty to put their municipality clients ahead of their own, it is up to the MSRB to create a regulatory framework that defines precisely what that means.

SEC Muni Chief John Cross has said previously that he expects the number of registered MAs under the final regime to be similar to that under the temporary one.

The Bond Buyer
BY KYLE GLAZIER
JUN 30, 2014 3:00pm ET

MSRB Reminds Dealers of July 7, 2014 Effective Date for Fair-Pricing Rule Changes.

The Municipal Securities Rulemaking Board (MSRB) reminds municipal securities dealers that a revised MSRB Rule G-30, which consolidates dealers’ existing fair-pricing obligations to facilitate compliance with a fundamental investor protection regulation, becomes effective on July 7, 2014.

View the new rule or the May 12, 2014 MSRB Regulatory Notice.

[SEC's Harvey Action Illustrates MCDC Vulnerability for Issuers.]

WASHINGTON — The Securities and Exchange Commission's enforcement action against Harvey, Ill., and its comptroller may give issuers pause about participating in the SEC's self-reporting program, a top municipal bond lawyer said.

John Grugan, a partner in Ballard Spahr's Philadelphia office, said the SEC's most recent muni enforcement action is a perfect illustration of why it's unrealistic to expect all issuers to participate in the commission's Municipalities Continuing Disclosure Cooperation initiative. In a civil suit filed earlier this week in the U.S. District Court for the Northern District of Illinois,, the SEC accused the city and comptroller Joseph Letke of misusing bond proceeds and misrepresenting investment risks and Letke's own financial interests in connection with bond offerings in 2008, 2009, and 2010. A federal judge blocked an imminent sale of the Chicago suburbs bonds at the request of SEC lawyers, an almost unheard-of step in the municipal market.

Grugan, who is co-leader of Ballard's municipal securities regulation and enforcement group, said that the case is a straightforward misuse of bond funds action on its face, not much different from many others the SEC has charged over the years. But this case came to light during the MCDC period, and was brought by the Chicago office where MCDC architect Peter Chan works, Grugan pointed out. The MCDC allows issuers, other borrowers and underwriters to get lenient settlement terms if they voluntarily self-report certain disclosure failures to the SEC by Sept. 10, but the commission has been clear that the settlement will not apply to individuals and will not cover violations other than offering documents that paint a false picture of the issuer's continuing disclosure record.

"This case illustrates how the SEC, once it begins its investigation, can go in different directions," Grugan said. "It can mushroom into something that's not controllable by the issuer."

There is no indication that Harvey attempted to participate in the MCDC, Grugan said, adding that the kind of activity alleged in the case could be easily discoverable by SEC investigators and would not fall under the MCDC's lenient terms, which include immunity from civil penalty for muni issuers. Some securities lawyers have said publicly that participation in the initiative is a slam dunk for all underwriters and most issuers.

Robert Feyer, senior counsel at Orrick, Herrington & Sutcliffe in San Francisco, said the case represents another exclamation point on the SEC's increasingly vocal vows to be tough on muni securities lawbreakers.

"It's certainly a significant action," Feyer said.

Lawyers said it was unclear if the SEC could pursue action against Letke under the municipal advisor regime. According to court documents, Letke ran two companies which both were registered municipal advisors and provided financial advisor services regarding the issuance of municipal bonds to Harvey and other municipalities. Most of the MA regulatory regime remains in effect and most of the conduct mentioned in the complaint pre-dates the 2010 Dodd-Frank Act, after which all MAs have been subject to fair dealing rules.

The case does have some parallels with a 2001 enforcement action against Pacific Genesis Group, Inc., a municipal securities underwriting firm based in Alameda, Calif., and its former lead underwriter, David Fitzgerald. In that case, filed in late 2000, a judge ordered all proceeds of a recent bond offering be returned to investors when the SEC accused the firm of raising money for residential developments via misleading offering documents. Fitzgerald went on to lose his broker's license.

The Bond Buyer
BY KYLE GLAZIER
JUN 26, 2014 5:25pm ET

[Ballard Spahr: SEC Announces First Investment Adviser 'Pay-to-Play' Enforcement Action.]

The U.S. Securities and Exchange Commission (SEC) announced its first enforcement action under "pay-to-play" rules for investment advisers since those rules were adopted nearly four years ago. TL Ventures Inc., a Philadelphia-area private equity firm, has agreed to pay nearly $300,000 in disgorgement and penalties to settle the charges that it continued to receive advisory fees from city and state pension funds after making mayoral and gubernatorial campaign contributions.

[Continue reading.]

June 24, 2014

by M. Norman Goldberger, John C. Grugan, Christine O'Neil, and Tesia N. Stanley

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[NYT: S.E.C. Stops City in Illinois from Selling Municipal Bonds.]

Federal regulators went to court on Wednesday to keep a city in Illinois from bringing its bonds to market, an unprecedented step they called necessary to halt a widening securities fraud.

The Securities and Exchange Commission, in a complaint filed in United States District Court for the Northern District of Illinois, said that Harvey, an impoverished city of 25,000 south of Chicago, had sold $14 million in municipal bonds under false pretenses since 2008 and was planning to bring more of them to market this week.

Harvey issued bonds three times from 2008 to 2010, telling investors it was using the proceeds to rebuild a large Holiday Inn near a busy stretch of Interstate highway, something that was supposed to create jobs and bolster the city's fortunes. It used a legal provision that allows cities to share the value of their bonds' tax exemption with commercial companies for such projects.

Harvey said it would repay the debt from a dedicated stream of taxes it was counting on, including taxes collected from the travelers who would stay at the hotel. But the prospectus also called the securities "general obligation bonds."

Instead of renovating the hotel, the S.E.C. said, Harvey was using some of the money to meet its payroll and for other general operations. The developer who received most of the bond money moved to India, leaving a half-gutted hotel building standing empty "with dangling wires and exposed studs," the S.E.C. said. Work on the derelict site is at a standstill, and no one can stay at the hotel, much less pay the occupancy taxes pledged to bondholders.

Despite these many setbacks, the S.E.C. said, Harvey planned to bring a new batch of tax-exempt bonds to market as soon as this week — this time to build a supermarket — and its draft prospectus failed to tell prospective buyers about its previous bond disaster, which is still unresolved.

In addition to the city, the S.E.C.'s complaint named Harvey's comptroller, Joseph T. Letke. It said that Mr. Letke, an accountant, had worked at the same time for the city and for the developer who was given the bond proceeds to rebuild the hotel. He received $269,000 of the proceeds without disclosing the payments, as required, it said.

Mr. Letke's lawyer, Dean Polales, declined to comment.

In its complaint, the S.E.C. asked the court to prohibit Harvey and its officials from offering any municipal bonds for five years unless it retained a court-appointed independent consultant to make the offering legal. It also asked the court to make Mr. Letke forfeit ill-gotten gains and pay unspecified civil penalties.

The action against Harvey was the first time the S.E.C. sought an emergency court order to keep a municipality's bonds off the market, according to a person briefed on the case, who spoke on the condition of anonymity because the investigation was continuing.

"We moved quickly to stop this city and its comptroller from issuing more bonds under false pretenses," Andrew J. Ceresney, director of the S.E.C.'s enforcement division, said in a statement. "We will continue to aggressively pursue municipalities and public officials who raise money through fraudulent bond transactions that harm both investors and residents."

Throughout its existence, the S.E.C. has had only limited authority to police the municipal bond market. The law assumes that cities are under the control of the states, which are sovereigns. But in recent years, as municipal bankruptcies and bond defaults have become more common, the commission has been finding ways to step up its activities in the $3.7 trillion municipal bond market.

It has censured two states, New Jersey and Illinois, for misleading investors about their pension systems, for example, saying they papered over the risk that investors might find themselves competing with pensioners for the same limited pool of dollars — something that has happened in the bankruptcy of Detroit.

Bondholders have expressed surprise and anger at the way Detroit proposes to settle its debts, prompting market participants to look more carefully at city finances in general and the quality of the resources pledged to secure bonded debt.

By MARY WILLIAMS WALSH JUNE 25, 2014

The SEC Halts Fraudulent Bond Offerings in Harvey, Illinois.

A Chicago suburb is under investigation for allegedly diverting at least $1.7 million in bond proceeds meant for a new hotel to instead pay for the municipality's operating costs including wages, the Securities and Exchange Commission announced Wednesday.

The SEC has filed fraud charges in U.S. District Court for the Northern District of Illinois against the city of Harvey, Ill., and its comptroller, Joseph Letke, who the SEC says received approximately $269,000 in undisclosed payments from the bond proceeds. The commission also halted a planned bond offering by the city this week via an emergency court order.

“We moved quickly to stop this city and its comptroller from issuing more bonds under false pretenses,” Andrew Ceresney, director of the SEC’s Division of Enforcement, said in an issued statement. “We will continue to aggressively pursue municipalities and public officials who raise money through fraudulent bond transactions that harm both investors and residents.”

In 2008, 2009 and 2010, Harvey issued limited obligations bonds that were to be repaid from dedicated tax revenue streams such as Harvey’s hotel-motel tax, sales tax or incremental tax from the Tax Increment Financing District created for the planned Holiday Inn development. The payback structure meant that it was vitally important to bond investors that the money raised in the bond offering was actually used to fund the hotel development. That’s because the amount of funds available to repay the bonds were derived from tax revenues collected by the project — and those revenues would be materially affected by the funding and progress of the project.

However, the SEC alleges that Harvey’s bond investors were misled about the purpose and risks of the bonds they purchased from the city. The SEC’s release cited news reports that described the Holiday Inn hotel and conference center as “a decrepit shell” with a façade pocketed with holes and a gutted interior with dangling wires and exposed studs.

“As Harvey and Letke perpetrated the scheme to divert bond-related proceeds,” the commission said, “the hotel redevelopment project turned into a fiasco for bond investors and city residents.”

The SEC action comes as part of increased enforcement by the commission on municipalities and states. Last year, the commission reached independent settlements with the Illinois and Harrisburg, Pa. The commission had accused both governments of securites fraud. It said Illinois had misled investors about the poorly funded state of its pensions while accusing Harrisburg of misleading investors by not reporting important city financial data. Both governments reached financial settlements with the SEC and did not have to admit to wrongdoing.

This is the first fraud charge by the SEC this year against a government. The commission has hinted at more to come. This spring, the Enforcement Division announced a self-reporting offer, encouraging “issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws rather than wait for their violations to be detected.” In exchange, the SEC is promising “standardized, favorable settlement terms,” but did not specify what those terms could be. The offer stands until Sept. 10.

BY LIZ FARMER | JUNE 25, 2014

WSJ: SEC Is Gearing Up to Focus on Ratings Firms.

Moves by Head of the Agency’s Office of Credit Ratings Signal Potential Flurry of Regulatory Activity

The government’s top credit-rating watchdog has kept a low profile since taking the job two years ago to help prevent another financial crisis. That may be about to change.

Thomas J. Butler, head of the Securities and Exchange Commission’s Office of Credit Ratings, said he has referred multiple cases to the agency’s enforcement division and is helping complete several industry regulations to address quality and transparency in how big debt deals are rated.

Those moves signal a potential flurry of regulatory activity involving ratings firms, which have been largely untouched as government oversight has increased in most other financial sectors in recent years.

Mr. Butler, a 56-year-old former Citigroup Inc. C -0.19% executive, has been relatively quiet since launching the office in 2012 to oversee firms including Standard & Poor's Ratings Services and Moody's Investors Service. MCO +1.06% The creation of the office was mandated in the Dodd-Frank financial-overhaul law.

His office has produced annual reports summarizing industry activity and monitored ratings firms to make sure they comply with existing rules that dictate how criteria are developed for evaluating bonds and whether internal protocols are followed, among other things. Mr. Butler's office doesn't have direct enforcement powers over firms, but monitors their activities and can make referrals to the unit headed by Andrew Ceresney, the SEC's top enforcement chief, for potential action. Mr. Butler declined to say how many referrals he has made or what firms are involved.

Some critics have questioned whether the office has moved quickly enough to bring substantive changes to an industry widely blamed for helping trigger the financial crisis, largely by giving top ratings to mortgage bonds that later soured and left investors with billions in losses.

They point out the three biggest firms—S&P, Moody's and Fitch Ratings—still dominate the industry, despite lawmakers saying they hoped to attract new entrants. Momentum to adopt major revisions, such as changing the business model or standardizing ratings across asset classes, also has petered out.

"While we've made some progress, I'm frustrated that key reforms still aren't fully implemented," said Sen. Al Franken (D., Minn.), who wrote a Dodd-Frank amendment in 2010 that would have overhauled the credit-rating business model but hasn't been adopted. Issuers of bond deals pay ratings firms to grade their deals, a model that Sen. Franken and others have said gives firms an incentive to compromise their criteria in order to win business.

In an interview, Mr. Butler acknowledged his office has work left to do, but said, "I couldn't be happier with what we've accomplished." He added that he is seeing "real results" from the firms responding to the findings in the annual reports and recommendations from his staff in routine examinations.

Other SEC officials have similarly indicated the ratings world is increasingly in focus.

Chairman Mary Jo White told Congress in late April that rules improving transparency and rating integrity "are a priority for the commission in 2014." Mr. Ceresney, the enforcement chief, at a Wall Street Journal event last week in Washington said, "You'll see a lot of activity" with credit-rating firms in the near future.

Since the financial crisis, the SEC has taken action against one ratings firm, Egan-Jones Ratings Co. The small firm was barred from rating certain bonds for 18 months, starting in January 2013, for allegedly overstating the number of ratings it had done. "We are glad the matter is behind us," said Alan S. Futerfas, a lawyer for Egan-Jones President Sean Egan.

Mr. Butler is a ratings-world outsider. A Rutgers University law graduate, he spent 14 years at what became Morgan Stanley Smith Barney, Citigroup's former wealth-management joint venture with Morgan Stanley. His roughly 40-person staff represents less than 1% of the SEC's total workforce. Mr. Butler spends most of his time in lower Manhattan, working out of a sparse office with little more than government-issued furniture and a few photos of his dogs.

Mr. Butler said his staff is developing rule recommendations for Chairman White that clarify what disclosures should be made and how best to separate analysts from sales staff. Those recommendations, done with the SEC's Division of Trading and Markets, will be completed versions of regulations that were first proposed in 2011 but not yet implemented.

Rating firms have largely embraced regulation and Mr. Butler's team, saying they give investors added insight into how ratings are determined. Moody's shares the SEC's goals of making the ratings process easier to understand and effective, said a Moody's spokesman.

Adam H. Schuman, chief legal officer for Standard & Poor's Ratings Services, which is owned by McGraw Hill Financial Inc., MHFI +0.59% said Mr. Butler's annual reports have given useful guidance on what the firm should be doing for compliance.

Many smaller firms say some of the regulations and compliance requirements disproportionally affect them, making it harder for new players to emerge. "It's expensive and far easier for the bigger firms to absorb those costs" around email retention, recordkeeping and compliance, said Joseph Petro, chief operating officer at Morningstar Credit Ratings LLC.

By TIMOTHY W. MARTIN
Updated June 25, 2014 1:29 p.m. ET

Write to Timothy W. Martin at timothy.martin@wsj.com

Panelists Dissect MA, MCDC Impact on Issuers.

SEATTLE – Small issuers and firms will be most impacted by the imminent regulatory changes that the municipal industry will soon undergo, according to issuers, underwriters, and financial advisors speaking at The Bond Buyer's Pacific Northwest Municipal Market Symposium on Tuesday.

With just one week left before the municipal advisor rule takes full effect, market participants anticipated how the rule will impact the market.

"I've been a financial advisor for 28 years and there's no question that this is the biggest change I've witnessed in these years," Chip Pierce, a partner at Western Financial Group, LLC, said during the conference.

Once the rule takes effect July 1, firms providing advice on the issuance of muni bonds or the management of muni proceeds or escrows will be required to register with the Securities and Exchange Commission and the Municipal Securities Rulemaking Board.

The SEC has made clear that absent a firm's ability to utilize one of several exclusions or exemption available in the rule, providing muni advice bars a firm from underwriting a bond issuance on the same transaction.

The amount of time and money needed to comply with the regulations is significant, panelists said.

"There's no question this is going to disadvantage smaller firms," Pierce said.

Small advisory firms will likely take the biggest hit from rule's implementation, having to consolidate or lose staff in order to deal with the greater costs of compliance, according to Pierce.

That will particularly disadvantage less-frequent issuers, because small firms have historically sought their business and large firms may not see it as worth their while for an issuer that issues every three years or so, he said.

Bob Lamb, president of Lamont Financial Services Corporation, said his firm will likely end up spending 20% of its effort complying with new rule, adding 0% to its productivity.

Firms will take different strategies to deal with the greater need for compliance, whether they staff current employees or hire third parties.

Pierce likened his firm's deliberation on how to deal with increased compliance to a game of "hot potato"—whoever was left holding the potato will have had to be chief compliance officer.

He said they ended up deciding to pay someone else to "hold the potato," which will cost Western Financial an estimated $10,000 to $15,000 extra a year.

"This is a new landscape," he said. "It is what it is, but it's taking away from things we pride ourselves on."

Another possible outcome from the rule's implementation is a continued shift among issuers away from the tax-exempt bond market and toward the banking and direct loan market.

Leslie Norwood, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said there has already been some movement, but she wouldn't be surprised if the new rule further contributed to the shift.

Market participants also discussed the implications of the SEC's Municipalities Continuing Disclosure Cooperation Initiative, which aims to come down on municipal and underwriters that have violated federal securities laws.

Specifically, the MCDC initiative will address violations of Rule 15c2-12, which prohibits underwriters from purchasing or selling municipal securities unless the issuer has committed to providing continuing disclosure regarding the security an issuer.

It also requires that official statements contain a description of any instances in the previous five years in which the issuer failed to comply with any previous commitment to provide such continuing disclosure.

Under MCDC, underwriters and issuers have until September 10 to voluntarily fill out a questionnaire to report any type of material misstatement in return for receiving favorable settlement terms.

Smaller issuers are less likely to have the resources needed to understand and comply with the initiative, said Robert Feyer, senior counsel at Orrick, Herrington & Sutcliffe LLP, and moderator for the panel.

He added that legal counsel can help guide issuers on what might be considered material statements, but it's up to each issuer to determine its own risk tolerance and whether it's in their best interest to self-report.

Laura Lockwood-McCall, director of debt management division at the Oregon State Treasury, said she has thought long and hard about whether or not to cooperate with the initiative and self-report.

Since there's the possibility that the underwriter might report on any violations of the issuer, it's a huge risk not to report.

However, Lockwood-McCall said that before deciding whether or not to report, issuers should first go over all of their municipal bond issuances in the past ten years to see if they have, in fact, any materially inaccurate statements.

Lockwood-McCall herself created a database of all Oregon's issuances in the past ten years, and mailed a list to the bankers on each issue to ask them to notify the state if they planned to report on anything.

"We are relying on the word 'cooperation' in the MCDC Initiative's title," she said.

Brian Hellberg, an RBC Capital Markets director for municipal finance policy and procedure, also said that there will need to be a significant amount of cooperation, especially since much of the information is in the hands of the issuer.

He referred to the situation as a "prisoner's dilemma," because of the possibility underwriters will self-report a problem under the MCDC program that an issuer has decided not to.

"The next two months will be about working through the process," Hellberg said. "Not until all the cards on the table will we be able to decide about material statements."

The consequences for an issuer that does not participate in the MCDC self-reporting program and subsequently faces SEC charges for what it didn't report are serious, Feyer said. And underwriters have an incentive to report as much as possible, he said, because they can reduce potential future liability while there is a cap on their total financial penalties under the program.

BY TONYA CHIN
JUN 24, 2014 6:21pm ET

MSRB Reminds Dealers of July 5, 2014 Effective Date for Fair-Dealing Rule Changes.

The Municipal Securities Rulemaking Board (MSRB) reminds municipal securities dealers that consolidated fair-dealing obligations, contained in revised MSRB Rule G-19 on suitability of recommendations and transactions, new MSRB Rule G-47 on time of trade disclosure obligations, and new MSRB Rules G-48 and D-15 on sophisticated municipal market professionals, as well as related changes to MSRB Rule G-8, become effective on July 5, 2014.

Read the March 12, 2014 MSRB Regulatory Notice.

The MSRB will host a free educational webinar about upcoming rule changes to consolidated fair-dealing obligations for dealers on Thursday, June 26 from 3 p.m. to 4 p.m. ET. Register for the webinar.

Public Pensions Fire Back at SEC.

Major government associations are chastising the Securities and Exchange Commission's Daniel Gallagher for his public slamming of pension fund management during a speech he gave last month at a Municipal Securities Rulemaking Board summit. You may recall that Gallagher took a hard line on the way that public pension fund liabilities are calculated, chiming in on the side of conservative-minded economists who say that funds hide their true liabilities. In particular, he pointed to the now familiar argument about which discount rate to use in calculating a pension's liability (the higher the discount, or investment rate of return, the lower the assumed liability).

Gallagher accused plans of not being transparent and for playing numbers games. This week, in response, 11 government associations including the National Governor's Association and the National Association of State Retirement Administrators, called him out for highlighting a few bad apples. "We understand the SEC's interest in appropriate disclosure of state and local government pension obligations," the June 16 letter said. "However, your comments could lead many to believe that the disclosure issues are systemic, rather than individualized problems."

Almost snidely, the letter adds that the commissioner "may not be aware of" governments' actions in this arena and goes on to list the many types of pension reforms that they have implemented in recent years to manage their liabilities, in addition to establishing a pension funding task force that made recommendations to elected officials. The letter concludes by offering to discuss these reforms and upcoming disclosures changes further with the commissioner.

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NYT: S.E.C. Chief Seeks to Enhance Disclosure in Bond Markets.

The Securities and Exchange Commission is seeking to shine a light on trades in the relatively opaque markets for corporate and municipal bonds.

Mary Jo White, the head of the S.E.C., said in a speech on Friday that she had asked the agency to pursue an effort to make information about bond prices more widely available. The initiative, which would require the public dissemination of price quotes generated in alternative trading systems and other electronic markets, could enhance transparency in a sector of Wall Street where middlemen may now have an advantage over investors, Ms. White said.

Just weeks after unveiling sweeping proposals for the stock market, Ms. White signaled a renewed commitment by the S.E.C. to treat oversight of bond trading as a priority. The agency in 2012 released several recommendations related to municipal bonds, but that report did not produce the changes that many in the market had expected.

The market for municipal bonds is highly fragmented, with tens of thousands of issuers and nothing resembling a centralized exchange. Even the market for corporate bonds, while more centralized and consistent than the municipal market, lacks an easy way for average investors to find information about price quotes. Bonds, in general, trade far less frequently than stocks.

A requirement to make more information public could eat into the profits of Wall Street brokerage houses, which can use the market's opacity to their advantage.

Ms. White, in the remarks delivered to the Economic Club of New York, indicated that the S.E.C. would support other regulatory bodies as they complete separate efforts to enhance oversight of the bond markets. She said the agency would work with the Municipal Securities Rulemaking Board, a self-regulatory body, as it finalizes a rule to make sure that investors in municipal bonds have their orders executed on the best available terms.

The agency would also collaborate with the Financial Industry Regulatory Authority, Wall Street's self-regulator, and the municipal board to help them provide guidance on how brokerage firms can follow the best-execution requirement, Ms. White said.

In addition, Ms. White said the S.E.C. would work with the two self-regulatory bodies as they write rules governing the disclosure of mark-ups in "risk-less principal" transactions. In that type of transaction, a brokerage firm executes a client's order by simultaneously executing an identical order in the market, with the intention of eliminating its own risk. Brokerage firms can charge a markup for this service.

Ms. White contrasted the bond market with the stock market, which she said had largely benefited from advances in technology. In the bond market, also known as the fixed-income market, it is an open question whether "the transformative power" of technology and competition has "been allowed to operate to the extent it should to benefit investors," Ms. White said.

"I am therefore concerned that, in the fixed income markets, technology is being leveraged simply to make the old, decentralized method of trading more efficient for market intermediaries, and its potential to achieve more widespread benefits for investors, including the broad availability of pre-trade pricing information, lower search costs and greater price competition, especially for retail investors, is not being realized," Ms. White said.

The S.E.C. chief's assessment of the bond markets followed her recommendations earlier this month for new rules in stocks, aimed at strengthening the structure of the stock market and improving disclosures for investors.

Her recommendations for the bond market were similarly aimed at improving disclosure.

"Properly implemented, rules providing for better pre-trade pricing transparency have the potential to transform the fixed income markets by promoting price competition, improving market efficiency and facilitating best execution," Ms. White said.

By WILLIAM ALDEN JUNE 20, 2014 1:17 PM

SIFMA Plugs New TOB Structure.

WASHINGTON — The Securities Industry and Financial Markets Association has sent a letter to numerous federal regulators arguing that the joint venture structure used for the first time last week to sell tender option bonds is compliant with the Volcker rule.

The five-page letter was signed by David Cohen and Matthew Nevins, managing directors and associate general counsel for SIFMA's municipal securities division and the asset management group, respectively. It was addressed to the regulators responsible for implementing the Volcker rule, including the Securities and Exchange Commission, Federal Reserve, Federal Deposit Insurance Corporation, Comptroller of the Currency, and Commodity Futures Trading Commission. The letter seeks to communicate to the regulators that the joint venture trust structure laid out in an accompanying term sheet is a legal solution for the TOB market, the SIFMA lawyers said.

TOB programs have traditionally provided a supply of short-term tax-exempt bonds to money market funds, and have generally accounted for approximately 25%-30% of the assets of muni MMFs, according to Fitch Ratings. In a traditional TOB program, the sponsor will deposit a fixed-rate bond or note into a trust, which will issue two new certificates — a floating rate certificate sold to a money market fund and a residual certificate which may be sold to a mutual or closed-end fund or held by a bank. The floating rate certificate will have a tender option, through a liquidity facility that is typically issued by the program's sponsor or an affiliate, that shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

But the Volcker Rule, finalized late last year, prevents banks and their affiliates from sponsoring a TOB program, owning a residual certificate issued by a TOB trust, or providing credit enhancement, liquidity, or remarketing services to these programs.

The joint venture solution, first used by Merrill Lynch, Pierce Fenner & Smith in an $8.5 million deal last week, relies on an exemption in the rule. Joint ventures that exist between banks or their affiliates and unaffiliated parties, and are exempt from the rule as long as they have no more than 10 unaffiliated co-venturers and only engage in activities permitted of banking entities. Under the new structure, banking entities will provide liquidity while a co-venturer holds the floating note and another holds the residual note.

Some experts have warned that regulators might view the JVTs as a re-definition of an existing structure to get around the rules, but Cohen and Nevins said in an interview that the structure represents months of work by "various SIFMA stakeholders" and the letter is intended to inform the regulators of the group's reasoning.

"We wanted to inform the regulators of our solution," Cohen said. "It allows the market to move forward in an orderly fashion."

Nevins said the various attorneys and market experts who worked on the project came to the consensus that the JVT structure complies with Volcker and is the most logical way forward.

"I think what we've done is in the spirit of what the regulators have done under the Volcker rule," he said.

The JVT structure is likely to be the way the TOB market is going to operate going forward, said Cohen. Some market participants have floated a second idea, which would swap the bank sponsor out for a non-banking entity such as a mutual fund or a dealer. That option would not work for banks.

Rating agencies had previously said that the TOB market would "unwind" in the months following the final Volcker Rule, but have since dubbed the emergence of the JVT structure a positive development that can keep the market functioning.

BY KYLE GLAZIER
JUN 16, 2014 1:39pm ET

BDA Sends Letter to SEC; Suggests Modified Approach to MCDC Initiative.

The Bond Dealers of America sent a letter to the SEC, urging limitations to the scope of its Municipal Continuing Disclosure Cooperation (MCDC) Initiative.

The letter, sent to the SEC Chairman and Commissioners states that the MCDC initiative has caused a financial and personnel investment by issuers and underwriters that goes beyond what is needed to achieve the goals of the SEC because its scope relies upon the now defunct NRMSIR system.

Specifically, the asks that the deadline be extended until December 15 and that the scope of the initiative is limited to access to information on the MSRB's EMMA website, which dates back to 2009.

You can view the full letter here.

Web Tool Offers Pricing Information for Municipal Bonds.

The self-regulatory organization overseeing municipal bonds introduced on Monday a new way for investors to analyze prices in the often opaque market.

The Municipal Securities Rulemaking Board launched a tool on its Electronic Municipal Markets Access website designed to enable users to more easily find and compare prices for municipal securities with similar characteristics, such as geography, interest rates and maturity.

The tool will provide side-by-side comparisons of price and yield for up to five bonds at a time. It also can produce a graph of a bond's historical pricing.

"It's another tool to allow retail investors to better understand the value of bonds that they own or are considering purchasing," Lynnette Kelly, MSRB executive director, said. "They're better able to have access to information so that they can have more constructive conversations with their investment professionals."

Investment advisers said that the web tool would help them and their clients.

"It's a really good step forward, and it's long overdue," said Richard Goldman, principal at Conscient Capital. "The municipal securities market has been a backwater in terms of price transparency."

As advisers switch from putting their clients in bond funds to placing them in individual bonds, the MSRB tool will assist them in making recommendations, according to Michael Kitces, a partner and director of research at Pinnacle Advisory Group.

"Anything that provides greater transparency so that advisers can get prices for bonds is good," Mr. Kitces said. "More transparency allows us as advisers to understand if we're getting good execution and to hold accountable our trading and brokerage arrangements that we use."

The EMMA tool will help investors, but it won't be able to tell them precisely how much they should be paying for a bond because markups are still hidden, according to Bradford Pine, president of Bradford Pine Wealth Group.

"That's where it need to be more transparent – [the price] where the adviser is buying it and where, ultimately, the client purchases it," Mr. Pine said. "You need to work with an adviser you trust and feel comfortable with. It's still a very fragmented market that needs be corrected."

In another move to strengthen pricing fairness, the MSRB at its meeting in early May agreed to send a rule to the Securities and Exchange Commission that would require bond dealers to use "reasonable diligence" in obtaining the best execution price for retail investors.

The SEC must approve MSRB rules and will ask for public comment on the best-execution rule.

Without a benchmark, such as a 10-year U.S. Treasury bond, the municipal market can be difficult to navigate among 50 states and hundreds of local governments that offer debt instruments to finance construction and other projects.

Recently, Detroit, New Jersey and Puerto Rico have been embroiled in controversies over bonds.

"The MSRB needs to put pressure on issuers to update their financial positions and make that information available to investors," Mr. Goldman said.

The biggest boon to market transparency is technology, such as the MSRB's EMMA site, according to Ms. Kelly.

"Technology has fundamentally changed the market," Ms. Kelly said. "The ability for retail investors to access information about pricing is better than it ever has been."

By Mark Schoeff Jr.
Jun 9, 2014 @ 2:08 pm (Updated 3:27 pm) EST

Mark Schoeff Jr. Email @twitter LinkedIn Google
Mark Schoeff Jr. covers legislation and regulations affecting investment advisers and brokers and wants to hear from you about how Washington policymakers are influencing your business.

Pair of U.S. Senators Urges Disclosure on Bond Markups.

(Reuters) – Municipal and corporate bond dealers would have to tell investors how much they charge to cover their compensation under bipartisan legislation currently in the U.S. Senate to end secret price markups.

The proposal, quietly introduced earlier this year by Virginia Democratic Senator Mark Warner and Oklahoma Republican Senator Tom Coburn, comes as momentum is growing among U.S. securities regulators to bring more transparency to the combined $13 trillion-plus municipal and corporate bond markets.

This week, executives from Charles Schwab met with federal lawmakers, Securities and Exchange Commission officials and other regulators to advocate for requiring disclosure on municipal bond markups.

"It's very opaque and somewhat confusing to investors," said Peter Crawford, a senior vice president at Charles Schwab.

"One of the things we have found in this over-the-counter market is the degree of price difference from one dealer to the next can be significant."

Most individual investors, the $3.7 trillion municipal bond market's backbone, are in the dark about how much dealers add to prices in trades.

Complicating matters, regulation on compensation is hazy. Currently, dealers must disclose if they act as agents facilitating trades but not if they act as principals in the trades. For most trades in the municipal market, then, dealers are "riskless principals," purchasing securities from their customers and immediately reselling them to other dealers.

Crawford, whose firm levies a flat charge of $1 per bond transaction to customers, said Charles Schwab has studied the lack of disclosure for about seven years.

The brokerage analyzed a California general obligation bond with a 5.25 percent coupon bond offered by five different dealers on its trading platform. It found the prices ran from $120.938 to $124.10, which meant on a $10,000 trade there was a $316.40 difference in prices.

The current federal push on dealer compensation in the municipal market began two years ago, when a comprehensive SEC report found individual investors pay more for bonds than institutions because they lack information, specifically about markups and markdowns.

In recent months the call for change has grown louder, with SEC Republican Commissioner Michael Piwowar saying in January retail investors must be given a better sense of markups.

Last month, his fellow SEC Republican Commissioner Daniel Gallagher said "'riskless principal' is basically just a fancy name for 'agency,'" and disclosing markups and markdowns "would enable customers to assess the fairness of the execution prices."

Meanwhile, the two self-regulatory organizations helping the SEC oversee the bond markets are focusing on the issue.

The Municipal Securities Rulemaking Board is currently taking steps that may lead to new rules on riskless principal transactions. At the same time the Financial Industry Regulatory Authority is "reviewing" the issue for corporate bonds, Richard Ketchum, its head, told reporters last month.

Crawford said this was the firm's first visit to Washington policymakers about markups, which was inspired by Piwowar's comments.

Thu Jun 5, 2014 3:24pm EDT
By Lisa Lambert and Sarah N. Lynch

Ballard Spahr: SEC Charges Charter School Operator with Disclosure Violations, Suggests It May Charge Individuals.

This publication was written by members of Ballard Spahr's Municipal Securities Regulation and Enforcement Group.

The U.S. Securities and Exchange Commission recently charged a Chicago charter school operator with defrauding investors in a $37.5 million bond offering by failing to disclose transactions that presented conflicts of interest. According to the SEC's complaint, UNO Charter School Network, Inc.

(UNO) failed to disclose a multimillion-dollar construction subcontract with a company owned by a brother of UNO's Chief Operations Officer, as well as the potential impact of this transaction on UNO's ability to repay its bond obligations. This announcement is notable both in itself and for what may be forthcoming: SEC officials have stated that the agency may bring charges against individuals in the ongoing investigation.

UNO has settled the complaint without admitting to or denying the charges. The settlement can be instructive for issuers and underwriters determining whether to self-report under the SEC's Municipalities Continuing Disclosure Cooperation Initiative (MCDC).

The MCDC, spearheaded and publicized by the SEC's Chicago Regional Office, which is handling the case against UNO, allows issuers and underwriters to voluntarily report materially inaccurate statements made in offering documents regarding prior continuing disclosure obligations in exchange for lesser sanctions. When determining whether to self-report, however, an issuer or underwriter must determine whether its prior disclosure lapses were material—a determination that can be difficult to make, particularly in a realm involving mostly settled actions.

In announcing its charges against UNO, however, the Chicago Regional Office demonstrated that there is a category of disclosures that it considers material—those relating to the issuer's ability to repay the bonds. As the SEC noted, "[i]nvestors had a right to know that UNO's transactions with related persons jeopardized its ability to pay its bonds because they placed the grant money that was primarily funding the projects at risk." Determinations of whether to self-report under to the MCDC still must be made on a case-by-case basis, but this case may provide a guidepost regarding the SEC's view on materiality.

A more detailed analysis of the complaint is available here.

June 4, 2014

Ballard Spahr's Municipal Securities Regulation and Enforcement Group helps municipal market participants navigate a rapidly evolving regulatory, investigative, and enforcement environment, enabling them to anticipate and address compliance issues and respond effectively to investigations when necessary. For more information, please contact John C. Grugan at 215.864.8226 or gruganj@ballardspahr.com or Christine O'Neil at 215.864.8228 or oneilc@ballarspahr.com.

MSRB Seeks Approval to Amend Rule G-3 to Eliminate FINOP Requirement and Limit Permissible Series 6 Activities.

The Municipal Securities Rulemaking Board (MSRB) today requested approval from the Securities and Exchange Commission of a proposal to amend MSRB Rule G-3(a) to: (1) limit the scope of permitted activities for a limited representative – investment company and variable contracts products to sales to and purchases from customers of municipal fund securities; (2) eliminate the FINOP classification, qualification and numerical requirements in MSRB Rule G-3(d); (3) clarify in Supplementary Material .01 to Rule G-3 that references to sales includes the solicitation of sales of municipal securities; and (4) make certain technical and clarifying amendments to Rule G-3.

These amendments will affect MSRB Rules G-3 (classifications of principals and representatives; numerical requirements; testing; continuing education), G-7 (information concerning associated persons) and G-27 (supervision).

View the rule filing.

Reminder: Complete New MSRB Registration Form by August 10.

Effective May 12, 2014, MSRB Rule A-12 was amended to consolidate MSRB registration requirements into a single rule and to create a simplified electronic registration form. Municipal advisor firms that are currently registered with the MSRB under the previous requirements must verify, update and complete their registration information in the new form by August 10, 2014. The MSRB provides a number of educational resources below to assist municipal advisors with submitting their first Form A-12.

- MSRB Registration Manual
- Checklist on Preparing to Submit MSRB Form A-12
- FAQs on MSRB Registration
- Guidance on the MSRB Municipal Advisor Registration Process
- Webinar on the New Registration Rule and Form (June 12, 2014)

SEC's Gaunt Sees Fines for Muni Bond Breaches: Five Questions.

The head of the U.S. Securities and Exchange Commission's unit overseeing municipal bonds and pensions is urging local governments to come clean if they failed to keep investors informed about the state of their finances.

If they do: Localities can escape fines, while Wall Street firms that sold their bonds would see them capped at $500,000. If not: "They absolutely should be expecting harsher sanctions."

Gaunt took over in November, policing a $3.7 trillion market coping with record bankruptcies, depleted pension funds and new rules aimed at protecting localities from banks and once-unregulated financial advisory firms.

The unit has charged New Jersey, Illinois, and Harrisburg, Pennsylvania, with fraud for misleading investors about deteriorating finances. In November, it took a new tack, fining a Washington authority that defaulted on hockey-rink bonds after hiding misgivings, marking the first financial penalty against an municipal issuer.

Following is condensed from a recent telephone interview about her priorities as the market's top enforcement official:

Q: In March, the SEC offered leniency to municipalities and underwriters in cases where buyers were told that a borrower had been providing adequate updates on their financial affairs, even when they weren't. They have until September to report violations. What has the response been?

A: On the one hand, it's a little disturbing that they don't know whether they have been in compliance. On the other hand, it's great that people are trying to get their houses in order. We certainly hope that if they find problems, they take advantage of the initiative. They absolutely should be expecting harsher sanctions if they elect not to.

Q: Since last year the agency has been scrutinizing the disclosures of distressed borrowers. Can we expect enforcement actions to result?

A: We certainly are seeing situations where issuers would have strong incentives to be less than fully candid. We're going to be prepared to bring enforcement actions when we find the right kind of cases. We are actively monitoring distressed issuers, including whether they are continuing to comply with their disclosure obligations. Our Harrisburg case was particularly instructive. Harrisburg had not been complying, creating a kind of information vacuum, which is particularly dangerous for an issuer that's in distress.

Q: During the financial crisis, municipalities were hurt by complex transactions. Since Dodd-Frank, the Municipal Securities Rulemaking Board has updated its rules to put added requirements on underwriters' dealings with municipalities. What is the agency's approach toward enforcing regulations aimed at protecting issuers?

A: We're looking at the conduct of banks as it relates both to issuers and investors. What you sometimes see is that conduct that hurts issuers also hurts investors. We're investigating cases where the posture is issuer as victim, as distinct from issuer as perpetrator. Are they being dealt with fairly? Are they getting competent advice from their advisers? Are these sensible structures? Are they getting the lowest possible borrowing costs? What are the risks? Are they getting unconflicted advice? That's a very high priority for us. That's a core focus.

Q: Are there areas of the municipal market where you feel there aren't sufficient regulations?

A: There's a lot of work to be done around issues associated with markups in the secondary market, just in terms of ensuring there's adequate disclosure to investors about what markups they're paying.

Q: Your division also oversees pensions. What is the agency's focus there?

A: There's a substantial intersection between underfunded pension funds and municipal securities issuers. Accurately reporting the extent of the underfunding is important, and the failure to do so could be materially misleading to investors.

Separately, we're focused on instances where pension funds have been victimized by bad behavior by other participants. We always have a very healthy stable of pay-to-play investigations. As we're seeing more pensions investing in alternative investments, we're interested in fee disclosures. Many pension funds are sophisticated. Many are not — and we're interested in whether they're receiving adequate disclosure about the fees associated with those types of investments.

By William Selway Jun 4, 2014

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To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Schoifet

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MSRB to Survey Municipal Advisors on Business Activities.

Alexandria, VA – To inform the development of a professional qualification exam for municipal advisors, the Municipal Securities Rulemaking Board (MSRB) will conduct a survey of registered municipal advisors later this month. The confidential electronic survey will assess the business activities of municipal advisory professionals.

An independent survey administrator will distribute the survey to those individuals at registered municipal advisor firms who are designated as a regulatory contact for the MSRB. Survey recipients are invited to distribute it to other appropriate professionals within the firm. Municipal advisors who have previously indicated a willingness to complete the survey will also receive the survey, which will run from the week of June 16, 2014 until early July 2014.

“The MSRB hopes to collect survey information from as many municipal advisor professionals as possible,” said MSRB Executive Director Lynnette Kelly. “Because of the diversity of the industry, responses from variety of firms will play a central role in guiding the MSRB’s work to develop a professional qualifications program that makes sense for all municipal advisors.”

The MSRB will host a webinar to provide detailed instructions for completing the survey on Wednesday, June 18, 2014 at 4:00 p.m. EDT. Registered municipal advisors will receive a registration link to the webinar from the MSRB.

NABL Recommends Treasury Revise SLGS Procedures.

NABL this week sent a letter offering Treasury officials alternative proposals to the current practice of suspending the sales of State and Local Government Securities (SLGS) subscriptions when the federal debt approaches the statutory limit. In the letter, NABL recommended several non-exclusive alternatives. One was that Treasury should “only suspend subscriptions for larger SLGS purchases,” making the cutoff at $10,000,000. “Since purchases of smaller quantities of SLGS have the most difficulty with alternative adjustments, suspensions of SLGS subscriptions over [the $10,000,000 limit] would solve the problems for many local government units.”

The letter also suggests that, if necessary, Treasury should “consider an increase of the advance subscription period when extraordinary measures are in effect.” NABL went on to explain that “small issuers could in extraordinary times adjust to a longer subscription period of… 10 days,” understanding that a longer period would make it easier to adjust treasury auctions in response to subscriptions for SLGS.

NABL also suggested that SLGS terms could be limited to a “relatively short period,” as short-term treasuries “are the most difficult to bid as an alternative to SLGS. The final recommendation from NABL was to “allow subscriptions for 0% SLGS during periods of extraordinary measures.”

The NABL letter can be seen here.

Brokers Under Fire from SEC Over Commissions on Muni-Bond Trades.

Retail investors buying municipal bonds may overpay for their trades because brokers aren’t always required to disclose their commissions, according to a member of the U.S. Securities and Exchange Commission.

Brokers who acquire bonds to fill an immediate customer order should be required to disclose how much they mark up the securities at sale, SEC Commissioner Daniel M. Gallagher said in a speech in Washington on May 29. Rules only require the broker to trade with customers at a "fair and reasonable" price, Gallagher said.

His comments underscore how regulators are focusing on the $3.7 trillion municipal-bond market, where retail investors constitute a majority of participants. The Municipal Securities Rulemaking Board is weighing a proposal to require that brokers seek the most favorable prices for clients in the municipal-bond market, which lacks a centralized exchange.

"It is still common for investors to place corporate- and municipal-bond trades by calling their broker for a quote, without much insight as to whether they are receiving best execution and a fair price," Gallagher told the rulemaking board's annual regulatory summit.

Meanwhile, the Municipal Securities Rule Making Board said today it will be making gauging the fair price for infrequently traded municipal securities easier next week with a new Web tool allowing investors to compare prices of similar bonds.

Gallagher also criticized state and local governments for understating the risk of their bonds by undervaluing pension liabilities. Lax accounting practices used to estimate those future payments "can amount to a fraud on municipal bond investors," Gallagher said.

"In the private sector, the SEC would quickly bring fraud charges against any corporate issuer and its officers for playing such numbers games," he said.

JUNE 2, 2014 • BLOOMBERG NEWS

Chicago's UNO Charter Schools Defrauded Bondholders, SEC Says.

(Reuters) – A Chicago charter school operator lied to holders of $37.5 million of municipal bonds about conflicts of interest and risked having to liquidate its schools, the U.S. Securities and Exchange Commission said on Monday in charging the operator with defrauding investors.

The SEC said UNO Charter School Network Inc did not admit or deny the charges, but agreed to a settlement where it would improve its internal procedures, including appointing an independent monitor. The commission's enforcement division is continuing to investigate, as well. The attorney for UNO did not respond to requests for comment.

The charges and settlement stem from a spending scandal that led the state of Illinois to suspend grants to UNO, which operates 16 charter schools. The scandal also prompted the resignation of UNO's long-serving Chief Executive Officer Juan Rangel in December, according to the Chicago Sun-Times.

According to a complaint filed in federal court in Chicago, UNO breached a conflict of interest provision in grants it received from the Illinois Department of Commerce and Economic Opportunity (IDCEO) to build three schools. It contracted with two companies owned by its chief operating officer's brothers, with one company installing windows for $11 million and the other acting as an owner's representative during construction. One of the brothers was a former UNO board member, as well, the SEC said.

The bond offering document had a specific section assuring investors of a "robust" policy against conflicts of interest, the SEC said. UNO also failed to tell investors that the commerce department could take back all of its grant money if the provision was violated.

“Had IDCEO exercised its rights under the grant agreements and recouped the entire amount of the grants, UNO would not have had the cash to repay the grants and therefore would have had to liquidate its charter schools – the very revenue-producing assets essential for repayment of the bonds,” the SEC said in a statement.

For more than a year the SEC has cracked down on the $3.7 trillion U.S. municipal bond market, often using its greatest regulatory power over tax-exempt debt – citing issuers for not disclosing information important to bond buyers.

When it comes to charter schools, though, credit rating agencies have led the charge. Last July Fitch Ratings said the average charter school it rates had speculative-grade credit as the schools, which receive charters from their local districts to operate independently, had burdensome debt levels and “breakeven” margins.

Over the course of five years, UNO received $280 million in public money but had very little oversight from Chicago’s educational agencies, according to a profile published in Chicago Magazine in February.

WASHINGTON Mon Jun 2, 2014 2:41pm EDT

Hawkins Advisory: SEC Staff Posts Additional FAQs and Related Responses.

Read the Advisory.

Muni-Bond Buyers May Overpay, SEC’s Gallagher Says.

Retail investors buying municipal bonds may overpay for their trades because brokers aren’t always required to disclose their commissions, according to a member of the U.S. Securities and Exchange Commission.

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"In the private sector, the SEC would quickly bring fraud charges against any corporate issuer and its officers for playing such numbers games," he said.

By Dave Michaels May 29, 2014

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MCDC Spurs More Notices of Disclosure Failures.

WASHINGTON — Issuers are disclosing more failures to comply with their continuing disclosure agreements than in past months — a development some market participants said stems from a Securities and Exchange Commission's program encouraging them and their underwriters to self-report instances in which bond documents falsely stated the issuer was in compliance with its CDA.

Event notices of failures to comply with CDAs posted by issuers to the Municipal Securities Rulemaking Board's EMMA website in April and May far exceeded those in any of the previous several months before the announcement of the SEC's Municipalities Continuing Disclosure Cooperation initiative on March 10.

Searches for such event notices reveal almost 300 were posted in both April and May, compared with less than 100 in February.

The MCDC focuses only on OS' that omitted past disclosure failures. Correcting past mistakes does not shield an issuer from SEC action, but some market participants said the controversial program's existence has spurred a much more detailed look at whether any disclosure failures have remained unacknowledged.

"We're taking a second look to make sure," said Anthony Inverso, a senior managing director at municipal advisor firm Phoenix Advisors in Downingtown, Pa.

Phoenix filed a May 27 notice on behalf of one of its clients, Hamilton Township, N.J., indicating that the municipality failed to file its annual financial information in a timely manner in 2008, 2009, and 2010. Under a provision of the SEC's Rule 15c2-12 on disclosure, an OS must disclose anytime within the last five years that the issuer failed to meet its self-imposed deadline for filing annual financial and operating information filing. But in 2010, Hamilton sold more than $24 million of general obligation bonds and said in the official statement that its filings were late only in 2002, 2003, 2006, and 2007.

The MCDC allows issuers and underwriters to get favorable settlement terms if they voluntarily report their own CDA violations by Sept. 10, when the initiative expires. The program creates what SEC enforcement officials have termed a "modified prisoner's dilemma," in that it creates tension between issuers and underwriters who can effectively turn one another in to the SEC.

Dealer groups have said most firms will probably participate in the MCDC, tempted by the promise of relatively low financial penalties, which cannot exceed $500,000. Issuers face no financial penalties if they participate, but would effectively be pleading guilty to securities fraud and would be it with an order to cease and desist from further such violations.

Inverso said he is very aware of the MCDC and the SEC's increased scrutiny of continuing disclosure in general. The SEC issued a risk alert in March 2012 warning that underwriters can be exposed to enforcement action if they do not have policies and procedures in place that allow them to reasonably determine that issuers will comply with their continuing disclosure obligations.

In November, the SEC collected the first ever financial penalty from a muni issuer when it fined both an issuer in Wenatchee, Wash. and its underwriter Piper Jaffray & Co., in connection with misleading investors with false information in an official statement.

"It's important to make sure everything is done to a 't,'" Inverso said. "You could get the wrath of the SEC on you." Inverso added that the SEC's intense focus on this issue will probably result in many issuers making corrections to their filings on EMMA.

Some issuer officials have questioned whether the MCDC initiative is an SEC scare tactic, but the commission has maintained that the purpose of the entire effort is to improve the disclosure behavior of market participants.

"You may see a flood," Inverso said of the corrected filings and past failure notices. "I think you'll see quite a few."

Issuers who participate in the MCDC will have to take remedial action to correct their failings, including filing any necessary notices, annual financial reports, or other obligated information to EMMA. They would have 180 days after the SEC files the MCDC case to correct delinquent filings. Securities lawyers said it is unlikely that any issuers have concluded an MCDC agreement yet, but that many are aware of the program and are taking it seriously.

Michael Decker, managing director and co-head of municipal securities at the Securities Industry and Financial Markets Association, said he does not know if issuer notices of disclosure failures are connected to the MCDC program, but acknowledged that it has "magnified" awareness of 15c2-12 obligations. Many dealer firms are still in the process of looking back over the last five years' worth of their transactions to see if they have any problematic ones that might warrant self-reporting, he said.

Some issuers said their recent corrections had nothing to do with SEC activity. Rockland County, N.Y. disclosed in an event notice filed on May 27 that it had not filed notices of its rating changes in a timely fashion several times from 2009 to 2012, during which time both Standard and Poor's and Moody's Investors Service cut the county's rating multiple notches. Stephen DeGroat, deputy commissioner of finance for Rockland County, said the notice wasn't inspired by any looming SEC threat, but is instead part of the county's continuing effort to recover from recent hardship.

Cindy Epperson, finance and budget director for Yakima, Wash., said she has heard of the MCDC and knows the SEC is becoming more serious about preventing disclosure-based fraud. But she said that Yakima's recent admission that it failed to disclose bond insurer downgrades and was late filing some financial operating data was prompted by a new bond offering and the past mistakes were detected either by the underwriter or by bond counsel.

Securities lawyers said issuers should be making an effort to correct past mistakes on EMMA, but added that there is no "one size fits all" advice for issuers considering whether or not to participate in the MCDC if they find themselves eligible.

“We’re trying to encourage issuers to review their records,” said Teri Guarnaccia, a partner at Ballard Spahr in Baltimore. “We think that if they found a failure, they should correct it.”

Guarnaccia said the key issue for participation in the MCDC is whether an issuer’s claim in its OS that it was in compliance with its CDA, when it wasn’t, is materially misleading. The SEC has said it is highly unlikely to offer any guidance on what it would consider material, despite calls from issuers, underwriters, and many attorneys to do so. Materiality has generally been defined in Supreme Court cases as whether an investor would want to know the information in question before making an investment decision.

Guarnaccia said underwriters are probably more likely to have a tendency to report more failures as material than issuers. She added that, while making corrections or new disclosures on EMMA will not save an issuer from SEC scrutiny if a past bond sale had a misleading OS, it will at least prevent future OS’ from containing false statements.

Kenneth Artin, a shareholder in Bryant Miller Olive’s Orlando office, said his firm is getting calls from issuers asking them what to do. “It’s a case-by-case situation,” he said. “It has heightened the awareness of continuing disclosure.”

Orrick, Herrington, & Sutcliffe has put together a national task force of its lawyers to work on the MCDC, said Roger Davis, a partner in the firm’s San Francisco office and chair of its public finance practice. That task force includes former SEC muni enforcement leader Elaine Greenberg, who joined Orrick’s Washington, D.C. office last year. Davis said there is no generic advice to be offered to potential MCDC participants, and called counseling such clients a “tricky exercise.”

“This is occupying a lot of people’s time and attention,” he said.

Market participants have expressed a desire to see the MCDC extended beyond its current expiration date, to include the remainder of 2014 or possibly beyond. SEC officials have downplayed that possibility.

BY KYLE GLAZIER
MAY 30, 2014

Lawmakers Urge Bank Regulators to Rethink Muni Liquidity Proposal.

WASHINGTON — Two members of Congress are urging federal regulators to reevaluate a proposal to exclude municipal bonds from qualifying as high quality liquid assets under banking rules designed to ensure banks are equipped to handle severe financial and economic stress.

Reps. Gwen Moore, D- Wis. and Terri Sewell, D- Ala., made the request in a two-page letter sent to Federal Reserve chairman Janet Yellen, Federal Deposit Insurance Corporation chair Martin Gruenberg, and Comptroller of the Currency Thomas Curry on Wednesday. Both women are members of the House Committee on Financial Services, which has jurisdiction over banks and capital markets.

The two lawmakers are the latest to question the decision not to classify munis as HQLA in the rule that the Fed, FDIC, and Comptroller’s office proposed in October.

The proposed rule would require large banks to maintain a minimum liquidity coverage ratio, defined as the ratio of HQLA to total net cash outflows. Assets would qualify as HQLA if they could be easily and immediately convertible to cash with little or no loss of value during a period of liquidity stress.

The rules could be finalized as soon as this summer, and become effective Jan. 1. Local government groups, banks, and others have already argued that a failure to include munis will hurt the market by making tax-exempt securities a less attractive investment for banks.

Moore and Sewell wrote that they are "concerned" about the rule as proposed. Including munis as HQLA would actually make the rule stronger by diversifying investments and therefore reducing systemic risk, they argued in the letter argues.

"In fact, during the 2008 financial crises, classes of municipal bonds, specifically highly-rated dollar-denominated general obligation and revenue bonds, exhibited greater price stability than comparably rated corporate bonds," they told the banking regulators. "Presumably, this is due to the low default rate of these securities."

The lawmakers also wrote that munis have a lot in common with the securities already classified as HQLA under the proposal, such as corporate bonds. Munis trade over a real-time reporting system and the muni market includes a diverse range of participants, the letter noted, adding, the Fed already accepts municipal bonds as collateral for overnight lending.

Regulators said that they did not include munis as HQLA because "these assets are not liquid and readily-marketable in U.S and thus do not exhibit liquidity characteristics necessary to be included in HQLA under this proposed rule."

Moore and Sewell urged Yellen, Gruenberg, and Curry to collaborate with the Securities and Exchange Commission and Municipal Securities Rulemaking Board to "further evaluate" the proposal and reach "additional findings."

BY KYLE GLAZIER
MAY 28, 2014

Coming Soon: EMMA Price Discovery Tool.

The Municipal Securities Rulemaking Board (MSRB) next week will introduce a new tool to allow investors and others to more quickly and easily gauge the trade price of a municipal bond on the Electronic Municipal Market Access (EMMA®) website. EMMA's price discovery tool will enable users to find trade prices of municipal securities with similar characteristics, which can be helpful in assessing the potential value of a security that has not traded recently. Additional enhancements to the display of trade data on EMMA will help users visualize trends in municipal bond trade prices over time.

Read about EMMA's price discovery tool.

Register for a webinar tour of the new tool on Thursday, June 19, 2014.

SEC's Gallagher Sounds Calls For Pension, OPEB 'Disclosure Baseline'

WASHINGTON – Securities and Exchange Commission member Daniel Gallagher said Thursday that pension and other post-employment benefit liabilities need to be made more transparent for investors, and argued for a universal "disclosure baseline" that all cities should use.

Gallagher, who has been outspoken on his interest in the muni market and who told The Bond Buyer last year that he had taken a "blood oath" to keep the SEC's attention on munis, made the remarks at the Municipal Securities Rulemaking Board's 1st Annual Municipal Securities Regulator Summit here. The summit was a non-public event open to regulatory officials and staff from the SEC, MSRB, Financial Industry Regulatory Authority, and others, an MSRB spokeswoman said.

Recent accounting standard reforms undertaken by the Governmental Accounting Standards Board have improved transparency for investors in municipal securities, Gallagher said, but take a step back by doing away with the annual required contribution and a need for more OPEB transparency remains.

"The ARC was the amount plan sponsors had to pay to amortize unfunded liabilities over a maximum 30-year period," Gallagher said. "Every plan was required to disclose the ARC, and so it was a well-defined, easy-to-use measuring stick to determine whether plan sponsors were meeting their funding obligations. While I understand the need to divorce the technical nature of accounting for pension promises from the political nature of funding those pension promises through the state budgetary process, removing the ARC will diminish transparency on this important issue."

Gallagher said he hopes GASB will revisit its standards again in time, but added that supplemental disclosure could be a help for investors more immediately. Municipalities should value and disclose their total liabilities using a risk-free discount rate such as the treasury yield curve, Gallagher suggested. They should then calculate and disclose a baseline plan contribution equal to the amount actuarially necessary to fully fund the plan.

"Investors would then be able to readily compare financials calculated using GASB standards and disclosures about the current level of plan funding against this common baseline," he said. "Entities would be free to explain to investors why the differences exist."

Gallagher also spoke about three steps muni regulators can take in the near future to improve the secondary market — requiring disclosure of riskless principal markups, improving post-trade price transparency, and adopting a best execution rule.

Commissioner Michael Piwowar has also made public comments recently about plucking some of this "low hanging fruit" that would not require radical overhauling of the market or legislative action.

Riskless principal transactions occur when a dealer almost simultaneously buys and sells securities, thereby taking on little or no risk that the market will move against the firm during that short time. The SEC's comprehensive 2012 report on the municipal market recommends the MSRB consider requiring dealers to disclose to customers any markups or markdowns on these transactions.

"Given that 'riskless principal' is basically just a fancy name for 'agency,' there is no real reason to perpetuate this dichotomy," Gallagher said. "Disclosure of the markup or markdown in riskless principal transactions would enable customers to assess the fairness of the execution prices."

The MSRB should consider amending its Rule G-15 on confirmation to require this disclosure, he said.

Gallagher said the fixed income markets are a mystery to most investors, and drew a Hollywood comparison to what the bond market looks like.

"Maybe a good approximation of today's debt markets are the scenes from the equity markets of 25 years ago as portrayed in 'The Wolf of Wall Street,' he said. "Although I do hope there is a lot less fraud, and at least a little less debauchery, than what was depicted in that film. It is still common for investors to place corporate and municipal bond trades by calling their broker for a quote, without much insight as to whether they are receiving best execution and a fair price."

The MSRB has already proposed a best execution rule that would require broker-dealers to use "reasonable diligence" to obtain the best price for a customer based on prevailing market conditions, and is also exploring options for improving both pre and post-trade transparency on its EMMA website.

BY KYLE GLAZIER
MAY 29, 2014

SIFMA Statement from GFOA Conference.

Minneapolis, MN, May 20, 2014 – SIFMA today issued the following statement from Kenneth E. Bentsen, Jr., SIFMA president and CEO, after his luncheon remarks at the Government Finance Officers Association (GFOA) Annual Meeting taking place May 18-21, 2014 in Minneapolis:

"SIFMA is committed to promoting efficient municipal markets that facilitate capital formation, investor opportunity and economic growth. The municipal bond markets fuel local economies through infrastructure investment and job creation – in fact, state and local governments have already accessed over $88 billion in capital this year. It is vital to the prosperity of U.S. communities that this public-private partnership remain strong and not be constricted by unnecessary regulatory reform. Specifically, SIFMA is concerned that in more than one occasion, regulators have taken actions that work to the detriment of the municipal bond markets and state and local government issuers.

"For instance, in the case of the recently approved municipal advisor rule, the SEC incorrectly interpreted legislative history to create new burdens for both underwriters and issuers, as opposed to establishing a much needed, industry supported, regulatory framework for otherwise unregulated financial advisors. We are also concerned that the SEC's Municipal Continuing Disclosure Cooperation Initiative (MCDC Initiative) creates a prisoner's dilemma by trying to incentivize underwriters to report on their clients under the threat of penalty by the SEC. Instead, the SEC should be focusing on helping issuers comply with their obligations in an efficient manner and ensure investors have the information they need going forward. In the tax arena, we are closely monitoring the threat to end the tax-exemption for municipal bond interest, which would lead to higher capital costs and decreased municipal investment.

"SIFMA is dedicated to working with regulators and market participants to help craft well thought out rules and business practices that strike the appropriate balance between investor protection, safety and soundness and market efficiency. We are also working to stay ahead of future threats including systemic cyber attacks or other emergency scenarios that could impact the municipal markets and the industry's broad ability to fulfill its role of intermediating capital and credit between investors and end users. We remain steadfast in our goal of promoting efficient, resilient municipal markets that can facilitate economic growth across the country."

Release Date: May 20, 2014
Contact: Liz Pierce, 212.313.1173, lpierce@sifma.org

[Day Pitney: Disclose Bank Loans to Standard & Poor's or Risk Rating Withdrawal.]

This month, Standard & Poor's Ratings Services ("S&P") sent letters to all issuers of the bonds it rates advising the issuers to provide all relevant documentation related to any private debt, including bank loan financing, that the issuer enters into.

What Type of Debt Does S&P Want Disclosed?

- Direct Bank/Private Loans
- Private Placements
- Private Debt
- S&P is looking to be notified of all such debt, regardless of whether or not such additional debt is rated by S&P.

What Documentation Is S&P Looking For?

- All relevant documentation
- Form of Note or Bond
- Loan or Financing Agreement
- Covenant Agreement
- Security Documentation (mortgages, security agreements, etc.)

When Does S&P Want the Information?

No later than promptly following the closing of the transaction, though preferably before closing.

What Is the Consequence of Not Disclosing?

Risk suspension or withdrawal of your S&P rating.

While S&P is requiring direct disclosure of the referenced debt to it, bondholders and their representatives have also encouraged issuers to voluntarily post information about such bank loans and private debt on the Electronic Municipal Market Access ("EMMA") website, which is maintained by the Municipal Securities Rulemaking Board ("MSRB"). In 2012, the MSRB published a notice in which it encouraged, but did not mandate, issuers to post such information in order to provide timely access to investors and other market participants to allow them to make informed investment decisions. The MSRB encouraged the filing of either a PDF of the appropriate loan documents or a summary of the transaction, including the name of the lender, payment dates, maturity and amortization, prepayment provisions, purpose, security, tax status, guarantees, events of default, and remedies, among other information.

Any issuer considering voluntary disclosure on EMMA or with questions on when and what to send to S&P may wish to consult with counsel prior to any disclosure. The attorneys in Day Pitney's Municipal Finance Group routinely counsel clients on such matters. Please feel free to contact any of the attorneys listed to the right of this alert if you would like to discuss this alert or your disclosure obligations.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Last Updated: May 22 2014
Article by Namita Tripathi Shah
Day Pitney LLP

[GFOA, SIFMA to Push for MA Rule Tweak.]

MINNEAPOLIS – The Securities Industry and Financial Markets Association will help large issuers of municipal bonds pressure the Securities and Exchange Commission for a sophisticated issuer exemption from its municipal advisor rule, and will also request another delay in the rule's effective date if more guidance is not available soon.

SIFMA's Leslie Norwood and Michael Decker, co-heads of municipal securities at the group, told members of the Government Finance Officers Association's debt committee during GFOA's annual conference here Saturday that SEC muni chief John Cross is unable to make substantive changes to the MA rule through additional guidance, but that the commissioners could grant the so-called "sophisticated issuer" exemption. Many large, frequent issuers have said they would support such a change, which would exempt investment bankers and other professionals from having to register as MAs when giving advice to issuers who do not feel they need the rule's protection.

The MA rule, a part of the Dodd-Frank Act, aims to shield municipalities from receiving bad financial advice by regulating anyone who gives a state or local government advice on issuing muni bonds or investing muni bond proceeds. By law, MAs owe their muni clients a fiduciary duty to put the issuer's interests ahead of their own and the SEC has made clear that dealers who become MAs will not be able to underwrite a transaction for which they provide advice.

Dealers who wish to offer advice to issuer officials must now rely on an exemption from the rule. Exemptions exist for firms engaged to underwrite a specific bond transaction, firms responding to a competitive request for proposals, and firms giving advice to an issuer who retains and says it will rely on its own municipal advisor. Ben Watkins, who chairs the GFOA debt committee and also serves as Florida's bond finance director, has supported the idea of also offering an exemption to firms who give advice to issuers with the expertise to parse the good ideas from the bad.

The debt committee floated the idea to Cross at its winter meeting in Washington, which Decker also attended. One committee member here Saturday said she had gotten the impression that Cross was dismissive of the idea of a sophisticated issuer exemption, but Decker said Cross seemed "amenable to it" and simply could not do it unilaterally through the muni office. Watkins said the GFOA meets with SEC commissioners "from time to time," and that now is probably a good time to have a sit down.

Norwood said SIFMA would support the GFOA's efforts.

"We support anything that makes the rule more workable," she said.

Cross told those at the GFOA meeting that more guidance on the MA rule will be released Monday. The rule's effective date was moved back to July from January after a previous round of written SEC guidance did not come out until very near that first scheduled effective date.

BY **KYLE GLAZIER**

MAY 19, 2014 7:03am ET

SEC Issues More Muni Advisor FAQs.

The SEC Office of Municipal Securities today issued an updated set of Frequently Asked Questions concerning municipal advisors. The updated FAQs are available here. The updated FAQs include questions concerning obligated persons, investment strategies and proceeds of municipal securities (including pension obligation bonds), the engineering exclusion, the bank exemption and the attorney exclusion. The original FAQs, which were issued on January 10, 2014, are included in the document released today. The date of each FAQ is at the end of the answer.

SIFMA Leader Blasts SEC's MA Rule and MCDC Initiative.

MINNEAPOLIS — The leader of a dealer group criticized recent Securities and Exchange Commission efforts to further regulate the muni market, telling issuer officials on Tuesday that a new rule and initiative could undermine productive relationships between municipalities and underwriters.

Kenneth Bentsen, chief executive officer of the Securities Industry and Financial Markets Association, made the remarks in a speech at the Government Finance Officers Association's annual meeting here. His comments were a full-throated critique of the SEC's municipal advisor registration rule and its Municipalities Continuing Disclosure Cooperation initiative, both of which he warned are misguided efforts that will penalize issuers.

SIFMA has long held that the MA rule, which becomes effective July 1, was included in the Dodd-Frank Act to bring previously unregulated non-dealer financial advisors under the supervision of regulators. Not all market participants agree with SIFMA's interpretation of what lawmakers intended to achieve, but Bentsen told GFOA members that the rule completely misses the mark and will actually impose new costs on issuers through one of its provisions. The MA rule restricts potential underwriters from giving bond advice to municipalities with a few exceptions, such as when the issuer has retained and certified that it will rely on the advice of its own MA. The rule does not require issuers to have an MA, but GFOA best practices recommend it.

“In short, the SEC turned the statute on its head, contrary to intent, and created a new regulatory regime for underwriters, restricting their ability to advise state and local government issuers, while indirectly imposing an unfunded mandate on governments by prescribing the hiring of a financial advisor as one way to garner advice and information from underwriters,” Bentsen told GFOA members. “So whereas Congress intended to regulate otherwise unregulated financial advisors, the SEC chose to create a redundant and inefficient new regulatory regime for underwriters, and restrict access to information for state and local government issuers, unless they hire a financial advisor. That makes no sense.”

GFOA members questioned SEC muni chief John Cross earlier in the week about the possibility of an exemption for underwriters dealing with “sophisticated issuers,” but Cross said such a change to the rule would require action by the SEC’s commissioners.

Bentsen, a former Texas Congressman who sat on the House Financial Services Committee and its predecessor committee from 1995 to 2003, also skewered the MCDC program, a controversial SEC initiative that offers reduced penalties to issuers and underwriters that voluntarily report any instances in which they offered bonds without disclosing material information or otherwise failing to meet their continuing disclosure agreements. GFOA debt committee members worried that the MCDC could expose unsophisticated issuers to huge risks if they are turned in by their own underwriters. The initiative expires Sept. 10.

“The SEC’s motives under this initiative are misplaced,” Bentsen said. “They are trying to penalize state and local governments, through their underwriters, for past transgressions during a time when the continuing disclosure system was chronically broken.”

“Rather than engage in a retroactive game of gotcha,” he continued, “the MCDC should represent an opportunity for the SEC, state and local governments, and their underwriters to work together towards a workable solution that benefits the investor.”

Bentsen said SIFMA does not oppose all rules and appreciates the value of well-written regulations to promoting a fair and efficient market.

He also warned issuers to heed the most recent threats to the tax-exempt status of muni bonds. Dustin McDonald, director of GFOA’s federal liaison center, told issuer officials earlier this week that tax reform plans from both House Republicans and Senate Democrats attack the tax exemption, increasing the chance that the idea of capping the exemption will continue to linger even if neither plan is ever implemented. Bentsen said SIFMA, GFOA, and other market groups are prepared to continue resisting a move in that direction.

“While it is unlikely that Congress will take up the matter this year, we should not expect the issue to go away,” he said. “It is a threat we take seriously, especially if it were applied retroactively to outstanding bonds.”

The GFOA conference wraps up Wednesday, which features a panel on the MCDC that will include Peter Chan from the SEC’s Chicago regional office.

BY **KYLE GLAZIER**

MAY 20, 2014 3:17pm ET

SIFMA: SEC Should Reject MA Fee; MSRB Should Overhaul Fees.

WASHINGTON — A dealer group is urging the Securities and Exchange Commission to suspend and reject the Municipal Securities Rulemaking Board's proposal to charge each municipal advisor professional $300 per year, warning it is unfair to dealer firms that have already paid for rules the MSRB is developing for MAs.

The group also wants the MSRB to overhaul its entire fee system so that fees are based on gross revenues from four sources: dealer underwriting, dealer sales and trading, MA advice on debt issuance, and MA advice on muni financial products.

The Securities Industry and Financial Markets Association made the pleas in a 10-page letter sent to the SEC on Wednesday that was signed by its managing director and associate general counsel David Cohen.

The letter also criticizes the MSRB for failing to provide more information or seek industry feedback on the proposed fee for MA professionals, which became effective immediately when announced on April 17. The SEC is currently collecting comments on the fee, with a May 22 deadline, and could revoke it.

The MSRB already charges MA firms a one-time initial fee of $100 upon registration and a $500 annual fee. Those fees have been in effect since 2010 when MAs had to begin registering with the MSRB. The MA professional fees, which are effective, technically won't start to be collected until July 1, when the SEC's final MA rule becomes effective with a phased-in compliance period.

"What SIFMA is asking for is an equitable allocation of MSRB's expenses across all regulated parties," Cohen said in a brief interview. "Dealers are currently funding about 90% of the MSRB's budget."

The board's expenses totaled nearly $27.78 million in 2013 according to its annual report, SIFMA said.

SIFMA is frustrated that dealers have already paid for all of the MSRB's rules, including those on registration, recordkeeping, professional qualifications and political contributions that the board must now develop or revise to cover MAs as well as dealers.

As a result, the proposed fee would amount to "a double tax on dealers," Cohen said, an irony since dealers wanted non-dealer MAs to become subject to MSRB rules to level the playing field.

Cohen told the SEC that most SIFMA dealers that have no intention of pursuing municipal advisory business are still considering registering public finance investment bankers as MAs "'as belt and suspenders' protection in the event of an MA 'foot fault.' They should not be made to shoulder the cost of additional MA regulation and rulemaking."

Broker-dealers already pay: a one-time fee of $100 upon registration; annual fees of $500; an assessment of $.03 per $1,000 of the par value paid by underwriters on most primary offerings; a fee of $.01 per $1,000 of the total par value of interdealer muni sales they report; a fee of $.01 per $1,000 of the total par value of the sales to customers that they report; a technology fee of $1.00 per transaction for each interdealer muni sale reported; and a technology fee of $1.00 per transaction for customer sales reported.

Cohen said the MSRB's "current hodgepodge of fees and assessments … has evolved over decades and is not necessarily fair, reasonable or equitable."

"The MSRB should consider abandoning its existing system of assessments in favor of a single tax on dealers and advisors that is based on an equalizing factor such as the gross revenue derived from municipal-related business regulated by the MSRB," he said in the letter.

SIFMA also criticized the MSRB for filing the MA professional fee as immediately effective.

"SIFMA believes all MSRB fee changes, including the [MA professional fee], could benefit from reasonable prior notice of proposed changes, solicitation of feedback from market participants on implementation / effectiveness of fee changes, and a more fulsome discussion of the rationale for a fee change," he told the SEC. "SIFMA thinks [the MA professional fee], in particular, lacks a sufficient discussion of the rationale for the fee changes or methodology of deriving the fee structure or the amount of the fee."

The proposed MA professional fee "deviates from existing MSRB fees, which are primarily based upon market activity of regulated entities," Cohen said.

BY **LYNN HUME**

MAY 21, 2014 2:20pm ET

BDA Opposes, NAIPFA Supports MA Fees.

WASHINGTON — Another broker-dealer group is asking the Securities and Exchange Commission to suspend the Municipal Securities Rulemaking Board's proposal to charge each municipal advisor professional $300 per year, but non-dealer MAs are giving the MSRB's fee structure their support.

Bond Dealers of America president and chief executive officer Mike Nicholas told the SEC in a letter that the MSRB's new Rule A-11, which was effective immediately upon its filing last month, is unduly burdensome to dealer firms and will disproportionately affect middle-market firms.

Under the rule, beginning with the July 1 effective date of the SEC's final MA rule and following it's phased-in compliance dates, each municipal advisor registered with the SEC will be required to pay an annual fee of $300 for each FORM MA-I that they fill out.

"The BDA believes the application of this fee is unduly burdensome to broker-dealer firms since the fee will be imposed not only on the newly-regulated municipal advisor firms, but will also apply to broker-dealers that employ municipal advisors and who are already funding over 90% of the cost of supporting the MSRB," Nicholas wrote.

The MSRB already charges MA firms a one-time initial fee of $100 upon registration and a $500 annual fee. Those fees have been in effect since 2010 when MAs had to begin registering with the MSRB. The MA professional fees technically won't start to be collected until July 1, when the SEC's final MA rule becomes effective with a phased-in compliance period.

The MSRB should provide a calculation of how much money it expects to collect through this requirement, Nicholas wrote, so that a direct comparison can be made between the MSRB's expenses from the new regulations and the revenues it stands to receive.

The Securities Industry and Financial Markets Association made similar comments in an earlier letter to the SEC, but Nicholas said the rule would be even harder on BDA members.

"We believe that the additional burden of this fee will disproportionately fall on middle-market broker-dealers, where advisory activities are more likely to represent a larger proportion of the firm and whose clients often are not the big issuers, but rather smaller, less frequent issuers, who will need the additional time and attention paid to them," his letter states.

The National Association of Independent Public Finance Advisors, which represents non-dealer MAs, however, submitted a letter supporting the rule.

"In general, we believe the fees established by the notice are appropriate," wrote NAIPFA president Jeanine Rodgers Caruso. "Although there exists the potential that these additional fees may further the financial burdens placed on municipal advisor firms, we believe that the Municipal Securities Rulemaking Board has established a fee structure that at this time appears to be reasonable in light of its rulemaking efforts vis-à-vis municipal advisors."

Nathan Howard, a lawyer who serves as counsel to NAIPFA, said that it would be impractical to impose transaction-based fees on MAs because their roles in a financing can very widely depending on the terms of their engagement.

NAIPFA's letter requests, however, that future changes in the MA fee structure be put out for comment rather than submitted to the SEC for immediate effectiveness. The SEC has been collecting comments on the fee even though the rule is already effective, and could change or revoke it.

BY **KYLE GLAZIER**

MAY 22, 2014 2:36pm ET

BDA Submits Comment Letter to SEC on MSRB Proposed Rule Change on Assessments for Municipal Advisor Professionals.

The BDA filed a comment letter with the SEC asking for them to summarily suspend the MSRB's proposed rule change consisting of new rule A-11, on $300 assessments for municipal advisor professionals.

Specifically, the BDA asked the SEC to suspend the implementation of the new rule because the assessment is unduly burdensome for broker-dealers and would affect middle-market dealers disproportionately. Additionally, we asked that the MSRB perform a calculation as to how much money they anticipate collecting from the $300 assessment for municipal advisor professionals so that the MSRB can make a direct correlation between the money it collects and the money it spends on the costs and expenses of operating this wholly new municipal advisor regime. We believe that since MSRB will be using the additional monies from these assessments to create the municipal advisor regulatory regime, it should outline just how expensive this regulatory activity will be so that it correlates with the monies it collects from municipal advisors and would not take from the underwriter assessment fees it already collects from broker-dealer firms.

You can find the final letter here.

05-22-2014

BDA Submits Comment Letter on MSRB Draft Amendments to Rule G-3.

Today, the BDA submitted a comment letter addressing MSRB Draft Rule G-3 on professional qualification requirements for municipal advisors.

Specifically, the letter addresses the following:

- All municipal finance professionals should have the same training;
- BDA suggested alternatives to the MSRB's approach so as to alleviate some of our anticipated concerns;
- The rule, as proposed, would be prohibitively costly to the industry; and
- A suggested delay in implementation.

You can find the final comment letter here.

NFMA Advance Seminar on Municipal High Yield Steering Committee.

The NFMA Advanced Seminar Co-Chairs, Dan Berger and Chris Mauro, are forming their steering committee to plan the Fall 2014 Advanced Seminar on Municipal High Yield. The event will be held in Chicago, Illinois at The InterContinental Chicago Magnificent Mile from Thursday, October 23 through Friday, October 24, 2014.

Steering committee responsibilities include participating on regular conference calls (two or three times per month), reviewing panel ideas, and seeking qualified moderators and panelists. Each steering committee member will be responsible for organizing one panel. Participation on the steering committee neither guarantees nor requires participation as a speaker or moderator.

Interested parties should contact Dan Berger at daniel.berger@thomsonreuters.com or Chris Mauro at chris.mauro@rbccm.com by Friday, May 30th. Please also include information on the sectors you cover or any relevant expertise relating to Municipal High Yield. Dan and Chris also invite all members to submit ideas for panel topics and/or speakers.

NABL Committee Seeks Board Candidates.

At the recent May meeting, the NABL Board of Directors selected the following members to participate on the 2014 Nominating Committee to select the nominees for the 2014-2015 Executive Committee and Board of Directors: Scott Lilienthal, Chair, Allen Robertson, Vice Chair, Antonio Martini, Carol McCoog, Deanna Gregory, Stefano Taverna, and Stephen Weyl.

NABL members are encouraged to submit nominees for Board positions to Linda Wyman, NABL COO, no later than Monday, June 16, 2014. Submissions should include a description of the nominee's qualifications and past and current NABL committee and project participation. The Committee will consider all qualified nominations from the membership. The list of the current Board of Directors can be found here.

The candidates selected by the Nominating Committee for the 2014-2015 Executive Committee and Board of Directors will be sent to the membership by August 15, 2014, thirty days prior to the Annual Membership Meeting, in accordance with the NABL By-Laws. (Additional nominations from the floor are accepted only if provided in writing to the Chief Operating Officer and the President, not less than 14 days prior to the Annual Meeting.) The election will take place on Wednesday, September 17 during the 39th Bond Attorneys' Workshop at the Fairmont Chicago.

Asset Managers Might Have to Register as MAs.

WASHINGTON — Asset managers may have to register as municipal advisors to protect themselves from violating the Securities and Exchange Commission's MA rule, which restricts non-MAs from giving advice about muni bond proceeds and escrows as well as other financial products commonly used by states and localities.

At issue is the status of asset management companies that are not registered investment advisors under the Investment Advisers Act of 1940. Registered investment advisers are exempt from the MA rule, which otherwise requires any individuals or firms providing advice to state or local governments about the issuance of muni bonds, the investment of muni proceeds, swaps, or muni escrows to register as MAs.

With the July 1 effective date of the MA rule fast approaching, asset managers said they might have to play it safe and register rather than risk violating the rule and facing possible SEC or Financial Industry Regulatory Authority enforcement action because the funds they oversee may contain bond proceeds.

The managers are finding that, because funds become commingled, neither they nor the issuers whose funds they manage are sure whether the funds include bond proceeds or not.

“We’re still grappling with the notion,” said Matthew Nevins, managing director and associate general counsel for SIFMA’s asset management group. Asset managers not registered as investment advisors or as swap advisors with the Commodity Futures Trading Commission had believed they would not be captured by the rule because their primary business is not to handle muni fund proceeds or securities-based swaps, he said.

Asset managers are also concerned about the issue of pooled investment vehicles, which can include muni bond proceeds. Nevins said asset companies are having difficulty determining if these pools contain bond proceeds and therefore are requiring their manager to register as an MA.

“Very difficult to prove,” Nevins said of determining whether a given fund contains muni bond proceeds. “Very cumbersome for our managers.”

SIFMA sent a letter to the SEC earlier this year asking that it either grandfather all existing investment vehicles and grant them an exemption, or allow a “good faith effort” to suffice in determining if they include municipal bond proceeds or not. SIFMA is hopeful that additional guidance on the rule, which the SEC has said it aims to release prior to July 1, will clear the matter up. If not, Nevins said, asset management companies may have to just register as MAs.

“If things stay the way they are, I think the answer is yes,” Nevins said when asked if asset managers will be forced to submit MA registration paperwork. “Their default is going to be just to register,” agreed Leslie Norwood, SIFMA managing director, associate general counsel, and co-head of municipal securities.

Victor Siclari, assistant general counsel and managing director at BNY Mellon said his bank established a separate division as a registered MA because there was no alternative. The exemptions available under the MA rule are not sufficient protection for firms placed in this position, Siclari said.

The rule would allow an asset management firm to give advice about muni proceeds if the issuer had retained and certified that it would rely on its own MA, but Siclari said that exemption probably would not be available often enough.

Some market participants have questioned why asset managers placed in this position do not either route such business through a registered investment advisor arm of their businesses, or register as investment advisors themselves. But RIAs typically operate under a totally different fee and organizational structure that could not just be changed to solve the problem, Nevins said. “There is no escape valve here,” he said.

Nevins added that asset managers are already highly-regulated by the states they operate in and are often already bound by a strict federal fiduciary duty to put their clients’ interests ahead of their own, as an MA is required to do. This duty is imposed on RIAs by the Employee Retirement Income Security Act if they handle retirement or pension funds.

Asset managers have asked municipalities to certify whether certain funds includes muni proceeds, but New York City finance director Alan Anders said issuers would probably not be comfortable with that idea. Issuers have often been spooked by legal communications from bankers in the past. “Many of them are going to be confused, and resist it until it’s explained to them pretty clearly,” Anders said. A lot of issuers don’t even know where their bond proceeds are, sources said.

BY KYLE GLAZIER

MAY 15, 2014 3:50pm ET

SEC Approves Fair Pricing Rule Consolidation.

WASHINGTON — The Municipal Securities Rulemaking Board got the go-ahead from the Securities and Exchange Commission to consolidate muni dealers' existing fair-pricing obligations into a single rule.

Effective July 7, all pricing-related obligations will be contained in revised MSRB Rule G-30 on prices and remuneration, the MSRB said Monday. The revised rule will replace but not alter the meaning of parts of Rules G-18 on execution of transactions and G-30 on prices and commissions, and incorporate existing guidance regarding fair pricing currently included in interpretive guidance to MSRB Rules G-17 on fair dealing and G-30. The consolidation is part of the MSRB's effort to streamline interpretive guidance, especially on G-17, which has ballooned to many pages over the years.

"The MSRB continues to focus on opportunities to further improve our Rule Book to better highlight key principles and support regulatory efficiency and compliance," said MSRB executive director Lynnette Kelly. "Consolidating all fair-pricing rules and interpretations into a single rule is an important step forward in this effort."

The consolidated rule will continue to require dealers to use a "fair and reasonable" standard for the pricing of muni securities. The Securities Industry and Financial Markets Association had previously asked the SEC not to approve a new pricing rule until dealers received more guidance on how pricing requirements are related to the board's proposal to adopt a best execution standard requiring dealers to use "reasonable diligence" to achieve for their customers a price that is as favorable as possible under prevailing market conditions. The MSRB announced last week it would seek SEC approval on that rule proposal as well.

BY KYLE GLAZIER

MAY 12, 2014 3:42pm ET

FINRA's Stance on MA Oversight, Exams.

WASHINGTON — The Financial Industry Regulatory Agency's director of fixed income recently tried to dispel some myths about the agency's oversight of municipal advisors and detailed its plans for examinations.

Cindy Friedlander told those attending or listening to a Securities Industry and Financial Markets Association seminar on the muni advisor regulatory scheme on Friday that, contrary to what some people think, FINRA has no plans to begin enforcement of the Securities and Exchange Commission's final MA registration rule before July 1, when it becomes effective. FINRA cannot enforce a rule until it takes effect, she said.

“We will be talking to firms about whether they should register under the temporary rule and the final rule,” she said. MAs were supposed to begin registering with the SEC and Municipal Securities Rulemaking Board in 2010 under an SEC temporary rule. But the temporary rule was significantly amended before being approved as a final rule in September.

Friedlander also said that FINRA has no plans to give firms a grace period on enforcement. Muni market participants were already given a six-month delay with the July 1 effective date of the SEC’s final rule, she said.

Friedlander said it is not true that FINRA will enforce compliance with the rule for firms that are not FINRA members. FINRA does not have jurisdiction over non-member firms, she said.

Beginning July 1, Friedlander said, FINRA plans to look at whether firms are complying with four requirements for MAs: registration under SEC and MSRB rules; recordkeeping under the SEC’s final rule; the fiduciary duty imposed by the Dodd-Frank Act; and the fair-dealing obligations under the MSRB’s Rule G-17.

Friedlander said she is concerned about some underwriters that have long-term close relationships with issuer clients. They need to realize that some of their traditional activities will now qualify them as MAs.

She said the SEC has already been conducting some exams and that the regulators have monthly meetings about what they are findings “so that we can proceed together in lockstep.”

“The goal is not ‘gotcha,'” she said, but rather to check activities and get information about what should be included in risk-based exams.

Friedlander said she thinks MA rules “will be a challenge” for small firms.

Larry Sandor, the MSRB’s deputy general counsel, said firms have been required since Dec. 31, 2010 to be registered as MAs and that they also have been required to comply with fiduciary duty and fair-dealing obligations as well as the federal anti-fraud securities laws, and statutes in some states.

The MSRB has a new consolidated Rule A-12 on registration and all MAs must re-register under that rule by Aug. 10.

The board has proposed changes to its Rule G-3 on classifications that would classify MAs as registered representatives who provide services and MA principals who are supervisors. MAs would have to take a general exam and there would be no grandfathering of current financial advisors, Sandor said. If an MA representative fails the MSRB exam, he or she would be able to retake it within 30 days, and if they fail that, they could retake it again in 30 days, he said.

The MSRB is still deciding about developing an exam for principals, Sandor said. The MSRB plans to send out surveys to muni market participants seeking information about what should be included on the exam for MA representatives, he said, adding he hopes there will be 100% response to the survey.

The MSRB has requested comments on its proposed qualifications rule changes, setting a May 16 deadline.

BY LYNN HUME

MAY 13, 2014 12:37pm ET

SEC: State of the Municipal Markets.

Securities and Exchange Commission State of the Municipal Markets

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Read the Report.

GFOA Alert: The MA Rule and Issuers.

Rule's Implications When Hiring Municipal Advisors and Underwriters

The Securities and Exchange Commission (SEC) has given final approval to a rule which takes effect July 1, 2014, defining the term "municipal advisor" (MA), and has produced supplementary Frequently Asked Questions about the rule. The SEC Municipal Advisor Rule specifies activities which will be covered by the Dodd-Frank Act's imposed fiduciary duty of a municipal advisor to its government client, may result in the need for underwriters to receive new written representations from issuers, and may limit the manner in which underwriters and other professionals interact with issuers. While the Rule does not regulate issuers directly, there are numerous indirect implications. The practical effect of the MA Rule on issuers is to limit the ability of underwriters to provide advice to issuers. However, a few exemptions to the Rule may apply, thus allowing underwriters to provide advice to issuers as described below. This alert seeks to assist governments in understanding key aspects of the Rule and how it will likely require modifications to how issuers interact with underwriters.

Regulating Municipal Advisors

The MA Rule, which regulates municipal advisors, places a fiduciary duty on those professionals that advise governments when they sell bonds. GFOA recommends that unless a government has sufficient internal expertise that it use a municipal advisor when considering and developing a bond transaction. Municipal advisors must also now be registered with the SEC and Municipal Securities Rulemaking Board (MSRB). Issuers can check the MSRB's Municipal Advisor registration page to ensure their professionals are registered.

The MA Rule and Underwriters

The role of the underwriter is to sell bonds for the issuer. They do not have a fiduciary duty to the issuer. However, many investment banking firms have previously provided other services to their clients, including financing recommendations and advice on bond sales. The MA Rule states that only professionals with a fiduciary duty to the state or local government may provide advice, unless an exemption is in place. While investment bankers may continue to respond to RFPs, talk in general terms with issuers about general market information, and pitch products within certain limits, specific advice from investment bankers is prohibited unless certain exemptions apply. Below is a discussion of the exemptions along with model language that issuers may wish to use themselves, or may be sent to them from underwriters or other professionals.

The MA Rule and Investment of Bond Proceeds

Due to the SEC's Municipal Advisor Rule and forthcoming MSRB rules, investment bankers may be considered municipal advisors if they provide advice on investments of bond proceeds to governments. Additionally, currently proposed MSRB rules may restrict the ability of municipal advisors to sell the products that they "recommended" as investments to their government clients. Investment bankers will be deemed to have made a "recommendation" when they advise their government clients to buy a particular security. Additionally, the underwriter may not provide advice related to the investment of bond proceeds unless; (1) the government issuer has in place a municipal advisor or an investment adviser, or (2) the underwriter is responding to the government's request for proposal process regarding how to invest the bond proceeds. The SEC is expected to issue new MA Rule guidance to clarify whether or not broker recommendations on the investment of bond proceeds will be considered advice, and the MSRB is likely to further discuss this issue in their rulemaking. This document will be updated with this clarifying information.

Key Items Issuers Need to Know About the MA Rule

- "Municipal advisor" is defined as a person (not including a municipal entity or employee of a municipal entity) who provides advice to 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 undertakes a solicitation of a municipal entity or an obligated person.
- The term "advice" is not specifically defined, but includes recommendations regarding municipal finance products or the issuance of municipal securities, including recommendations as to structure, timing, terms and other similar matters concerning such financial products or issues. Advice on the issuance of municipal securities encompasses advice given during the entire lifespan of the transaction, from earliest pre-planning stages through maturity or earlier redemption.
- In the past, issuers may have communicated with underwriters and banks about matters such as structure or timing of municipal securities or been pitched financing ideas, but such communications are likely to change upon the implementation of the MA Rule. Underwriters will not be able to provide advice to issuers unless certain exemptions apply.
- • Underwriters will be able to communicate with issuers about general market issues, facts and ideas. However, unless an exemption is met, underwriters cannot advise a government to take a specific action.
- There are exclusions and exemptions from the definition of municipal advisor that would allow freer communications between underwriters and issuers, but it is not yet clear how these exemptions will be satisfied. While there is some guidance about how the exemptions should apply, the interpretation of the Rule by compliance departments of individual underwriters may determine whether certain communications between the underwriter and an issuer are permitted.
- Issuers may still obtain advice on the investment of monies that are not bond proceeds or held in escrow to pay for bonds, but may be required to provide a written representation to their broker regarding the nature of such funds before such advice will be given.
- Exemptions from the definition of "municipal advisor" allow underwriters to provide advice to issuers in certain circumstances:

The Independent Municipal Advisor Exemption

An issuer may obtain advice from an underwriter when the issuer has retained an independent registered municipal advisor. The independent registered municipal advisor must not have been associated with the underwriter within the past two years. The issuer must represent in writing to the underwriter that it has retained and will rely on a municipal advisor for advice. The underwriter must have a reasonable basis for relying on the issuer's representation. The municipal advisor may be hired for a specific deal for which the underwriter may be providing advice, or if a government hires a municipal advisor on a retainer basis, an underwriter may approach the issuer on any type of financing, as long as the issuer states in writing that it will rely on advice of its municipal advisor. Upon request, the issuer may send the representation to the underwriter directly, or post it on its web site. The GFOA recommends posting this language on the government's website for efficient distribution and access by underwriters. It is important to note that the issuer remains in control of the scope of work it wishes to receive from its municipal advisor. GFOA discourages an underwriter from speaking with or sending materials directly to the issuer's municipal advisor unless specifically authorized by the issuer . Additionally, for those entities that use multiple municipal advisors, suggested language is noted below for those circumstances.

Independent Municipal Advisor Exemption Language

[State or local government] has retained an independent registered municipal advisor. [State or local government] is represented by and will rely on its municipal advisor [Include name of firm here] [If desired, include name of advisor at the firm here] to provide advice on proposals from financial services firms concerning the issuance of municipal securities and municipal financial products (including investments of bond proceeds and escrow investments (if applicable)). This certificate may be relied upon until (insert date). Proposals may be addressed to [State or local government] at ______________. If the proposal received will be seriously considered by [State of local government] the entity will share the document with its municipal advisor. Please note that aside from regulatorily mandated correspondence between an underwriter and municipal advisor, the underwriter should not speak directly with or send documents directly to the municipal advisor unless specifically directed to by the issuer.

Draft language for 2nd sentence to be used by larger entities – The [State or local government] uses several municipal advisors in its debt management program. To know which firm is being used for a particular credit, please contact the issuer at _______________, [or see below for the appropriate listing].

[If posted on the issuer's website, add the following language at the beginning: By publicly posting the following written disclosure, [State or local government] intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption to the SEC Municipal Advisor Rule.]

Issuer Uses RFP/RFQ Process/RFP Exemption

Underwriters responding to an RFP may include recommendations without violating the MA Rule. For this exemption to apply, the RFP may not be outstanding for more than six months and the issuer must widely distribute the RFP to at least three reasonably competitive firms or post it on their web site. The GFOA recommends that the RFP be posted on a government's web site to ensure wide distribution. If an issuer uses a pool of underwriters from which it chooses underwriters for a particular transaction, the issuer may have to issue a mini-RFP to receive advice from members of its underwriting pool. Issuers may be asked to provide – or may provide on their own – a disclaimer that they their RFP process is in line with the MA Rule, as noted here:

Issuer Uses RFP/RFQ Process/RFP Exemption Language

[State or local government] is aware of the "Municipal Advisor Rule" of the Securities and Exchange Commission (effective July 1, 2014) and the RFP/RFQ exemption from the definition of "municipal advisor" for a person providing "advice". In response to an RFP/RFQ, [State or local government] hereby notifies [all] [certain designated] investment banking firms that it wishes them to provide advice and recommendations on [insert description of particular objectives concerning the issuance of municipal securities and/or municipal financial products (as such terms are defined in the

Municipal Advisor Rule)]. [State or local government] intends for such advice and recommendations to qualify for the RFP/RFQ exemption. The advice and recommendations may be made orally or in writing. [State or local government] reserves the right to accept or reject any proposals submitted to it and to conduct a formal procurement process, in each case if deemed by [State or local government] to be in its best interests and to comply with applicable laws or procurement policies. This RFP/RFQ is open from ________ to [insert date no later than six months after the first date or, in the case of mini RFPs, a date that is no later than 3 months after the first date]. [State or local government] understands that by responding to this RFP/RFQ, respondents are not municipal advisors to [State or local government]. [If not posting publicly, add the following language: This RFP/RFQ is being sent to [a least three investment banking firms] [the entire pool of firms].
Underwriter is Selected for a Transaction/Letter of Intent

Upon selection of an underwriter for a specific transaction (GFOA recommends selecting underwriters through a competitive RFP process), the GFOA recommends issuing a “letter of intent”, which will allow the underwriter to more freely discuss the transaction as its being developed. Model language for this exemption is suggested as followed:

Underwriter is Selected for a Transaction/Letter of Intent Language

[State or local government] is aware of the “Municipal Advisor Rule” of the Securities and Exchange Commission (effective July 1, 2014) and the underwriter exclusion from the definition of “municipal advisor” for a firm serving as an underwriter for a particular issuance of municipal securities.

[State or local government] hereby designates [Underwriter] as an underwriter for [brief description of the Bonds] (the “Bonds”) that [State or local government/Conduit Issuer/Obligated Person] currently anticipates issuing. [State or local government] expects that [Underwriter] will provide advice to [State or local government] on the structure, timing, terms, and other matters concerning the Bonds.

It is [State or local government’s] intent that [Underwriter] serve as an underwriter for the Bonds, subject to satisfying applicable procurement laws or policies, formal approval by [governing body/issuer], finalizing the structure of the Bonds and executing a bond purchase agreement. While [State or local government] presently engages [Underwriter] as the underwriter for the Bonds, this engagement letter is preliminary, nonbinding and may be terminated at any time by [State or local government] without penalty or liability for any costs incurred by the underwriter, or [Underwriter]. Furthermore, this engagement letter does not restrict [State or local government] from entering into the proposed municipal securities transaction with any other underwriters or selecting an underwriting syndicate that does not include [Underwriter].

____
[Underwriter]

____
[[State or local government] duly authorized official responsible for public finance]

Resources

- SEC Municipal Advisor Rule
- SEC MA Rule Frequently Asked Questions 1/16/14
- GFOA Issue Brief: SEC Municipal Advisor Rule
- GFOA Best Practice, Selecting and Managing the Engagement of Municipal Advisors (2014)
- GFOA Best Practice, Selecting and Managing the Engagement of Underwriters for Negotiated Bond Sales (2014)

- GFOA Best Practice, Selecting and Managing the Method of Sale of State and Local Government Bonds (2014)
- GFOA Best Practice, Investment of Bond Proceeds (2013)

Wednesday, May 14, 2014

SEC Approves Amendments to FINRA Rule 5110.

The SEC approved amendments to FINRA Rule 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements) to expand the circumstances in which termination fees and rights of first refusal are permissible; exempt from the filing requirements certain collective investment vehicles that are not registered as investment companies; and make clarifying, nonsubstantive changes regarding documents filed through FINRA's electronic filing system. The amendments become effective May 15, 2014.

Effective Date: May 15, 2014

Questions concerning this *Notice* should be directed to:

- Paul Mathews, Vice President, Corporate Financing, at (240) 386-4623;
- James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270;
- Kathryn M. Moore, Associate General Counsel, OGC, at (202) 728-8200.

View Full Notice

UBS Faces $5 Million Class Action Claim on Puerto Rico Bond Funds.

A class action claim filed this week in federal court sheds new light on the possible conflicts of interest surrounding UBS' sale of Puerto Rico municipal bond funds.

The complaint, filed on Monday in U.S. District Court for the Southern District of New York on behalf of seven investors in Puerto Rico, is asking for damages "in excess of $5 million" on the grounds that UBS AG's wealth management group violated its fiduciary duty in selling funds with proprietary products and high commissions.

UBS marketed the tax-free investments as secure "fixed income" securities that would preserve investors' principal, when in fact the funds were highly volatile and contained a large portion of bonds that UBS had underwritten, according to the complaint.

"For defendants, however, the funds were cash cows, which defendants milked for hundreds of millions of dollars in fees and commissions," the complaint said.

UBS said the complaint is "wholly without merit," according to a statement provided by spokesman Gregg Rosenberg.

"We intend to defend ourselves vigorously against [the allegations]," the firm said.

The complaint is not the first class action claim made with regard to the bond funds. As of April, Finra had received more than 200 arbitration claims on similar grounds.

But this class action is one of the first to make claims about breach of fiduciary duty and present numbers around the fees UBS collected.

“The fee issue in the class actions, and for that matter in arbitrations, will be an extremely important issue,” said Andrew Stoltmann, an attorney who is representing claimants in Finra arbitrations regarding the funds. “The onion is getting peeled in terms of what UBS did and how much they were paid.”

The plaintiffs say that under Puerto Rico’s securities laws, UBS was acting under a fiduciary standard of care, which would have made the conflicts of interest illegal.

UBS was the lead or co-lead underwriter in 19 municipal financings from 2008 to mid-2013 and collected more than $200 million in underwriting fees, the lawsuit said.

The firm also collected fees from its asset management unit for managing the closed-end bond funds and “generated tens of millions of dollars in advisory and transactional fees by causing the funds to purchase the Puerto Rico bonds they had underwritten,” according to the claim.

UBS made around $50 million in fees per year for managing the UBS closed-end funds, the complaint alleges.

Clients then paid a 4.75% commission when investing in the bond funds, which was much higher than if UBS had sold individual securities or bonds directly to consumers, according to the complaint.

The complaint also states that UBS advisers in Puerto Rico encouraged clients to borrow against their brokerage accounts and then re-invest the money into the funds. The firm made approximately $500 million in loans to Puerto Rico customers, plaintiffs said.

Investors had been pouring money in as Puerto Rico bond funds had demonstrated strong performance prior to 2013. The Tax Free Puerto Rico Bond Fund II Inc. generated a market return of 9.95% in 2012, according to an annual report from UBS.

“For more than 20 years, investors in UBS’ Puerto Rico and closed end funds received excellent returns that frequently exceeded the returns available through investments in other bonds or bond funds,” Mr. Rosenberg said. “In addition, because they are exempt from Puerto Rico and US estate and gift taxes and may have provided tax-exempt or tax-advantaged income, Puerto Rico municipal bonds and closed end funds provided additional benefits to investors.”

But a number of the funds tanked in 2013 as interest rates began to increase, the City of Detroit filed for bankruptcy and critics began to question Puerto Rico’s ability to deliver on its budgetary reform measures.

The Tax Free Puerto Rico Bond Fund II lost 49.75% for 2013 based on the market value of the shares of the fund.

The losses were amplified by the fact that many of the funds were over concentrated, highly leveraged and therefore unsuitable for retirees, the complaint said.

UBS said, however, that the funds’ holdings had to consist of at least 67% Puerto Rico assets in order to achieve the tax benefits, and that the concentration was disclosed in the prospectuses.

UBS’ head of wealth management and investment solutions, Robert Mulholland, had characterized the situation as a “perfect storm” during a September 2013 trip to San Juan, the complaint said.

The complaint also names Banco Popular de Puerto Rico, and a subsidiary, Popular Securities, which had around 50 financial advisers in Puerto Rico and jointly managed some of the Puerto Rico municipal bond funds, according to the complaint.

A spokesperson for Banco Popular was unable to be reached by press time.

By Mason Braswell

May 7, 2014 @ 2:29 pm (Updated 4:54 pm) EST

MSRB Pay-to-Play Proposal for Advisors.

In the next step of the MSRB’s regulatory framework for municipal advisors, it plans to request comment on extending the MSRB’s pay-to-play rule for dealers to include municipal advisors. MSRB Rule G-37 has played a central role in curbing the use of political contributions to secure municipal securities business for two decades. At its April meeting, the MSRB Board agreed that extending these provisions to municipal advisors would help prevent quid pro quo political corruption, and the appearance of it, in public contracting for both dealers and municipal advisors.

In other municipal advisor news, the MSRB is revising its draft Rule G-42 on core standards of conduct for municipal advisors. The revisions seek to clarify and respond to concerns raised by commenters on the rule, including those regarding the treatment of principal transactions. The MSRB will continue to consider the comments received on draft Rule G-42 and will announce next steps soon.

MSRB: New Fairness and Pricing Efforts.

The MSRB is moving forward with establishing the first-ever “best-execution” standard for transactions in the municipal market. At its April 2014 meeting, the MSRB Board of Directors agreed to seek approval from the Securities and Exchange Commission on a rule to require dealers to use “reasonable diligence” when handling and executing municipal securities trades for retail investors. The rule aims to improve pricing for retail investors by ensuring dealers have appropriate procedures in place to achieve a price that is as favorable as possible under prevailing market conditions. The rulemaking process is ongoing. Read the draft best execution rule from February 2014.

The MSRB also is advancing three initiatives to enhance price transparency for municipal securities investors on its Electronic Municipal Market Access (EMMA®) website. The MSRB plans to:

- Introduce a “price discovery tool” on EMMA that will allow investors to easily find and compare prices of municipal securities with similar characteristics and provide a graphical view of historical pricing
- Develop a concept release on the presentation of market information to aid investors in assessing markups or markdowns on their transactions
- Expand the pricing-related data available on EMMA by developing a proposed framework for

collecting additional post-trade information for public display and exploring an approach for collecting and disseminating relevant, selected pre-trade data
- These developments will be introduced in the coming months.

MSRB to Consolidate Fair-Pricing Rules for Municipal Securities Dealers.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) has received approval from the Securities and Exchange Commission (SEC) to consolidate municipal securities dealers' existing fair-pricing obligations into a single rule, facilitating dealer compliance with a fundamental investor protection regulation. This action is part of a larger, multi-year initiative that the MSRB has underway to review and streamline its Rule Book.

"The MSRB continues to focus on opportunities to further improve our Rule Book to better highlight key principles and support regulatory efficiency and compliance," said MSRB Executive Director Lynnette Kelly. "Consolidating all fair-pricing rules and interpretations into a single rule is an important step forward in this effort."

Fair-pricing requirements for dealers with respect to customer transactions currently are contained in three separate MSRB rules, Rule G-30 on prices and commissions, Rule G-18 on execution of transactions, and Rule G-17 on fair dealing, and in various interpretive guidance under Rules G-30 and G-17.

The new, single fair-pricing rule, which requires dealers that transact municipal securities with or on behalf of customers to use a "fair and reasonable" standard for the pricing of the security and for any related commission or service charge, does not make any substantive change to existing dealer pricing obligations. Effective July 7, 2014, all pricing-related obligations will be contained in revised MSRB Rule G-30.

Date: May 12, 2014

Contact: Jennifer A. Galloway, Chief Communications Officer
(703) 797-6600
jgalloway@msrb.org

MSRB Provides Guidance to Municipal Advisors on Changes to its Registration Process.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) published guidance to assist municipal advisors with understanding changes to the MSRB's registration process taking effect today. The guidance seeks to clarify that these changes are separate and apart from the Securities and Exchange Commission's transition to a permanent registration regime for municipal advisors.

MSRB Rule A-12 was amended to consolidate registration requirements into a single rule and to create a simplified electronic registration form. Firms that are currently registered with the MSRB under the previous requirements must verify, update and complete their registration information in the new form by August 10, 2014. The MSRB's guidance responds to frequently asked questions about the MSRB's new registration process, which may be useful for both municipal advisors and municipal securities dealers.

The MSRB is also hosting an educational webinar to assist current registrants with submitting the new registration form.Learn more and register to attend the webinar.

Date: May 12, 2014

Contact: Jennifer A. Galloway, Chief Communications Officer
(703) 797-6600
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Bond Ratings: Two Sides to Transparency.

ORLANDO — Increased transparency in the bond rating agencies has been a positive for both investors and issuers, even though it can potentially create a false sense of analysis being an exact science, experts told fellow municipal analysts on Thursday.

They made their comments during a panel discussion on the evolution of bond ratings here at the National Federation of Municipal Analysts' annual conference. The Dodd-Frank Act required a number of changes to the industry, among them a requirement that agencies disclose their rating methodologies.

Jeffrey Previdi, managing director of U.S. public finance at Standard & Poor's, said the evolving business has created positive developments for the market such as an increase in competition among those weighing in on credit quality. Whether the market agrees with a rating or not, he added, the rationale behind it will always be clear.

"The investor will be hard-pressed to say 'I don't understand how they arrived at that triple-A,'" Previdi said.

Standard and Poor's has launched both web and Ipad applications allowing users to simulate their own local government credit scenarios. The tool is available to anyone who registers for a free account with the agency, and provides a blank slate into which users can input information about a local government of their choice.

But Eric Friedland, a portfolio manager and head of municipal research at Schroder's Investment Management said the extreme transparency and scorecards that require only that numbers be punched in create the false sense that anyone can play analyst.

"It seems quantitative on the surface," Friedland said, but credit analysis has to go beyond the numbers to include qualitative evaluation as well. "I think that creates a lot of confusion," he said.

Rachel Barkley, a credit analyst with Morningstar Inc., said that while it isn't up to the rating agencies to be "policemen" who push issuers into responsible behavior, they can play a positive role by setting forth benchmark criteria that municipalities will want to adhere to in order to earn better ratings. Barkley said the quality of ratings should not be judged by how bonds perform in the marketplace, pointing to strong demand for Puerto Rico's junk-rated to GOs.

“Sometimes the market is just irrational,” she said.

Friedland said there would be little need for investment professionals if bond prices always matched ratings.

“A lot of us wouldn’t have jobs,” he said.

The NFMA conference concluded Friday, and will convene again next May in Las Vegas.

BY NAOMI JAGODA

MAY 9, 2014 11:07am ET

California Ruling Exempts Personal Devices From Open Records Laws - Will It Stand?

A California appeals court ruled last month that emails and other forms of electronic communication about public business are not subject to the state’s Public Records Act if they’re conducted on a private computer or device. But the decision’s impact on government transparency policies may cause aftershocks well beyond the Golden State’s borders.

The 6th District Court of Appeal in San Jose’s March 27 opinion gives elected officials and government employees a free pass to conduct public business in secret on their own devices. And with other states grappling with data retention and transparency issues, the decision could serve as a model to pull back on open government efforts over the last several years.

Peter Scheer, executive director of the First Amendment Coalition, a nonprofit group that advocates for free speech and open government, explained that public records laws are built on a presumption that when writing or communicating about government business, that speech is public record. There are exemptions that address policy considerations that justify confidentiality at times, but it’s generally accepted that government communications can be requested by the average citizen.

“This goes way beyond that,” Scheer said, referring to the 6th District’s decision. “This simply creates a whole new parallel channel of communication which is totally untouched and unregulated and is outside of the freedom of information system and rules we have.”

The 6th District Court of Appeal’s ruling overturned a lower court decision that would have enabled a citizen to obtain messages sent on private devices through private accounts of the San Jose mayor and city council members. The California Supreme Court may take up the case, but if it doesn’t, the 6th District’s decision would stand, creating a precedent for similar situations in the future.

Emily Shaw, national policy manager for the Sunlight Foundation, a nonprofit organization that favors government transparency, agreed with Scheer and felt the court’s decision was troublesome. She added that in every state’s public records law, private devices are either subject to records requests, or the states haven’t yet ruled on the issue. The California ruling puts the state in an entirely separate category, which could lead to big problems down the road.

“If California leads the way in saying that using private hardware means that the public no longer has access to those records, then it will be a very serious reduction in the amount of substantive information that people can access through the state's public records law," Shaw said. "Not necessarily because it's not happening already and we just have difficulty in capturing it, but it would … create a big loophole."

Chuck Thompson, general counsel and executive director of the International Municipal Lawyers Association, said the situation in California was hard to judge because all states have slightly different open records laws. But he said the appeals court decision "does seem to conflict" with the laws other states have on the books.

TECHNOLOGY OUTPACING THE LAW

Many state public records laws were written based on written communications – documents before, or at the very outset of, the digital age. For years it was generally accepted that verbal discussions occur every day in local and state government offices that aren't entered into the public record.

But as technology has advanced and somewhat blurred the lines of communication, some have proposed that serious changes need to be considered. Thompson noted that in the past, people who requested a public document would get a copy of that document – not the fingerprints on the original document, but a copy of the original. Now, however, people ask for the metadata associated with an electronic document, which has spurred debate on whether government agencies need to archive and release that information as well.

Texting is another example of a means of communication that has polarized public records discussion. Maine Gov. Paul LePage has been scrutinized over the past few weeks for outlawing text messaging as a means to do state business. While state employee text messages in Maine about public business are subject to the state's Freedom of Access Act, the messages aren't stored by state servers and almost impossible to recover.

The decision to ban texting was made after a former employee of the Maine Center for Disease Control and Prevention was allegedly told by supervisors to use texts to communicate because they couldn't be obtained to fulfill public-records requests. But not everyone believes that was the right move.

One state CIO who wished to remain anonymous, told *Government Technology* last week that while text messaging was "writing," it arguably had more in common with telephone calls and verbal conversations made by public officials every day that aren't entered into the public record. For states – and local governments – that allow texting, the idea that text messages should be retained for public records requests comes with a potentially huge expense.

Thompson believes there are a number of additional issues that states need to consider that could become public record law nightmares. He pointed to cloud storage and the federal communications storage laws and how they may impact future public requests for information.

For now, however, government agencies and municipal attorneys are left waiting to see if the California Supreme Court steps in to tackle the private device question.

"I think it will take up the issue [but] it might not take up this case, because it may want to wait and see if other courts of appeal in California decide the issue differently," Scheer said. "But I do think that the issue ultimately will be decided in the state supreme court."

Brian Heaton | Senior Writer

Brian Heaton is a senior writer for *Government Technology*. He primarily covers technology legislation and IT policy issues. Brian started his journalism career in 1999, covering sports and fitness for two trade publications based in Long Island, N.Y. He's also a member of the Professional Bowlers Association, and competes in regional tournaments throughout Northern California and Nevada.

CDO Disclosures Don't Preclude Citi Fraud Claim: N.Y. Appeals Court.

NEW YORK (Reuters) – A state appeals court on Thursday denied Citigroup Inc's bid to dismiss a fraud claim in a lawsuit stemming from nearly $1 billion of collateralized debt obligations.

The Appellate Division, First Department, said that disclaimers and disclosures in marketing materials for the securities did not bar plaintiff Loreley Financing from establishing that it relied on Citi's allegedly false and misleading misrepresentations when it bought the securities in 2006 and 2007.

"We find that these disclaimers and disclosures fall well short of tracking the particular misrepresentations and omissions alleged by plaintiffs," Justice Dianne Renwick wrote for a unanimous panel.

Loreley, a group of special-purpose entities formed to invest in CDOs, sued Citi in 2012 for defrauding it into purchasing "fraudulent investments that are now worthless," according to the complaint.

The suit, filed in Manhattan Supreme Court, claimed Citi used the CDOs to offload risks of toxic mortgage-backed securities and to help preferred clients short the housing market. It accused Citi of fraud, rescission, fraudulent conveyance and unjust enrichment.

In June 2012, Citi moved to dismiss the complaint.

In December 2012, Justice Jeffrey Oing granted Citi's motion to dismiss the rescission and fraudulent conveyance claims, but denied its bid to dismiss the fraud and unjust enrichment claim.

On appeal, Citi argued that the marketing materials for the securities required purchasers to disclaim reliance on Citi's advice or representations. The materials, Citi said, warned buyers that collateral underlying the securities was subject to risks and that Citi and its affiliates could act in numerous capacities in the deal that could conflict with buyers' interests.

The First Department disagreed, citing its decision earlier this year in Basis Yield Alpha Fund v. Goldman Sachs Group, a CDO lawsuit which it said included "indistinguishable" allegations of fraud.

In that case, the First Department said it affirmed a lower court's decision denying Goldman's bid to dismiss the case based on "very strongly-worded disclaimers and disclosures."

"Basis Yield … constitutes clear precedent that compels us to find that Citigroup's disclaimers and disclosures do not preclude, as a matter of law, a claim of justifiable reliance on the seller's misrepresentations or omissions," Renwick wrote.

The First Department did dismiss the unjust enrichment claim, however.

Justices Angela Mazzarelli, John Sweeny, Helen Freedman and Judith Gische joined Renwick in the decision.

“Loreley is very pleased with the First Department’s ruling today, and we look forward to presenting our case to the trial court,” said Sheron Korpus, a partner with Kasowitz, Benson, Torres & Friedman who represented Loreley.

Susanna Buergel, a partner with Paul, Weiss, Rifkind, Wharton & Garrison who represented Citi, did not immediately respond to a request for comment.

The case is Loreley Financing et al v. Citigroup Global Markets Inc et al, New York State Supreme Court, Appellate Division, First Department, No. 11886.

For Loreley: Sheron Korpus of Kasowitz, Benson, Torres & Friedman.

For Citi: Susanna Buergel of Paul, Weiss, Rifkind, Wharton & Garrison.

May 8, 2014

Bernard Vaughan

SIFMA Finalizes Model Documents for Compliance with Municipal Advisor Rule; Will Host "Muni Advisor Regulation - Implementation and Registration" May 9

New York, NY, May 7, 2014 – SIFMA today announced that it has finalized its model documents and related guidance to help brokers, dealers and other financial institutions serve their clients and comply with the new regulatory requirements created by the SEC’s Municipal Advisor Rule. The documents are available atwww.sifma.org/MAForms.

“We released the draft documents last month in an effort to help our members comply with this new rule,” said Leslie Norwood, managing director, associate general counsel and co-head of SIFMA’s municipal securities division. “We would like to thank the industry for its review and thoughtful comments on the drafts.”

The SEC’s Municipal Advisor Rule imposes a registration regime upon municipal advisors, i.e., firms that give advice absent an exemption or exclusion to municipal entities and obligated persons, and imposes a fiduciary duty upon municipal advisors that give advice to municipal entities. MSRB rulemaking will impose additional requirements and prohibitions on the conduct of municipal advisors.

SIFMA’s model disclosures are designed to be a starting point to aid firms with serving their clients and compliance with the SEC’s Municipal Advisor Rule; however, close attention must be paid to the specific language used, as the Rule and the SEC’s interpretive guidance is very specific as to what is required for compliance with certain exemptions or exclusions. SIFMA encourages firms to modify these documents as necessary to reflect their own analysis of the Rule or the specifics of particular client relationships or transactions.

SIFMA also recommends that firms update their internal policies and procedures and continue to educate their personnel about this new regulatory requirement ahead of the Municipal Advisor Rule's July 1 effective date.

SIFMA will also host a seminar and webinar titled "Muni Advisor Regulation – Implementation and Registration" on May 9, 2014 in New York City. The seminar will provide an in-depth discussion on the regulatory framework and outlook for municipal advisors and other firms potentially covered by this rule.

The program will begin with an introduction and launch of SIFMA's Municipal Advisor Model Documents, followed by three consecutive panel discussions: Municipal Advisor Regulation, with panelists from the SEC, FINRA and the MSRB; Municipal Advisor Registration Rule Implementation – Underwriting; and Municipal Advisor Registration Rule Implementation – Asset Management and Bond Proceeds. The seminar will conclude with a presentation from featured speaker Lanny Schwartz, Partner at Davis Polk & Wardwell LLP, who will cover specific practical tips and potential issues with respect to the filing of the Form MA. Filing deadlines and differences with the Form BD will be highlighted. Issuers can register for the event for free. Please click here to view more information on the conference: http://www.sifma.org/munireg2014/program/

Release Date: May 7, 2014
Contact: Katrina Cavalli, 212.313.1181, kcavalli@sifma.org

[Call for Entries: Municipal Securities Regulation Essay Competition.]()

Alexandria, VA– In conjunction with the [Securities and Exchange Commission Historical Society](), the Municipal Securities Rulemaking Board (MSRB) is inviting submissions to a writing competition on municipal securities regulation sponsored by the Society. The winning essay will be part of the Society's Gallery on Municipal Securities Regulation, opening in 2015.

The writing competition is open to all visitors to the Society's virtual museum and archive at [www.sechistorical.org](). The writing award will recognize an essay on any area of municipal securities regulation and will become part of the MSRB's gallery, opening December 1, 2015. The MSRB will celebrate its 40th anniversary in 2015.

The award recipient will receive a $5,000 prize. The submission deadline for essays is December 31, 2014. [View complete entry guidelines]().

The SEC Historical Society shares, preserves and advances knowledge of the history of financial regulation. The Society is a 501(c)(3) non-profit organization, independent of and separate from the U.S. Securities and Exchange Commission.

[5 Big Compliance Lessons from Recent SEC Cases.]()

With seemingly daily news about the Securities and Exchange Commission cracking down on advisory firms for wrongdoing, here's a list of five top issues and lessons learned from recent regulatory actions.

5. Do the due diligence you said you did

Barry Bekkedam, the former owner of investment advisory firm Ballamor Capital Management and a former Villanova University basketball player, touted to clients and prospects the high level of due diligence he performed on a private investment fund that turned out to be a Ponzi scheme, the SEC alleged in an April 30 complaint.

Take to heart what the SEC spelled out in a January exam program risk alert — it expects advisers to perform strict due diligence of alternative investments.

4. Repeating an error is an even bigger mistake

Transamerica Financial Advisors Inc. did not correct procedures throughout its firm after regulators found violations at a branch office that some clients weren't getting the breakpoint discounts they were due, the SEC said in an April 3 administrative complaint. The St. Petersburg, Fla.-based firm had to pay a total of $1 million in fines and client payments to more than 2,000 customers. Our story digs into the issue.

3. Conflicts of interest will get you every time

Advisory firm Total Wealth Management and owner Jacob Cooper failed to tell clients that the Altus family of funds they were recommending was paying them and others at the firm revenue sharing fees, the SEC said in an April 15 complaint.

Todd Cipperman, managing principal at Cipperman Compliance Services said revenue sharing isn't illegal, but it might not be possible for a firm to disclose enough to convince examiners there is no conflict. And in a bonus lesson, Mr. Cipperman said firing a compliance consultant — which the firm did, according to the SEC — is a red flag that "something may be amiss."

Details can be found in our coverage.

2. Insider trading applies to brokers, too

A broker who was at Oppenheimer & Co. and then Morgan Stanley, traded on inside information during four years in accounts for himself and 50 brokerage firm customers, the SEC said in a complaint on March 19. The tips originated from a law firm employee and were passed through a middleman who chewed up the Post-it or napkin on which they were written, the complaint said. The SEC now wants back the $5.6 million generated in ill-gotten gains. Our story looks into the matter.

1. Don't make it worse by lying

Columbus, Ohio-based Professional Investment Management repeatedly overstated client assets by at least $750,000 in client statements, and its president and chief compliance officer tried to hide the shortfall from SEC examiners by entering a fake trade in the firm's records, the SEC said in its May 5 complaint. A judge in the case, which began as a look into custody rule violations, has frozen the firm's accounts to protect client assets. The SEC also is seeking civil penalties "due to the egregious nature of the defendants' violations," it said in the complaint. Find more details on the issue inour recent story.

By Liz Skinner

MSRB Holds Quarterly Meeting.

Alexandria, VA – The Board of Directors of the Municipal Securities Rulemaking Board (MSRB) held its quarterly meeting April 30 – May 2, 2014, where it advanced several initiatives to improve the structure, efficiency and transparency of the municipal securities market. The Board also continued to develop a regulatory framework for municipal advisors, agreeing to propose extending its landmark pay-to-play rule to municipal advisors, among other actions.

Best Execution
The Board agreed to seek approval from the Securities and Exchange Commission (SEC) to implement a "best-execution" standard for transactions in the municipal market. The rule would establish for the first time an explicit obligation for dealers to use "reasonable diligence" when handling and executing municipal security trades for retail investors to achieve a price that is as favorable as possible under prevailing market conditions.

"Building on the MSRB's existing fair-pricing rules, the best-ex rule would add an additional layer of protection for retail investors while remaining flexible for dealers operating in a unique marketplace," said MSRB Board Chair Daniel Heimowitz.

Municipal Advisor Regulation
The Board continued its development of a regulatory framework for municipal advisors by agreeing to develop draft amendments to its pay-to-play rule for dealers to also include municipal advisors.

"For two decades, MSRB Rule G-37 has played a central role in curbing the use of, and the appearance of the use of, political contributions to secure municipal securities business," Heimowitz said. "Extending these provisions to municipal advisors will help prevent *quid pro quo* political corruption, or the appearance of such corruption, in public contracting for both dealers and municipal advisors."

To date, the MSRB has sought comment on draft rules for municipal advisors to establish core duties and standards of conduct, supervisory and compliance obligations, and baseline professional qualification requirements. The Board reviewed comments received on the first of these proposals, draft MSRB Rule G-42, on the duties of non-solicitor municipal advisors. The Board began revising the draft rule to clarify and respond to concerns raised by commenters, including concerns about the treatment of principal transactions. It will continue to consider the comments received and will announce next steps soon.

Price Transparency
The Board also advanced three initiatives to enhance price transparency for municipal securities investors. The first is the introduction of a "price discovery tool" on the MSRB's Electronic Municipal Market Access (EMMA®) website that will soon allow investors to easily find and compare prices of municipal securities with similar characteristics. A new graphical view of historical pricing will make data on EMMA even more useful and enable investors to clearly see prices at which any municipal security and other securities with similar characteristics were bought and sold over a specified period of time. The EMMA website, at emma.msrb.org, is the official source of municipal market disclosures and data, including trade prices for virtually all municipal securities.

“EMMA’s innovative price discovery tool will break new ground in terms of transparency for investors in the municipal market,” Heimowitz said. “This improved display of transaction prices has the potential of becoming a significant new tool for empowering investors to make more informed investment decisions.”

Second, the Board authorized MSRB staff to develop a concept release on the presentation of market information to aid investors in assessing markups or markdowns on their transactions. The MSRB supports a holistic review of the data available on the EMMA website and the ways that such data may enhance post-trade price transparency for investors and other market participants. The concept release will not contain a specific rule proposal, but will seek broad industry and public input in this area, including ways to address the topic of markup disclosure. Given many of the existing enhancements in post-trade price transparency on EMMA, fresh commenter input on markups and markdowns, including those on so-called “riskless principal” transactions or “matched trades,” may guide future rulemaking.

Third, the Board agreed to take the next steps toward expanding the pricing-related data available on EMMA as part of its central transparency platform initiative. The MSRB will develop a proposed framework for enhancing its Real-time Transaction Reporting System (RTRS) to collect additional post-trade information for public display on EMMA as well as a potential framework for a phased approach for the collection and dissemination of relevant pre-trade data. The MSRB will engage in outreach with market participants in advance of seeking formal comment, beginning this summer, on these two frameworks on separate tracks, consisting of a request for comment on proposed RTRS changes, followed by a concept release on a potential first phase of an incremental approach for collecting and disseminating relevant selected pre-trade data.

Dealer Continuing Education

At its meeting, the Board also agreed to file with the SEC a modified proposal to require that dealers provide annual training on municipal securities to registered persons regularly engaged in municipal securities activities as part of the MSRB’s firm element continuing education requirements. Although not specifying a minimum amount of training time, as originally proposed, the Board believes that the unique nature of the municipal securities market and its regulatory environment necessitate annual municipal securities training to persons regularly engaged in this business. This requirement will help ensure that firms consider the particular training needs of personnel responsible for understanding municipal securities products and complying with MSRB rules. The MSRB makes available a number of free educational resources about its rules on its website, including webinars about proposed and final rules.

Other Business

Finally, the Board met with SEC Commissioner Michael S. Piwowar, whose extensive background in economic analysis and municipal market structure lends an important perspective to the oversight of the municipal securities market. The Board and Commissioner Piwowar discussed the shared priorities of the MSRB and the SEC related to market structure issues and economic analysis of rulemaking.

Date: May 6, 2014

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Bond Firm’s Gifts to California School Officials Draw Scrutiny.

California’s political watchdog is investigating whether school officials failed to report gifts from municipal bond underwriter Stone & Youngberg, now a unit of Stifel Financial Corp.

The California Fair Political Practices Commission is looking into whether officials at districts that did business with Stone & Youngberg neglected to report meals and other gifts on mandatory disclosure forms, commission spokesman Jay Wierenga said by telephone.

Stone & Youngberg, based in San Francisco, was the state’s fourth-biggest muni underwriter when Stifel bought it in 2011. In the five years preceding the acquisition, Stone & Youngberg managed $14.7 billion in bond sales in California, according to data compiled by Bloomberg. Since October 2011, Stifel has overseen $7.9 billion of issuance in the state, the data show.

“It’s not necessarily Stone & Youngberg as the focus of our investigation,” Wierenga said yesterday by telephone from Sacramento. “The focus is on unreported gifts. A lot of companies give gifts. Those have to be reported.”

Stephen Heaney, a Stifel managing director in Los Angeles, didn’t respond to telephone calls and e-mail messages seeking comment. Linda Olszewski, a company spokeswoman in St. Louis, didn’t respond to e-mail after regular business hours.

Stone & Youngberg managed sales in two San Diego County school districts that pushed the largest debt payments decades into the future through capital-appreciation bonds. The Santee Unified School District sold $3.5 million in 2011 with no payment due until 2026 and $40.3 million payable in 2051. The Poway Unified School District deferred to 2033 all payments on $105 million in bonds issued in 2011, with interest totaling $1 billion.

‘Abusive’ Practice

State Treasurer Bill Lockyer criticized the practice as “abusive” and led a push in the legislature to cap interest costs at four times the principal.

Under California law, local elected officials must disclose gifts worth an aggregate of $50 or more. Gifts from a single source may not total more than $440 in a year. The state also prohibits elected officials from voting on matters from which they may personally profit.

Wierenga declined to provide details on the state’s investigation such as the school districts or officials under scrutiny.

By James Nash April 21, 2014

To contact the reporter on this story: James Nash in Los Angeles at jnash24@bloomberg.net

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[Bracewell & Giuliani: SEC Municipalities Continuing Disclosure Cooperation Initiative Targets Issuers and Underwriters with a "Prisoner's Dilemma"]

On March 10, 2014, the Enforcement Division of the Securities and Exchange Commission (SEC) announced the Municipalities Continuing Disclosure Cooperation Initiative (MCDC) – an offer for municipal issuers and their underwriters to turn themselves (and others) in now for certain potential violations of the securities laws in exchange for lighter punishments, in contrast to harsh penalties threatened for those caught after the September 9, 2014 deadline. The offer extends only to potential violations of the antifraud rules made in an Official Statement regarding the issuer's past compliance with continuing disclosure agreements and not to other violations of the antifraud provisions. The scope of transactions potentially covered by the MCDC is extensive and the terms provided in SEC materials raise many questions. The chief of the Enforcement Division's Municipal Securities and Public Pensions Unit, LeeAnn Gaunt, and her deputy Mark Zehner provided additional insight into MCDC in response to questioning during recent panels chaired by Paul Maco, one of the authors of this Alert. That insight is incorporated into this Alert.

Read the full Alert HERE.

BDA Submits Comment Letter on MSRB Draft Rule G-44.

BDA submits comment letter to the MSRB on Draft Rule G-44, on Supervisory and Compliance Obligations of Municipal Advisors.

Specifically, our letter addressed the following:

- We asked that the MSRB supply minimum standards for municipal advisors of all sizes;
- We asked that the MSRB make clear within the language of Draft Rule G-44 that the firm itself remain ultimately responsible for any decisions made or affected by the CCO, whether this position is outsourced or not;
- We believe it is critical for municipal advisors to self-certify that they are meeting the same professional qualification standards as those already established by those affiliated with broker-dealer firms; and
- We asked that the MSRB consider delaying the implementation of Draft Rule G-44, and any and all other municipal advisor rules, until at least six months after all the rules that will comprise the MSRB's entire regulatory framework have been finalized and approved by the SEC.

You can find our final comment letter here.

Non-Dealer MAs: Supervision Rule Could Hurt Market.

WASHINGTON — Non-dealer municipal advisors are warning the Municipal Securities Rulemaking Board's proposed rule on MA supervisory requirements could be costly to the market without greatly benefiting the issuers it is designed to protect.

The National Association of Independent Public Finance Advisors issued the warning in comments about the MSRB's proposed Rule G-44, Supervisory and Compliance Obligations of Municipal Advisors, on Monday.

While dealer groups said they approve of the MSRB's approach, NAIPFA president Jeanine Rodgers Caruso told the board in a letter that the problem this rule seeks to solve may not be big enough to justify the regulatory costs that MAs will have to pass along to issuers.

Proposed Rule G-44 would require MAs to establish, implement, maintain and enforce written supervisory procedures designed to ensure compliance with the federal securities laws and rules. It would mark the first time non-dealer MAs have been subject to supervisory requirements under MSRB rules,

To the best of our knowledge, since the enactment of the Dodd-Frank [Act] and the imposition of a federal fiduciary standard on municipal advisors, no enforcement actions have been brought against a municipal advisor for breach of fiduciary duty," Rodgers Caruso wrote. "Therefore, due to the lack of objective evidence indicating that firms have engaged in widespread violations of their fiduciary duties, NAIPFA does not believe that a need exists for the MSRB to articulate supervisory/compliance obligations at this time. In this regard, the costs, time and effort that will be required to be expended by municipal advisors will likely outweigh any incremental benefits that may be realized by municipal entities and obligated persons."

NAIPFA's letter said that many smaller MAs would likely merge or fade out of existence facing the regulatory burden of having to maintain compliance records for a minimum of five years and having to designate a chief compliance officer. Those that choose to stay in business will probably have to pass the costs along to issuers, raising borrowing costs for municipalities, the letter argues. The group, however, complimented several aspects of the MSRB's approach, such as accommodating single-member MA firms by allowing those practices to outsource the chief compliance officer job.

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said dealer-affiliated MAs have already been complying with similar requirements under the MSRB's dealer supervisory rule, G-27. Cohen said in an interview that the proposal is "the right approach," and is a step toward creating a level playing field between historically regulated dealer-MA's and unregulated non-dealer MAs despite being less stringent than G-27. Cohen's letter to the board asks that MAs be given a minimum of six months to comply with any final G-44.

Bond Dealers of America president and chief executive officer Mike Nicholas urged the MSRB to set baseline supervisory standards that all MAs must meet, rather than allowing small advisory firms to tailor their compliance programs in ways that might make them less stringent. The rule proposal allows small MA firms to take their size into account when designing their compliance programs.

"Small or one-man shops should not be permitted the opportunity, purposefully or otherwise, to diminish their obligation toward meeting the demands of the rule and this regulatory regime should in fact be comparable to the regulatory regimes for other entities and persons in the financial services industry," Nicholas wrote. "We believe firms of all sizes and business models should be held to the same standard of service and should be required to meet the requirements of the law."

The Investment Company Institute said it supports proposed Rule G-44 because it is consistent with existing obligations for broker-dealers. ICI's comment letter requests 12-months before compliance kicks in following the adoption of the final rule.

The MSRB is also developing rules on MA conduct, fees, qualification examinations, and political contributions. The Securities and Exchange Commission must approve any proposal before it could become a rule.

BY KYLE GLAZIER

APR 28, 2014 2:15pm ET

MSRB to Discuss Trade, Best Execution, MA Rules at Meeting.

WASHINGTON — The Municipal Securities Rulemaking Board next week will discuss plans to rebuild its real-time reporting system and the possibility of developing a rule to limit the political contributions of municipal advisors, as well as the comments it has received on its proposed rules on best execution and MA conduct.

The MSRB released topics for its meeting in Alexandria, Va. next Wednesday through Friday, including efforts to turn the RTRS into a true central transparency platform.

The board announced in October that price transparency would be a major objective for the new fiscal year, and that it hoped to strengthen its EMMA website by adding more post-trade pricing data. In January the board asked market participants to comment on the possibility of tweaking the current RTRS, including the possibility of no longer giving dealers extra time to report certain trades.

The board will discuss comments on its proposed Rules G-42 on the duties of municipal advisors who do not solicit muni business and G-18 on best execution. Rule G-42 touched off some intense debate among market participants when the MSRB proposed it in January, It would codify the language of the Dodd-Frank Act and the Securities and Exchange Commission's registration rule for MAs, which impose a fiduciary duty on them to put their client's interest first before their own. The draft rule says MAs owe both a duty of loyalty and a duty of care to their issuer clients.

It would prohibit an MA and its affiliates from engaging in any other transaction in a principal capacity with a client, which dealers warned could be "unworkable" for banks with associated muni advisory businesses. The bank would have to choose between providing banking services or MA services to a client under the proposal, banking and dealer group leaders told the MSRB.

The idea of a best execution rule, which would require broker-dealers to "use reasonable diligence" to obtain "the most favorable terms available under prevailing market conditions" for their customers, initially faced very heavy skepticism from dealer groups who warned that an attempt to impose a "trade-by-trade" corporate-style mandate wouldn't work in the more opaque and less liquid muni market.

More recently, dealers have softened their views on the proposal but requested more guidance on how a best-ex rule would interact with fair-pricing requirements. Non-dealer financial advisors said the board's fair-dealing rule would need to be amended, because of the proposed G-18 best execution rule, to reflect a dealer's new obligation to sell securities at prices most favorable to investors — something issuers would need to know if the proposed best-ex rule applies to new offerings as well as secondary market transactions.

Other topics of discussion will include a possible rule governing restrictions on political contributions by registered MAs, and dealer continuing education requirements.

BY KYLE GLAZIER

APR 23, 2014 2:22pm ET

Small Issuers Uninformed About MA Rules; Dealers Picking up Slack.

WASHINGTON — Many smaller issuers remain uninformed about what the impending municipal advisor regulatory regime will mean for them, with broker-dealers picking up the slack and providing them with information, according to market participants.

The Securities and Exchange Commission's MA registration rule takes full effect July 1. The Municipal Securities Rulemaking Board is also in the process of creating rules for MAs, including those on standards for conduct, professional qualifications, supervision and fees. The rules are required by the Dodd-Frank Act, which mandated that MAs register with the SEC, become subject to federal regulatory oversight, and be bound by a fiduciary duty to put their issuer clients' best interests first.

Issuers are not regulated by the SEC's or MSRB's rules, but the regulations will affect how they interact with the dealers who have largely driven conversations about the registration rule.

"Although the municipal advisor rule directly applies to those firms that meet the regulatory definition of advisor, the rule has significant implications for issuers as well, and all market participants should make an effort to stay abreast of regulatory changes," said Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at the Securities Industry and Financial Markets Association. SIFMA recently released model documents designed to allow underwriters to make sales pitches to issuers by utilizing any of three major exemptions that would allow a potential underwriter to provide them with advice without being considered an MA. The three are: becoming engaged as an underwriter; responding to an issuer's request for proposals, or confirming that the issuer has its own MA not associated with the underwriter.

"SIFMA and our members have been working with issuers to understand the breadth of the rule," Norwood said.

Ben Watkins, Florida's bond finance director and head of the debt committee at the Government Finance Officers Association, said the level of knowledge about the rule among some issuers is very low.

"There's a huge contingent in the market that doesn't have a clue," he said.

Watkins strongly disagrees with the way the SEC wrote the rule, and said it could have been a much more streamlined piece of regulation. Watkins said SEC muni chief John Cross, head of the SEC's Office of Municipal Securities, is "hamstrung" in terms of what he's able to do in terms of making the rule simpler for market participants, and that the SEC's "frequently asked questions" guidance earlier this year was only marginally helpful.

"They're not actively engaged in educating," Watkins said of the SEC. "In terms of outreach, there basically hasn’t been any.”

Cross said the mission of educating issuers is an important one that his office is not neglecting.

“It is very important to increase the awareness of municipalities about how the final municipal advisor registration rules will affect their interactions with regulated municipal advisors,” he said. “A core purpose of this regime is to enhance protections to municipalities through a fiduciary duty on municipal advisors to look out for the best interests of their municipal entity clients. I will speaking to the [Government Finance Officers Association’s] upcoming annual conference in May about this topic and also looking for other opportunities to provide outreach to municipalities about these important new final municipal advisor rules.”

Laura Lockwood-McCall, director of the debt management division in the Oregon State Treasury said that the MSRB’s chief education officer Ritta McLaughlin recently spoke to a conference of Oregon issuers about the rule, but that many small issuers still lack knowledge and will likely learn more about the new regime from dealers.

“I think that this new requirement will impact a lot of smaller issuers, particularly school districts in our state, in that they may not currently have a financial advisor on contract,” Lockwood-McCall said. “I’m not sure they will realize there’s a problem with the new rule, however, as they are infrequent issuers to begin with. The underwriting community will in some ways be the educator, as I can envision them asking issuers if they have an [financial advisor], and then pointing out that they need to have one on board in order for them to work with the district on a transaction.”

Mark Kim, chief financial officer at the District of Columbia Water and Sewer Authority, said he and other issuers got hit with a flurry of communications from investment bankers earlier this year. Because the SEC has made clear that a firm cannot be an MA on, and underwrite the bonds for, the same transaction, Kim said, dealers have been very eager to be the ones letting issuers know about the available exemptions and how to utilize them.

“The banks certainly gave their own interested spin on the MA regs,” Kim said.

DC Water retains its own MA, which it pays hourly whenever the authority wants it to look over a proposal from a dealer firm, Kim said. He said he receives pitches from would-be underwriters on a nearly daily basis, but often chooses not to forward those on to the MA because some he considers bad ideas and would prefer not to spend DC Water funds to further scrutinize them. Kim said he likes being able to be his own idea gatekeeper and likes being able to receive ideas from dealer firms without restriction thanks to the exemption available from the independent MA. Although the bankers and advisor firms have definitely been the leading sources of information for issuers in Kim’s view, the MSRB has also attempted some interaction and the SEC has made staff available at some issuer community events.

“I think the MSRB is trying very hard to get out in front of this,” Kim said. “I think the SEC has been trying to be accommodative.”

Glen Pederson, director of finance for Benson, Minn., said his MA began filling him in a few years ago but that he doubts most cities with only a few thousand in population are as well-informed.

“I happen to live in a smaller city and the experience there was much different,” he said. “They actually use or used a firm that would help them issue the bonds and then would also consider purchasing them. This was happening as recently as last year. I encouraged them to seek a different firm to act strictly as a financial advisor and they are in the process of taking proposals. So my take would be the cities of my size, 3,500 and up, are probably aware. But those smaller units are probably at the mercy of the [dealer] firm they are working with."

Other issuers are also still working on evaluating what the rule will mean for them. The American Association of State Highway and Transportation Officials is aware of the regulation, said its deputy director of management and program finance Joung Lee, and is taking stock of its potential effects.

The MSRB will likely take the educational lead among regulators, some sources said. Since Dodd-Frank, the self-regulator is tasked with protecting issuers and has a majority-public board.

"The MSRB views education as a central component of a comprehensive regulatory framework for municipal advisors," said MSRB executive director Lynnette Kelly. "We are reaching out not only to the municipal advisory community, but also to issuers that engage the services of municipal advisors. As part of our expanded outreach campaign to state and local governments, the MSRB is speaking to issuer audiences around the country about the regulatory framework for municipal advisors. The MSRB also conducts free public webinars to educate all interested stakeholders about our draft rules to establish standards of conduct and professional qualifications for municipal advisors."

BY KYLE GLAZIER

APR 21, 2014 1:47pm ET

Orrick: Update on Municipalities Continuing Disclosure Cooperation Initiative.

On March 10, 2014, the Securities and Exchange Commission ("SEC") announced that issuers and underwriters of municipal securities may voluntarily report materially inaccurate statements made in offering documents regarding prior continuing disclosure compliance through a program called the Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative").

Orrick and BLX Group have issued a client alert with key information.

Posted on April 10, 2014

by Elaine Greenberg and George Greer

MSRB Proposes Professional Qualification Requirements for Municipal Advisors.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today requested public comment on a proposal to establish qualification requirements for municipal advisor professionals. The Dodd-Frank Wall Street Reform and Consumer Protection Act charged the MSRB with developing professional standards for municipal advisors to enhance protections for state and local governments.

"The creation of a professional qualifications program for municipal advisors is a key step toward safeguarding the interests of state and local governments that engage the services of municipal advisors," said MSRB Executive Director Lynnette Kelly. "Individuals entrusted with providing financial advice to state and local governments will be required to demonstrate both an understanding of the business and regulatory requirements."

The MSRB's proposal would amend its existing rule on qualification requirements for personnel of municipal securities dealers to incorporate requirements for municipal advisor professionals. The draft amendments to MSRB Rule G-3 add registration classifications for municipal advisors to distinguish between those who engage in municipal advisory activities—municipal advisor representatives—and those who engage in their management, direction or supervision—municipal advisor principals.

Under the draft amendments to Rule G-3, municipal advisor representatives would be required to take and pass a professional qualification test to demonstrate a minimum level of competency before providing or continuing to provide financial advisory services to state and local governments. The MSRB is proposing a one-year grace period for all individuals currently engaged in municipal advisory activities to take and pass the test.

"Given the significant changes that accompany a new regulatory regime, the MSRB believes it is important for all municipal advisor representatives, regardless of their years of experience or other certifications, to take the exam," Kelly said.

Next steps in the development of the test include a survey of municipal advisors on their core activities to further inform the MSRB on the areas to be tested and the preparation of a study outline, which will be filed with the Securities and Exchange Commission (SEC). The MSRB anticipates implementing a pilot exam in 2015.

The MSRB earlier this year requested comment on a proposal to establish [core standards of conduct for municipal advisors]() and [supervisory and compliance obligations](). Future MSRB rule proposals for municipal advisors will include measures to address the potential for pay-to-play activities by municipal advisors; limitations on gifts and gratuities to employees of municipal securities issuers and other market participants; and duties of municipal advisors acting as solicitors. The MSRB also plans to implement a per-professional fee of $300 for municipal advisors to begin to fairly distribute assessments across all regulated entities.

While the majority of the draft amendments to MSRB Rule G-3 are targeted toward municipal advisors, the MSRB also proposes to eliminate the practice of apprenticeship, which required municipal securities representatives to shadow an experienced professional for 90 days before conducting business with the public. This change aligns with trends in other regulatory regimes toward allowing firms to identify appropriate training and supervision for new employees.

Comments on the draft amendments should be submitted to the MSRB no later than May 16, 2014. The MSRB is hosting an educational webinar on the main aspects of the municipal advisor professional qualification requirements on April 3, 2014 at 3:00 p.m. ET. [Register for the webinar]().

MSRB to Implement New MSRB Rule A-11 Establishing Fees for Municipal Advisor Professionals.

The Municipal Securities Rulemaking Board (MSRB) today filed with the Securities and Exchange Commission (SEC) a new rule to implement an annual fee of $300 per municipal advisor professional.Under the new MSRB Rule A-11, registered municipal advisors will be assessed this per-professional fee to help defray the costs and expenses of operating and administering the MSRB, particularly the increased costs associated with the regulation of municipal advisors.While the new rule is effective immediately, the first fees do not become due until the second half of 2014 in parallel with the SEC's phased-in compliance period for the permanent registration of municipal advisors.
View the rule filing or read the regulatory notice.

SIFMA Supports Shorter Settlement Cycle for U.S. Equities.

The U.S. securities industry says that it supports a move to reduce systemic risk and enhance efficiency by shortening the settlement cycle to T+2 from T+3.

The U.S. industry trade association, the Securities Industry and Financial Markets Association (SIFMA), announced today that it supports shortening the settlement cycle for U.S. equities, corporate bonds and municipal bonds to T+2 (trade date plus two days) from the current T+3 cycle. SIFMA says that it will work with the Depository Trust & Clearing Corporation (DTCC), which is advocating a reduced cycle, to determine the best timing for reducing the settlement cycle.

"SIFMA is committed to helping the financial industry identify new ways to improve market practices, enhance risk management, and promote efficiency. Shortening the settlement cycle could lead to important reductions in operational risk, more efficient allocation of industry capital, and streamline the clearing and settlement process," said Kenneth Bentsen, Jr., SIFMA's president and CEO.

While there are many potential benefits to be had, SIFMA also notes that shortening the cycle is a fundamental change that must be implemented with "great care to avoid any operational disruptions that could negatively impact investors." It recommends that the industry, DTCC and regulators continue to work together to ensure a smooth transition to T+2.

"We are delighted that SIFMA has decided to endorse a move to T+2," said Michael Bodson, DTCC's president and CEO. "Our own analysis, based on comprehensive discussions with the industry and robust cost-benefit studies, indicate that a shortening of the settlement cycle for U.S. equities, municipal and corporate bonds and unit investment trusts will drive down industry risk exposures and lead to greater efficiency. We look forward to working with the industry on this initiative."

WSJ: Treasury Turns Its Gaze to Municipal-Bond Market.

WASHINGTON—U.S. policy makers, concerned about strained public finances in places like Detroit and Puerto Rico, are moving to keep closer tabs on the ability of states and cities to raise money in the $3.7 trillion municipal-bond market.

The Treasury Department is forming a new unit to broadly monitor the market, with a focus on troubled borrowers, according to a Treasury official. The unit, which will be headed by a veteran public-finance banker at J.P. Morgan Chase & Co., also will track state and local pensions as well as the financing of bridges, roads and other infrastructure projects. Public-pension funding levels have been a problem area for many states and municipalities.

By boosting the department's monitoring of municipal finance, the Treasury hopes in part to better understand the ramifications of municipal-market stresses, the official said. The unit wouldn't have authority to write and enforce rules for the market like the Securities and Exchange Commission.

Efforts to boost oversight of the municipal-bond market have taken on new urgency in the wake of financial problems in places like Puerto Rico, which is beset by challenges including 15% unemployment and roughly $70 billion of outstanding debt.

Puerto Rico's troubles could reverberate well beyond its borders because roughly three-quarters of municipal-bond mutual funds own some debt issued by the commonwealth. It is among the biggest issuers in the municipal-bond market due to its tax benefits and often higher yields. The Federal Reserve's interest-rate-setting committee, meeting in January, said the commonwealth's financing situation "needed to be watched carefully," according to minutes of the meeting.

The SEC, which is the municipal-bond market's primary regulator, also has ramped up its scrutiny of the sector and is conducting a review of past disclosures by financially stressed states and municipalities to determine if they may have misled investors about their financial condition, according to SEC officials.

The Treasury's effort to gain greater insight into the municipal-bond market will be led by Kent Hiteshew, who will join the department in mid-May. Mr. Hiteshew has overseen J.P. Morgan's relationship with its housing-sector clients and municipal borrowers in the Northeast region. A J.P. Morgan spokeswoman declined to comment on Mr. Hiteshew's behalf.

"This office will centralize a lot of the work that is already happening across the building," said Matthew Rutherford, the Treasury's assistant secretary for financial markets. "It can look at various issues that arise in the municipal marketplace and make sure we understand what's driving them."

The municipal-bond market long has been seen by many mom-and-pop investors as a reliable source of tax-exempt income and as a vehicle for retirement savings. But that view has been rattled in recent years by episodes including the largest-ever municipal bankruptcy filing last July by Detroit and Puerto Rico's problems.

Last month, Puerto Rico sold $3.5 billion in new bonds to help pay down existing debt, a move that bought officials time to eliminate persistent budget deficits and jump-start the economy. The bonds have fallen in price in recent days amid reports that the island hired consultants that specialize in restructuring, though island officials haven't said they are working on a debt-restructuring plan. Credit-rating firms downgraded Puerto Rico to junk status this year.The commonwealth has said it plans to honor its obligations.

While the U.S. government has had talks with island officials about how Puerto Rico can improve its financial condition, Treasury officials have said they aren't contemplating a federal bailout. The Treasury official said the department doesn't have the authority to grant federal financial assistance.

Federal officials have sought to boost their oversight of the municipal-bond market in the wake of the financial crisis, when a contraction in state and local income-tax receipts squeezed municipalities andthreatened the ability of some governments to fulfill their financial obligations.

The SEC, which sets disclosure rules for state and local governments that issue bonds, is pushing for additional authority from Congress to crack down on municipalities that don't keep the public apprised of their financial health.

By

ANDREW ACKERMAN
April 16, 2014 6:39 p.m. ET

—Mike Cherney contributed to this article.

Write to Andrew Ackerman at andrew.ackerman@wsj.com

WSJ: Finra Scrutinizes Banks' Role in Bond Market.

Regulators have stepped up their scrutiny of the booming bond markets, launching an inquiry into Wall Street banks' trading profits and expanding a probe into how new offerings are doled out to investors, according to officials.

The Financial Industry Regulatory Authority, a Wall Street self-regulator, is taking a broad look at the trading profits of banks and other middlemen in some bond transactions. Finra is crunching through reams of trading data, looking for instances in which the middlemen have earned unusually large profits on bond deals, officials said. The inquiry could lead to a regulatory instruction to the banks to reduce the spreads between buying and selling prices they charge on certain trades, or even to enforcement action."There might be enforcement action with respect to the outliers," Richard Ketchum, Finra's chairman and chief executive, said in an interview with The Wall Street Journal. "We're certainly looking."Finra also is investigating how banks apportion hot bond offerings among investors, Mr. Ketchum said, alongside a previously reported Securities and Exchange Commission probe.

The Federal Reserve also has been asking large money-management firms about inefficiencies in the bond markets, said people familiar with the matter, which hasn't previously been reported. Among other things, the inquiry focuses on investors' troubles buying and selling bonds when credit markets tumbled in May of last year after the Fed signaled intentions to wind down its bond buying. A spokeswoman for the Fed declined to comment.

The spotlight on bond markets comes as regulators have launched several inquiries into potential inequities in the stock and commodities markets, where access to trading information can give certain investors advantages. Some market participants suspect dealers sometimes favor certain clients over others. Bond investors have complained for decades that their markets have been slow to adopt new technologies and that pricing and trading information should be more openly distributed.

The U.S. bond markets total about $40 trillion, twice the size of the approximately $19 trillion U.S. stock market. They provide ways for companies, the U.S. government and homeowners to obtain credit. Last year, companies borrowed a record $1.47 trillion in the U.S. corporate-bond market, including Verizon Communications Inc., VZ -0.44% which raised $49 billion in the biggest corporate-bond deal ever. Thus far, this year's new issuance is running apace, according to Dealogic.

The SEC has sought information on new bond sales from a number of big banks, including Goldman Sachs Group Inc., GS -1.97% Citigroup Inc., C -1.28% Deutsche Bank AG DB -1.41% and Morgan Stanley, MS -3.11% people familiar with the matter said. The Wall Street Journal reported in February that the SEC's inquiries of banksincluded Goldman Sachs and Citigroup. The banks haven't been accused of wrongdoing in relation to bond deals.

The SEC and Finra are together looking at whether banks are favoring the biggest money managers and giving them unfair influence over the pricing of new corporate bonds, which would disadvantage smaller investors.

"There aren't allocation rules in the U.S. at the present time," Mr. Ketchum said. "But there are issues about quid pro quos and other questions that can be raised."

One particular aspect of new bond issues the regulator is looking at, he said, is "flipping opportunities," or the chance for big investors to quickly sell newly acquired bonds—at a significant profit—to investors shut out of the deal initially.

Traders at investment firms sometimes call it a "kiss," said one large money manager, referencing the term often used to describe a range of favors investors can get from bankers working on selling and trading new bonds.

When a bond issue comes to market, bankers often give the largest portions of the deals to their biggest customers, who also may frequently trade with the bank or use its other services, said several investors and people familiar with dealer trading desks.

Bond deals, like stocks sold in initial public offerings, often rise in value just after they are issued. About 87% of the bonds issued in 2013 rose in price within five days of the initial sale, said Peter Tchir, a strategist at Brean Capital LLC, a registered broker-dealer.

In trading after Verizon's record $49 billion bond sale last September, investors made about $3 billion on three portions of the deal within the first week, according to an analysis by Mr. Tchir.

The Verizon deal is one of the offerings the SEC has asked banks about, the Journal previously reported

A Verizon spokesman didn't respond to requests for comment.

In its new inquiry into bond trading, Finra is scrutinizing the profits banks and other dealers make, known as markups and markdowns—the difference between selling and buying prices. Dealers typically keep a small profit on each trade facilitated. But bond prices aren't always publicly quoted, so it is difficult to know what competitors may be paying for the same bonds.

The regulator is zooming in on what Mr. Ketchum called "matched trades," where dealers are matching a seller with buyers, often very quickly. It estimates these now make up 60% to 70% of trades in corporate and municipal bonds.

Securities dealers are trying to reap profits from selling and trading debt as other aspects of their businesses have become more challenged. Interest rates remain at some of the lowest levels in history, and trading desks have been crimped by postcrisis regulation that limits assets they can hold and trade for their own books.

Regulators don’t set a fixed limit on what markups banks can charge, instead judging what is excessive based on industry best practice.

Mr. Ketchum said that, for these matched trades, where the risk is “relatively limited,” markups of more than 1.5% to 2% would be “questionable.”

Christopher Sullivan, chief investment officer at the United Nations Federal Credit Union, which oversees about $2.25 billion in assets, said that even worse than getting a smaller-than-wanted chunk of a new bond deal is then being offered the bonds from a trader right after the deal is priced “at some unjustifiably higher price.”

By

JEAN EAGLESHAM,

KATY BURNE and

JUSTIN BAER

April 10, 2014 7:13 p.m. ET

—Kirsten Grind contributed to this article.

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Citi Analysis Shows Bank Regulators That Most Munis Are Liquid.

WASHINGTON — Citi bankers are urging bank regulators to treat most municipal securities as high quality liquid assets in a banking rule proposed to ensure banks are equipped to handle severe financial and economic stress.

They made their plea in a three-page letter accompanied by 15 pages of analysis showing why most munis should be considered as eligible as HQLA. The letter, signed by Ward Marsh, Citi’s managing director for municipal securities, was sent to bank regulators on Wednesday. It follows several other dozen letters sent state and local officials and firms that have all warned the failure to categorize most munis as HQLA will hurt the muni market and governments.

Alan Anders, the director for finance in New York City’s Office of Management and Budget, warned the regulators in a recent letter that the proposed rule “is overly restrictive” and would cause banks to make fewer investments in munis, decreasing demand and liquidity for munis, while increasing borrowing costs.

It would also reduce the amount of bank capacity available to fund credit and liquidity support for muni variable-rate bond programs, Anders said.

Marsh echoed Anders’ concerns in a brief interview and said also that categorizing munis as illiquid could actually cause them to be less liquid. But Citi's letter did not contain concerns and focused instead on why munis should be considered eligible as HQLA.

The controversy over the rulemaking comes at a time when banks have been playing a growing role in the municipal market. Banks held $416.4 billion of munis last year, almost double from 2009. Banks have been the marginal buyers of munis over the past year as tax-exempt mutual funds have had record outflows.

The rule, proposed by the Federal Reserve Board and other bank regulators in October, could be finalized as soon as early summer and would take effect in January. It would create a standardized minimum liquidity requirement for large and systemically important banks and other financial institutions. These institutions would be required to maintain a minimum liquidity coverage ratio, defined as the ratio of HQLA to total net cash outflows over a 30-day period of stress.

Assets would qualify as HQLA if they could be easily and immediately convertible to cash with little or no loss of value during a period of liquidity stress. The rule proposes three classes of HQLA: Level 1, which would include sovereign securities, including U.S. government securities and U.S. government-guaranteed securities; Level 2A, securities issued by U.S. government sponsored enterprises and certain sovereign entities; and Level 2B, investment grade corporate debt with certain characteristics and equities in the Standard & Poor's 500 Index.

The regulators said they did not include munis in any of these categories because "these assets are not liquid and readily marketable in the U.S. and thus do not exhibit liquidity characteristics necessary to be included in HQLA under this proposed rule."

They did not give specific reasons for these views. Citi bankers met with officials at the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corp. in recent weeks so they could understand the basis of their concerns.

Citi's letter analysis addresses each concern and urges the regulators to treat investment-grade munis as eligible for Level 2A HQLA, on a par with GSE securities. Banks would have to take a 15% haircut, meaning they could only take 85% of their muni holdings into account in determining their liquidity coverage ratio. Industrial development bonds issued for nonprofit or other corporate obligors should be eligible for Level 2B HQLA, on a par with investment-grade corporates, which would have a 50% haircut.

To address concerns about concentration of assets, Citi recommended the rule limit to 25% the inclusion of eligible muni assets in a bank's total amount of HQLA.

Historically munis have been treated similarly to GSE securities in federal regulation and legislation, Citi said. Munis and GSE securities were given the same credit-risk weights under previous international Basel Accords on capital. They also have the same liquidity values at the Federal Reserve discount window.

From the standpoint of a liquidity coverage ratio, investment-grade munis would provide a greater diversification benefit than either GSE securities or nonfinancial corporate bonds, Citi said.

Munis, especially those that are investment-grade, generally have higher credit quality and lower historic default rates than corporate bonds, the bank said. "Despite the recent increase in media attention on U.S. public sector credit issues, cumulative realized credit losses on all municipal debt over the past 100 years has amounted to less than 1%," Citi told the regulators.

Citi also said muni defaults are less correlated with recessions than defaults of corporate bonds. In fact, the bank argued that when times get tough and munis become cheaper, the muni market becomes more liquid and deeper, with crossover buyers from the taxable market and more retail investors coming into the market.

To address concerns about the decline in muni trading during the financial crisis, Citi said it was auction rate securities and variable rate demand notes, neither of which is expected to be eligible as HQLA. The ARS market collapsed and there was, among other things, a lack of reasonably priced credit support for VRDNs.

"Rather than a precipitous drop-off in fixed-rate activity, we see that volumes have ebbed and flowed only marginally, with the highest trading volumes having occurred in 2008 and 2013," Citi said in its analysis.

The bank said there is a lot of price transparency in the muni market, particularly for investment-grade munis. The Municipal Securities Rulemaking Board's EMMA makes pricing and other trade data available for free on a near real-time basis. In addition, three major non-bank pricing services price munis for clients, the bank said.

To address concerns that the muni market did not have a large repo or repurchase agreement market, which most liquid markets have, Citi said investment-grade munis have "deep, diverse and stable secured funding availability away from the taxable repo market" and that it, alone, has roughly $8 billion of collateralized deposits from the public sector entities, almost 75% of which is secured with muni assets.

BY LYNN HUME

APR 10, 2014 5:11pm ET

Citi Analyst: Two Options to Save Tender Option Bonds.

WASHINGTON — Tender option bond market participants have two options available to keep those programs viable under the Volcker Rule, though neither is without risk or likely to please everybody with an interest in TOBs.

Vikram Rai, Citigroup vice president of fixed income research, has written a report detailing the two possibilities which could allow TOBs to exist within the limits of the recently-completed final Volcker Rule. The $70-$80 billion market has a problem because the rule did not exempt TOBs from its requirements, though the rest of the municipal market generally received an exemption. TOB programs have traditionally provided a supply of short-term tax-exempt bonds to money market funds, and have generally accounted for approximately 25%-30% of the assets of muni MMFs, according to Fitch Ratings.

In a typical TOB program, the sponsor will deposit a fixed-rate bond or note into a trust, which will issue two new certificates — a floating rate certificate sold to a MMF and a residual certificate which may be sold to a mutual or closed-end fund or held by a bank. The floating rate certificate will have a tender option, through a liquidity facility that is typically issued by the program's sponsor or an affiliate, that shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

This sponsor has normally been a banking entity or an affiliate of a bank, but the Volcker rule prevents banks and their affiliates from sponsoring a TOB program, owning a residual certificate issued by a TOB trust, or providing credit enhancement, liquidity, or remarketing services to these programs.

Rai's research report, published by Citi on March 27, lays out the two approaches he has found that could potentially allow the TOB structure to live on once full compliance with the Volcker Rule becomes mandatory in July 2015.

The first approach would involve restructuring TOB programs as "joint ventures," a type of entity exempted from Volcker. Joint ventures exist between banks or their affiliates and unaffiliated parties, and are exempt from the rule as long as they have no more than 10 unaffiliated co-venturers and only engage in activities permitted of banking entities. They also cannot be in the business of investing in securities for resale or hold themselves out as conducting such business.

The banking entity would be the sponsor in this scenario, while a co-venturing money fund would hold the floating note and a mutual fund would hold the residual note. This would allow the TOB structure to be redefined to comply with Volcker, "in theory," Rai wrote. This structure has the advantage of preserving the TOB structure for banks, but would not allow for the practice of splitting either the residual or the holding note into as many smaller internal funds as is sometimes the case for larger fund complexes, Rai wrote.

"By the definition of a [joint venture] under the Volcker Rule, each of the internal funds would be categorized as a co-venturer (which is capped at 10)," the report explains.

The report adds that there is also a risk that "regulators might view this as a re-definition of an existing structure to skirt the rules."

The other option would be to swap the bank sponsor out for a non-banking entity such as a mutual fund or a dealer. This option would not carry the same regulatory risk as the first alternative but would not work for banks. Rai wrote that given the importance of TOBs to both banks and muni investors, it is likely that an alternative will allow businesses to go on "as usual, even if it is with lower profit margins."

Fitch said in February that it expects "a gradual unwinding or restructuring of tender option bond programs over the next few months," because banks' ability to provide liquidity for them will soon be at an end if a solution for TOBs is not available. Like Rai, Fitch said it expects market participants to look for an answer because of the crucial liquidity short-term paper provides to the muni market.

David Cohen, managing director and associate general counsel at the Securities Industry and Financial Markets Association, said his group is continuing to explore the options its members will have under the Volcker Rule.

"SIFMA has a working group that is working diligently through this issue and hopes to come to a successful resolution in the near future," he said.

BY KYLE GLAZIER

APR 9, 2014 3:02pm ET

SIFMA Releases Model MA Documents.

WASHINGTON — The Securities Industry and Financial Markets Association has released model documents designed to help its members comply with the municipal advisor registration rule, which takes effect on July 1.

The seven draft documents, unveiled Friday, cover various types of communications between broker-dealers and issuers and aim to help prospective underwriters of muni bonds avoid having to register under the Securities and Exchange Commission rule.

The rule, approved in September, requires a firm to register as an MA if it provides advice to state or local governments or conduit borrowers. The SEC has said firms will not be able to underwrite the bonds of issuers for whom they have become municipal advisors, so broker-dealer firms are going to need to use one of three exemptions from the rule created by the SEC.

“Our firms want to know that if they are looking to take advantage of those exemptions and exclusions, that they have the language right,” said Leslie Norwood, managing director, associate general counsel, and co-head of municipal securities at SIFMA. “We just tried to get a base level of the documents we thought were most important.”

The model documents include: an issuer’s certification that an investment account does not include the proceeds of municipal securities, underwriter engagement letters for both generic firms and remarketing agents; a form advising issuers that they can receive advice from an underwriter by soliciting it through a legitimate a request for proposals, and an underwriter’s letter advising an issuer that its information is of a purely informational nature and not is intended as “advice.” to the issuer. All of these documents aim to allow the flow of information between prospective underwriters and issuers, which some had worried would be severely limited by the MA rule.

Two documents deal with the independent registered municipal advisor exemption, commonly called the “IRMA” exemption. That provision of the SEC’s regulatory regime allows an issuer to receive advice from underwriters and other market participants as long as they retain and certify that they will rely on the advice of the IRMA. The IRMA exemption is expected to be among the most broadly used of those available, since many larger and more frequent issuers have municipal advisors.

The first such model document takes the form of an issuer certification that it has an IRMA. If this is posted to the issuer’s publicly-accessible website, SIFMA suggests it include language showing the issuer “intends that market participants receive and use it for purposes of the independent registered municipal advisor exemption to the SEC municipal advisor rule.”

The second document is a confirmation letter from an underwriter firm to the issuer stating that the exemption applies and the firm assumes no advisory responsibilities.

“Thank you for your representation concerning your independent registered municipal advisor,” that model document reads. “By obtaining such representation from you, [the firm] is not a municipal advisor and is not subject to the fiduciary duty established in Section 15B(c)(1) of the Securities Exchange Act of 1934, as amended.”

SIFMA also released a collection of talking points for investment bankers speaking to issuers. That document includes an explanation and description of the exemptions available that will allow underwriters to provide advice to issuers, as well as some answers to common questions. Some issuer officials questioned whether they might be able to “opt out” of the registration regime, which is required by the Dodd Frank Act. SEC officials have been quick to dispel that notion in public appearances, and the SIFMA talking points do so as well.

“There is no way for issuers to simply ‘opt out’ of the rules outside the narrowly tailored exemptions,” one talking point states.

Norwood said additional documents may become available going forward, but emphasized that the newly-released documents are not final and are meant to generate feedback and provide a starting point for firms who will soon rely on similar documents to conduct their businesses within the limits of the rule.

“We encourage firms to modify these documents to suit their needs,” Norwood said. She added that comment is welcome not only from SIFMA members and other broker-dealers, but from all market participants.

“We’re looking for comment from all industry members,” she said.

The SEC has said it is going to release additional technical guidance on its registration rule before the effective date. The Municipal Securities Rulemaking Board is also in the process of creating rules governing MAs. The self-regulator has already proposed rules governing MA conduct as well as professional qualification and supervisory requirements.

- Model Negative Consent/Affirmative Consent Certificates Relating to Bond Proceeds
- Model Disclosures and Disclaimers for General Information Exclusion and Business Promotional Materials
- Model Independent MA Exemption Language
- Model IRMA Confirmation Letter
- Model RFP Language
- Talking Points for Public Finance Bankers

SIFMA is soliciting industry comment on these draft documents. Please forward any comments, questions or concerns to Leslie Norwood at lnorwood@sifma.org.

BY KYLE GLAZIER

APR 4, 2014 3:37pm ET

Bartolotta Takes Over as Chair of SIFMA's Muni Division.

WASHINGTON — FirstSouthwest vice chairman Michael Bartolotta has taken over the chairmanship of the Securities Industry and Financial Markets Association’s municipal securities division.

Bartolotta, who was a vice chair of the division, replaced Stratford Shields as chairman. Shields is moving from Morgan Stanley to RBC Capital Markets to be head of its Midwestern banking business. He is currently on a 90-day “garden leave” from Morgan Stanley and is not expected to start his new position until June.

Bartolotta, a former chairman of the Municipal Securities Rulemaking Board, is co-manager of FirstSouthwest’s public finance group in Houston and is also responsible for the firm’s information technology infrastructure. He has been at that firm for 18 years, but has more than 25 years of experience in the public finance industry. He is also a member of SIFMA's municipal executive steering committee.

David Stephens, a managing director at Bank of America Merrill Lynch, will continue as the municipal securities division's vice chair and John Rolander, a managing director at Fifth Third Capital Markets, will remain the division's treasurer, SIFMA said in a release.

BY LYNN HUME

MAR 28, 2014 12:27pm ET

WSJ: For Munis, SEC Offers Carrot, Threatens Stick.

Officials with the Securities and Exchange Commission's municipal-enforcement unit are urging local governments and the banks that help them sell bonds to self-report certain violations related to disclosure, indicating that harsher penalties could be sought if the violations are discovered later.

Earlier this month, the SEC launched a program to encourage municipalities and banks to come forward with violations regarding continuing disclosure agreements. The move comes after the SEC brought charges against a school district last year for falsely saying in bond-offering documents that it had complied with previous disclosure obligations.

"Think of it as an opportunity to clear your slate, before we come at issuers and underwriters very hard," Peter Chan, an assistant director with the muni enforcement unit in the SEC's Chicago office, said on Friday.

"We're going to go after the issuers," Mr. Chan said. "We're going to find out who was responsible."

Mr. Chan spoke at a National Association of Bond Lawyers conference in Boston. The enforcement unit's chief, LeeAnn Gaunt, said at the conference on Thursday that the SEC had separately been reviewing the past disclosures of financially stressed municipalities, to help ensure investors were not misled about financial conditions.

The comments come as the SEC turns a more critical eye toward the municipal-bond market, which had been viewed as a relatively safe spot for mom-and-pop investors but has seen large bankruptcies in Detroit and Jefferson County, Ala., in recent years.

Under the self-reporting program, called the Municipalities Continuing Disclosure Cooperation Initative, cities that come forward must establish policies and procedures regarding their disclosure obligations, but would not have to pay a monetary penalty. Underwriters that come forward would be subject to a financial penalty, but it would be capped at $500,000.

"We hear complaints from the financial sector and so forth about lack of predictability," Mr. Chan said. Under the program, "you're getting predictability," and Mr. Chan noted it's unusual that market participants "have a situation where you know exactly the type of settlement terms you're going to get."

Lawyers at the conference, who work with cities and banks to help sell debt, questioned whether the program was necessary, noting that disclosure practices have improved in recent years. Jack McWilliams, a former attorney fellow at the SEC's Office of Municipal Securities, which is separate from the enforcement unit, said the municipal-bond market isn't perfect but that there should be other ways to improve it.

"I find the initiative offensive, I find it bullying," said Mr. McWilliams, who now works at Lewis Longman & Walker PA. "The idea that you have to prostrate yourself…there must be a better way to make the market better."

But Mr. Chan noted that although the bond lawyers at Friday's conference may be providing good advice to their clients, they are "not the whole universe." Indeed, the U.S. Census Bureau says there are about 90,000 local governments in the U.S.

"There are bad actors," Mr. Chan said. If there weren't bad actors, "we wouldn't even be speaking here today."

Bonds and the BFF Problem.

A new rule tries to keep muni market players from getting too friendly.

The Beatles let us know that we all "get by with a little help from our friends." Those nine words from the Awesome Foursome capture the essence of the American municipal bond market. Some new developments, however, could redefine how friends help state and local governments get by in the muni market.

Like all markets, the municipal bond market is about buyers and sellers. The sellers are cities, counties, schools and other public entities that need to borrow money to build roads, bridges, hospitals and other major projects. The buyers are wealthy individuals, property-casualty insurance companies, mutual funds and others who like muni bonds for their secure, tax-free income. In concept, this market is simple and predictable.

Except that it's not. There are about a million bonds in the market. These bonds are sold by tens of thousands of governments and are backed by hundreds of different revenue streams. There is no central exchange where a buyer can go to find just the right bond. Different states apply different tax rules to the interest investors earn for holding muni bonds. For these and many other reasons, buyers and sellers work hard to find each other and even harder to agree on fair prices.

Fortunately, there are intermediaries—friends, if you will—who can help. Underwriters and financial advisers tell issuers how to design bonds that will appeal to just the right type of investors.

Investors rely on broker-dealers, brokers-brokers and other market makers to deliver the bonds they want. Issuers and investors alike depend on third-party data providers for crucial insights on market prices and dynamics.

That's why some recent regulatory changes have set the stage for a major shake-up. The Municipal Securities Rulemaking Board (MSRB), which oversees advisers and bond dealers, is now implementing rules that redefine the roles and duties of municipal financial advisers. Perhaps the biggest effect is that a bank or other institution that offers an issuer advice leading up to a bond sale cannot buy those bonds once they're sold. This rule is designed to prevent cozy friendships from morphing into the sort of corruption we saw in places like Jefferson County, Ala. That makes sense. At the same time, small issuers who access the markets infrequently depend heavily on advisers and other friends to make sense of this complicated market. This rule might limit their access to the market expertise they need just to get by.

Meanwhile, both the MSRB and Securities and Exchange Commission (SEC) are considering new rules to promote "pre-trade transparency." These changes apply to brokers-brokers, alternative trading systems and other intermediaries who help investors buy and sell bonds that have been out for a while (in what is known as the "secondary market"). The systems these intermediaries have developed are a bit like Craigslist for the muni market. Sellers post bonds they'd like to sell and interested buyers respond. Sometimes trades happen, but usually they don't. Either way, the information these systems collect can tell us a lot about a bond's "fair" or "actual" market price.

The SEC and MSRB are considering ways to use that information to improve the market's transparency and efficiency—a worthy objective. Investors who use these systems, however, are wondering why they should have to share such valuable information with anyone other than their closest trading friends.

With these actions, the regulators are sending a clear message. If you sell bonds, your real friends are those who work only for you. If you buy bonds, get ready to share friends-only information with the rest of the market. These changes are designed to focus accountability on buyers and sellers, and to keep friends, both well intentioned and otherwise, at arm's length.

Justin Marlowe | Contributor

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jmarlowe@washington.edu |

Scores of Puerto Rico Trades Sub-$100,000 Voided by Dealers.

Scores of trades in bonds Puerto Rico issued this month have been canceled by dealers, including some that were under the $100,000 minimum transaction level stipulated in deal documents, data compiled by Bloomberg show.

The self-governing U.S. territory sold $3.5 billion of debt March 11, in the biggest-ever high-yield offering for the $3.7 trillion municipal market. The issue gave the island, which was cut to junk last month, cash to pay bills through June 2015, as officials try to revive a shrinking economy. Hedge funds bought the majority of the bonds at issue.

Dealers report voided transactions to the Municipal Securities Rulemaking Board, said Ernesto Lanza, deputy executive director at the Alexandria, Virginia-based self-regulatory organization. The group removes such trades from its Electronic Municipal Market Access website, though regulatory authorities have access to the trading history, he said in an interview.

"If a dealer says 'I need to correct some data or change data,' they are making a correction that needs to go out to the marketplace," Lanza said. "Our system allows for modifications, amends and cancellations to make corrections to previous reports."

Finra's Exam

The canceled Puerto Rico trades included 99 below the minimum purchase threshold of $100,000, and some were nullified as late as this week, Bloomberg data show. Some that exceeded $100,000 were also scrapped, while some below the $100,000 floor remain.

The Financial Industry Regulatory Authority said March 21 that it was examining trading in Puerto Rico's new bonds. While offering documents stipulated a $100,000 floor for purchases, scores of transactions below that amount were still completed, according to Bloomberg data.

George Smaragdis, a Finra spokesman, said in an e-mail that the regulator had no comment on the canceled transactions.

Puerto Rico sale documents state that "the bonds shall be issued in the minimum denomination of $100,000 and any integral multiple of $5,000 in excess thereof," unless one of the three largest rating companies raises the commonwealth to investment grade.

Institutional Intent

The $100,000 threshold also applies to trading after issuance, said two people with knowledge of the sale who requested anonymity without authorization to speak publicly.

"These are intended for institutional purchasers, or at least for people that can afford the risk by making it a minimum denomination of $100,000," Martha Haines, who led the Securities and Exchange Commission's Municipal Securities office from 2001 to 2011, said in an interview last week.

Haines teaches municipal finance at the Maurer School of Law at Indiana University in Bloomington.

The Puerto Rico bonds are tax-free nationwide and mature in July 2035. They priced to yield about 8.73 percent, or 93 cents on the dollar. The securities traded today with an average yield of about 8.66 percent, or about 5.23 percentage points above benchmark municipal bonds.

The Bond Buyer reported the cancellations earlier yesterday.

Carol Danko, a spokeswoman in Washington at the Securities Industry and Financial Markets Association didn't have an immediate comment on the canceled trades.

By Brian Chappatta Mar 26, 2014 7:39 AM PT

To contact the reporter on this story: Brian Chappatta in New York atbchappatta1@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.netMark Tannenbaum

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WSJ: SEC Reviewing Municipalities' Disclosures.

Review Is Targeting Defaulted, Distressed Municipalities

BOSTON—The municipal-bond enforcement unit at the Securities and Exchange Commission is reviewing the past disclosures of defaulted and distressed municipalities to see if financial conditions were properly disclosed, the unit's top official said on Thursday.

LeeAnn Gaunt, the chief of the municipal securities and public pensions unit in the division of enforcement, said the review has been ongoing for a little more than a year and that it has resulted in some investigations. She said her unit, created in 2010, is looking at specific issuers, but declined to say which ones or how many.

The SEC is looking for instances where there is "tension between the disclosures and the subsequent announcements," Ms. Gaunt said at a National Association of Bond Lawyers conference in Boston.

The review comes as the SEC increases its attention on the municipal-bond market, which has been seen as a safe place for mom-and-pop investors, but has been rattled recently by major bankruptcies in Detroit and Jefferson County, Ala., and by financial troubles in Puerto Rico. Last year, the SEC assessed its first financial penalty against a municipal issuer and levied charges for the first time against a municipality for violating a previous cease-and-desist order.

The Wall Street Journal [reported last year](#) that the SEC had [asked at least one investment firm](#) for information relating to a largely private gathering in New York between some investors and officials from Puerto Rico. Ms. Gaunt declined to say whether the request was part of the continuing review.

Earlier this month, the SEC said municipalities and the underwriters that help sell their bonds could self-report violations relating to agreements that require municipalities to make certain disclosures after the bonds are sold. Last year, the SEC brought a case against a school district which had said in bond-offering documents that it had met all of its disclosure requirements, when in fact it had not.

The SEC is offering less severe penalties if issuers and underwriters self-report the violations before a September deadline, compared with what could happen if the SEC launches a separate enforcement action. For municipalities, there would be no financial penalty, and for underwriters, the financial penalty would be capped at $500,000.

Attorneys at Thursday's conference, many of whom work with municipalities and banks that arrange their bond deals, questioned whether a municipality that is selling bonds soon would be required to disclose to investors that it may be in discussions with the SEC about past violations. Ms. Gaunt said it would be up to the lawyers to decide whether to disclose the discussions.

She said the program was designed to create some tension between debt underwriters and issuers.

"I think of it as a modified prisoner's dilemma," Ms. Gaunt said. "You might want to report because the other guy might report. More likely people will talk with each other and come to us jointly."

In 2012, the SEC published a broad report on the municipal market that called for Congress to give it more authority so it can better improve disclosures from municipalities, among other suggestions.

By
MIKE CHERNEY
March 27, 2014 3:01 p.m. ET

Write to Mike Cherney at mike.cherney@wsj.com

FINRA Announces Updates of the Interpretations of Financial and Operational Rules.

Executive Summary

FINRA is updating the imbedded text of Securities Exchange Act (SEA) financial responsibility rules in the Interpretations of Financial and Operational Rules to reflect the effectiveness of amendments the SEC adopted. The updated imbedded text relates to SEA Rules 15c3-1, 15c3-3, 15c3-3a, 17a-3 and 17a-4.

Questions concerning this Notice should be directed to:

- Yui Chan, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8426; or
- Susan DeMando Scott, Associate Vice President, ROOR, at (240) 386-4620.

View Full Notice PDF *58 KB*

SEC OKs FINRA's New Supervisory Rules.

New consolidated rules govern supervision as well as guidance on email reviews

New FINRA Rules 3110 and 3120 replace NASD Rules 3010, 3012 and corresponding provisions of the NYSE Rules and Interpretations.

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's new consolidated rules governing supervision as well as guidance on email reviews.

Regulatory Notice 14-10 sets out FINRA's new consolidated rules governing supervision — rules 3110, 3120, 3150 and 3170, which replace NASD Rules 3010, 3012 and 3110(i) and other corresponding NYSE rule provisions.

The new rules become effective on Dec. 1.

The newly adopted FINRA supervisory rules address required supervisory systems, written supervisory procedures, branch-office inspections, testing and other related requirements.

New FINRA Rules 3110 (Supervision) and 3120 (Supervisory Control System) replace NASD Rules 3010 (Supervision), 3012 (Supervisory Control System) and corresponding provisions of the NYSE Rules and Interpretations.

Todd Cipperman, managing principal of Cipperman Compliance Services, says new rules 3110 and 3120 are "big deals" for compliance personnel and are read through carefully "because there's not a lot of guidance on how to build these compliance programs."

In addition, new FINRA Rules 3150 (Holding of Customer Mail) and 3170 (Tape Recording of Registered Persons by Certain Firms) replace NASD Rules 3110(i) and 3010(b)(2) (often referred to as the "Taping Rule"), respectively.

The Regulatory Notice offers guidance on reviews of electronic communications, including customer correspondence as well as internal communications.

Cipperman notes that "FINRA acknowledges that firms may use a 'lexicon-based' screening tool or system for email reviews but each supervisor 'is responsible for any deficiency in the system's criteria that would result in the system not being reasonably designed.'"

Said another way, Cipperman opines that FINRA means that "a firm does not get a free pass just for using an exception-based email review system. If a questionable email gets through, FINRA may still bring an action. Regardless, we recommend that firms utilize an email review system for the huge volume of communications."

By [Melanie Waddell, ThinkAdvisor](#) Washington Bureau ChiefInvestment Advisor Magazine [@thinkadv_career](#)

MARCH 24, 2014

[SEC Explains Self-Reporting Muni Enforcement Program.](#)

BOSTON – The Securities and Exchange Commission's new program to encourage self-reporting of a specific continuing disclosure violation is facing some skepticism from bond lawyers, even as one SEC attorney said it may eventually be expanded to cover other violations.

The SEC's Municipalities Continuing Disclosure Cooperation initiative, announced March 10, would allow issuers and underwriters to get favorable settlement terms if they voluntarily report that an official statement fails to state the issuer did not file annual disclosure and operating information at some point during the past five years.

The SEC's Rule 15c2-12 on disclosure requires an OS to specify if the issuer failed, at any time during the last five years, to file annual financial information in accordance with its continuing disclosure agreement.

The MCDC program has been compared to the Internal Revenue Service's Voluntary Closing Agreement Program.

Regulators attending the National Association of Bond Lawyers' Tax and Securities Law Institute here on Thursday told bond lawyers that issuers can count on no more than a cease-and-desist order if they participate. "You can take that to the bank," said LeeAnn Ghazil Gaunt, chief of the SEC enforcement division's municipal securities and public pensions unit. Gaunt said issuers who come forward under the MCDC will be able to settle for charges of negligence rather than securities fraud, will not face financial penalties, and will generally not have to admit wrongdoing. "I think what we're trying to do is offer a reset, but we're also trying to change the landscape," she said.

Issuers who decide not to participate could face fraud charges and could be hit with financial penalties, she said. Gaunt told NABL members, who may have to counsel clients about the advisability of participating in the program, that it could take as little as two months from start to finish and shouldn't hold up any other debt issuances a municipality wants to undertake.

Some bond lawyers said the program seems to drive a wedge between issuers and underwriters. Civil penalties for underwriters who self-report are capped at $500,000 under the initiative. Regulators acknowledged on Thursday that the initiative does create "tension" between issuers and the underwriters required to review the official statement for any misstatements or omissions before underwriting any bonds. SEC muni enforcement deputy chief Mark Zehner warned that an issuer self-reporting could have consequences for an underwriter if that firm does not also acknowledge such violations in the OS.

"It's from frying pan to fire, in my view, Zehner said. If the OS is silent on the matter and there were violations in the past five years, that means the document is not really a final OS under the law and thus the underwriter violated 15c2-12, Zehner explained. He also added that an underwriter who comes forward under the program, but does not catch all the violations over the previous five years, would still be in danger of facing enforcement action for any that they missed reporting.

Some attendees expressed skepticism over the SEC's position. One lawyer asked why the SEC would further punish an underwriter in such a case, especially if the firm were self-reporting and willing to pay the maximum fine. That lawyer said piling on more punishment to a cooperative underwriter would seem to do no good for the market. Another bond lawyer asked if the Financial Industry Regulatory Authority would jump to assess penalties for conduct brought to light under the SEC program, but FINRA associate vice president and chief counsel for enforcement James Day said that has not been determined yet.

In an earlier session at the conference, SEC muni office attorney Mary Simpkins said the program might eventually be expanded to cover other types of disclosure failures. She added that the program could start a dialogue that leads to better disclosure behavior in the muni market.

"Even if there is not a lot of self-reporting, we're hoping even the discussion will help," she said.

BY KYLE GLAZIER

MAR 27, 2014 3:02pm ET

SEC's Mary Jo White Directs Staff to Develop Fiduciary Options Document.

Securities and Exchange CommissionChairman Mary Jo White has told agency staff to draft a document that outlines ways the regulator can reform rules governing investment advisers and brokers.

The guidance would give the five-member commission a foundation for determining whether to advance a proposal to raise investment-advice standards for brokers.

The Dodd-Frank financial reform law allows the SEC to promulgate a rule that would require brokers to act in the best interest of their clients — a bar that investment advisers already meet. Brokers are held to a suitability standard when recommending investment products.

"In order to more fully inform the commission's decision on this matter, I have directed the staff to evaluate all of the potential options available to the commission, including a uniform fiduciary standard for broker-dealers and investment advisers when dealing with retail customers, and other measures that may be more targeted and achievable in the shorter term," Ms. White said in a speech at the Consumer Federation of America's Consumer Assembly in Washington on Friday.

"I have asked the staff to make the evaluation of potential options an immediate and high priority so that the commission has the information it needs to come to a decision as to whether and, if so, how best to exercise the authority provided in Section 913 of the Dodd-Frank Act," Ms. White continued. "I have made this a priority because it is very important and we need to move forward to a decision."

In a meeting with reporters after her remarks, Ms. White did not indicate what deadline she gave the staff.

"They are working on it as we speak," Ms. White said.

She would not elaborate on what actions the SEC could consider that would be more targeted than a fiduciary-duty rule.

"I want a full range of options, which will make for better decision making by the commission," Ms. White said.

The fiduciary issue is likely to split the commission. SEC members Michael Piwowar and Dan Gallagher have recently stated reservations about proceeding with a fiduciary-duty rule.

Ms. White did not reveal her position, but she indicated in her speech that she has doubts about disparate advice standards for brokers and advisers.

"Whenever you have substantially similar services regulated differently, I believe it is necessary to consider carefully whether the regulatory distinction makes sense," Ms. White said.

Fiduciary duty advocates in the audience were heartened by her remarks.

"The good thing about it is her re-articulation of this as a high priority for her and for the SEC, and that she is dedicating staff resources to put this forward," said Marilyn Mohrman-Gillis, managing director of public policy and communications at the Certified Financial Planner Board of Standards Inc. "That is good news for all of us who have been advocating for a very long time for the SEC to advance this rule making."

Barbara Roper, director of investor protection at the CFA, said that it's good for the SEC to look at a range of options for reforming investment advice rules but that it should settle on proposing a uniform fiduciary standard.

"We know disclosure doesn't work," Ms. Roper said in an interview on the sidelines of the conference. "We think the logical middle ground is articulated in the general approach in … Dodd-Frank."

The fact that the SEC is driving toward some kind of conclusion is a step in the right direction, Ms. Roper said.

"Given the number of years I've been working on this issue, just a decision is a light at the end of the tunnel," Ms. Roper said.

By Mark Schoeff Jr.

Mar 21, 2014 @ 9:19 am (Updated 12:47 pm) EST

FINRA Examining Puerto Rico Bond Sales; SIFMA Sends Out Notice.

WASHINGTON — The Financial Industry Regulatory Authority is examining allegations that broker-dealers violated municipal rules by trading bonds from Puerto Rico's recent $3.5 billion general obligation deal to customers in sizes less than the required $100,000 minimum denomination.

"FINRA is aware of this situation and is examining trading activity in this Cusip," a FINRA spokesman said, referring to the 74514LE86 identifier of the bonds.

Also on Friday, the Securities Industry and Financial Markets Association sent out a notice to members urging them to make sure they are complying with the minimum denomination requirement.

“We urge firms to examine the minimum denomination provisions of the official statement carefully and to take steps to ensure that all trades are in compliance with the minimum denominations established by the issuer,” SIFMA said in the notice. “For example, we urge firms to take care in cases where customers may request to split trades among accounts in ways that would result in trade sizes smaller the minimum denomination.”

The actions follow a story The Bond Buyer released Wednesday morning that said broker-dealers — in some 70 transactions executed between 9:16 a.m. on Tuesday, March 11, through 4:30 p.m. on Tuesday, March 18 — sold the Puerto Rico bonds to customers in amounts below $100,000.

The OS for the bonds stipulated that they should not be sold in minimum denominations of less than $100,000 unless of one of three major rating agencies — Standard & Poor’s, Moody’s Investors Service and Fitch Ratings — upgraded the rating on them to investment-grade from speculative.

The idea behind the minimum denomination requirement was to ensure the bonds would not be sold to retail customers who might not fully appreciate the risk of holding them.

The MSRB’s Rule G-15 on uniform practice requirements prohibits broker-dealers from executing trades in sizes below the minimum denomination set by the issuer, except in very limited circumstances. The board’s guidance on Rule G-17 on fair dealing says that a dealer would violate that rule if it fails to disclose to a customer that it is buying bonds below a required minimum denomination and that this could affect the liquidity of the customer’s position.

In a new examination of the trade data on the MSRB’s EMMA system, The Bond Buyer found six more sales of less than $100,000 of Puerto Rico bonds to customers, including two of $35,000 each executed on Thursday.

Michael Decker, SIFMA managing director and co-head of munis, told The Bond Buyer in an interview he initiated on Friday that he has been talking to members about the situation.

“It is true that some firms inadvertently did execute customer trades below the minimum denomination,” he said. Some of them have cancelled those trades when alerted to the requirement, he added.

“The minimum denomination provision is really novel,” Decker said, “I’ve not heard before a minimum denomination feature that’s triggered off of the bond rating,” adding some traders “didn’t pay close enough attention” to the provision.

“It’s very important that traders and sales people read the official statement carefully, understand the minimum denomination provision and make sure that all the trades they execute are in compliance,” he said.

“Dealers have to take responsibility for this issue,” he said. “They shouldn’t depend on the trustee, the clearing utility or trading platforms to monitor any of this,” he said.

Susan Collet, senior vice president of government relations at Bond Dealers of America, said Friday, “We certainly support regulators getting to the bottom of what occurred. She said trades below the $100,000 minimum denomination represent an “operational failure” and that “Clearly, broker-dealers need to follow the rules.”

BY LYNN HUME and KYLE GLAZIER

MAR 21, 2014 2:49pm ET

SIFMA, Chamber Give Thumbs Down to Finra's Data Collection Proposal.

Two more financial industry groups have called on Finra to rethink a proposal to collect reams of brokerage account information that the organization says will help it better detect fraudulent sales practices.

The Securities Industry and Financial Markets Association, the trade group for large broker-dealers, and the U.S. Chamber of Commerce filed comment letters Friday and late Thursday, respectively, opposing Finra's Comprehensive Automated Risk Data System. They join the Financial Services Institute Inc., a lobbying group for independent broker-dealers, in criticizing the idea.

The broker-dealer regulator put out a concept proposal in December. The comment deadline was Friday.

SIFMA warned that financial firms would be burdened with significant technology and compliance costs and that customers' financial privacy would be put at risk.

"CARDS would require firms to develop new systems and/or dramatically modify existing systems to collect data elements that they do not have currently, create storage capacity to store vast amounts of new data, develop methods to standardize data format … and save the data for an unspecified period of time," wrote Ira Hammerman, SIFMA executive vice president and general counsel. "The information that will be requested through CARDS is a road map to an individual's financial life and virtually all investors' information will be housed in one place."

The Chamber said the system's costs would outweigh its benefits.

"While efforts to streamline and standardize this data collection are laudable, the [Chamber] remains very concerned that any wholesale changes to the way in which broker-dealers provide data to Finra will come at a significant cost not only to broker-dealers but also to their customers," wrote David Hirschmann, president and chief executive of the Chamber's Center for Capital Markets Competitiveness.

By Mark Schoeff Jr.

Mar 21, 2014 @ 11:45 am (Updated 5:03 pm) EST

SEC Examining Hidden Prices in Bond Trading.

The practice of dealers' showing clients different prices for the same securities on electronic bond-trading platforms is drawing the scrutiny of the Securities and Exchange Commission, which is concerned that smaller investors are being penalized.

SEC regulators want to understand why brokers sometimes block their rivals and clients from seeing some of their prices for municipal, corporate and other bonds, according to a person with direct knowledge of the inquiry. They're examining whether being able to turn quotes on and off allows market manipulation, and whether smaller buyers are given worse prices, the person said.

The probe underscores the growing concern that the infrastructure of the U.S. bond market hasn't kept pace with a 23 percent expansion in the past six years, with much of the trading still conducted through telephone conversations and e-mails. The SEC separately is looking into the way the biggest banks allocate corporate-bond offerings and whether they give preferential treatment to certain clients.

"There's a club-within-a-club sort of atmosphere people started to get very concerned about," said Robert Smith, chief investment officer at Sage Advisory Services Ltd., which oversees about $10.5 billion. "In essence, you could start to see two different prices for the same security."

The inquiry into alternative trading systems has focused on those that cater to individual investors as well as dealers trading among themselves, according to the person, who asked not to be identified because the examination isn't public.

INCREASED TRADING

The probe is an attempt to get more information, rather than build a case for an enforcement action, and is being conducted by the Office of Compliance Inspections and Examinations wing of the SEC, according to the person familiar with the matter.

Even if alternative trading systems "don't account for a majority of the trading, they can be a source of information, and there's the potential for filters to be used in a manner that would distort the market," said Kevin Goodman, national associate director of the broker-dealer examination program at the division.

U.S. investment firms predict that 30% of corporate-bond trading will occur electronically by 2015, up from 14 percent of investment-grade notes in 2012, according to an August 2013 report by Greenwich Associates and McKinsey & Co. As much as 50% of municipal trades already may occur electronically, according to a comment letter to the SEC last year from trade-system operator TMC Bonds.

PROMOTING TRANSPARENCY

"We want to understand how we can promote more transparency" and how electronic trading is "either contributing or not contributing to transparency," said Mr. Goodman, who declined to confirm the existence of any examinations.

The SEC has contacted providers including Tradeweb Markets and TMC Bonds, seeking information about the systems they manage that allow dealers to buy and sell debt to one another and to investors, according to two people with direct knowledge of the matter who asked not to be identified because the conversations were private.

Bloomberg, the parent of Bloomberg News, competes with Tradeweb in some businesses, including bond trading with institutional investors. Bloomberg's trading platforms aren't geared toward individual clients.

There are reasons some electronic systems enable bond dealers to block rivals from seeing their price quotes, such as if they have found a firm consistently fails to stand by its offers or provides off-market values, said Thomas Vales, chief executive officer of TMC Bonds, who confirmed he'd discussed the issue with the SEC.

Clayton McGratty, a Tradeweb spokesman, declined to comment.

Banks have increasingly turned to electronic systems to sell bonds on behalf of their clients as a way of aggregating a greater number of bids. That's become more appealing as it's become more expensive for dealers to use their own money to make markets because of higher regulatory capital requirements.

"There's a lot of interest in the market given the way it's grown," the SEC's Mr. Goodman said.

NEW ISSUES

Rules issued in 2010 by the Basel Committee on Banking Supervision and the Dodd-Frank Act passed by Congress prompted Wall Street dealers to cut their inventories of corporate securities by 76% from the 2007 peak through last March, when the Federal Reserve changed the way it reported the data.

At the same time, the size of the U.S. bond market has swelled to $39.9 trillion from $33.6 trillion in 2008 as the Fed held borrowing costs near zero and bought trillions of dollars of Treasuries and mortgage debt, according to data from the Securities Industry and Financial Markets Association.

While the amount of debt outstanding has soared, trading volumes have failed to keep pace, prompting investors to hold onto notes rather than trade more actively and risk not being able to get the securities back. The scarcity of available bonds has led to increased demand from buyers for a slice of new corporate issues.

Regulators have been seeking more information about how the biggest banks decide to distribute the new bonds. The Goldman Sachs Group Inc.'s annual filing last month added "allocations of and trading in fixed-income securities" to a list of activities at the firm that are subject to open regulatory scrutiny.

One of the SEC's priorities this year is to evaluate "factors that may impact the quality of execution in the fixed-income market," including market structure and the use of alternative trading systems, it said in a January statement.

"In the wake of the credit crisis, investors have obviously had a greater focus on fixed income," said Will Rhode, director of fixed-income research at Tabb Group. "There's a question of how retail investors access this market."

Bloomberg News
Mar 21, 2014 @ 12:02 pm (Updated 1:32 pm) EST

Finra Says It's Examining Trading in New Puerto Rico Bonds.

The Financial Industry Regulatory Authority said it's examining trading in the $3.5 billion of general-obligations that Puerto Rico sold this month.

The self-governing U.S. territory sold the debt March 11, in the biggest-ever high-yield offering for the $3.7 trillion municipal market. The issue gave the island, which was cut to junk last month, enough cash to pay bills through June 2015, as officials try to revive a shrinking economy.Hedge funds made up the majority of buyers in the tax-exempt deal, according to David Chafey, chairman of the island's Government Development Bank. The securities mature in July 2035 and priced to yield about 8.73 percent.Sale documents stipulate that "the bonds shall be issued in the minimum denomination of $100,000 and any integral multiple of $5,000 in excess thereof," unless one of the three largest rating companies raise Puerto Rico to investment grade.The bonds were free to trade March 11. Since then, they changed hands in at least 75 transactions less than $100,000, data compiled by Bloomberg show. The bonds' highest price, 100 cents on the dollar, was for a $25,000 trade at 10:47 a.m. in New York on March 12.

Activity Examined

Asked about whether Finra was looking into the smaller trades, spokesman George Smaragdis said in an e-mail that the independent monitor of the securities business was "aware of the situation and is examining trading activity" in the bonds.

Trades below the minimum amount for investors that don't already own at least $100,000 of the debt violate the Municipal Securities Rulemaking Board's Rule G-15 subsection F, said Martha Haines, who led the Securities and Exchange Commission's Municipal Securities office from 2001 to 2011.

"These are intended for institutional purchasers, or at least for people that can afford the risk by making it a minimum denomination of $100,000," said Haines, who teaches municipal finance at the Maurer School of Law at Indiana University in Bloomington.The rule Haines referenced states that brokers and dealers can't execute a trade of a municipal security that's below the minimum denomination of the issue, according to the MSRB's website.

Minimum Denomination

The Securities Industry and Financial Market Association, a New York-based trade group that represents banks and investors, released a notice today warning firms about trading the Puerto Rico bonds in sizes below $100,000."We urge firms to take care in cases where customers may request to split trades among accounts in ways that would result in trade sizes smaller than the minimum denomination," according to the notice.The bonds declined today. Their average yield was about 8.73 percent, the highest since they were free to trade. The price touched 92 cents, the cheapest yet.

The finances of the Caribbean commonwealth of 3.6 million people influence the entire municipal market because 70 percent of U.S. mutual funds that focus on local debt hold the securities, according to Morningstar Inc. The island's bonds, like territories such as Guam, are tax-exempt nationwide.

Barbara Morgan, David Millar and Betsy Nazario, spokesmen for the Government Development Bank, which handles the island's debt sales, didn't immediately respond to an e-mail seeking comment.The Bond Buyer reported March 19 that smaller-denomination sales were being made in violation of the requirement.By Michelle Kaske March 21, 2014

To contact the reporter on this story: Michelle Kaske in New York at mkaske@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net

Mark Tannenbaum, Alan Goldstein

NABL Submits Comments on MSRB Draft Rule G-42.

This week, the National Association of Bond Lawyers (NABL) submitted comments to the Municipal Securities Rulemaking Board (MSRB) on MSRB Notice 2014-01, related to draft MSRB Rule G-42, on standards of conduct and duties of municipal advisors when engaging in municipal advisory activities other than the undertaking of solicitations. In the comments, NABL urged that "careful consideration be given to the precise language used" in the final rule "to insure that municipal advisors are clearly informed of their duties and not unduly burdened, and that the choices available to municipal entities and obligated persons in engaging municipal advisors are not inadvertently or unduly limited."

The comments were prepared by an ad hoc subcommittee of the NABL Securities Law and Disclosure Committee and can be seen here.

MSRB Proposes MA Qualification Exams.

WASHINGTON — The Municipal Securities Rulemaking Board on Monday proposed to amend its rule on professional qualifications to cover municipal advisors and require them to take a test as soon as next year.

The board plans to survey municipal advisors to determine what the test would include.

The test requirement would be in draft amendments that the MSRB wants to include in its Rule G-3, which would distinguish between MA representatives who provide services and MA principals who supervise them.

Under the proposal, all MA representatives would be required to take and pass a professional qualification test to demonstrate a minimum level of competency before providing or continuing to provide financial advice to state and local governments. The MSRB is proposing a one-year grace period for all individuals currently engaged in municipal advisory activities to take and pass the test.

"The creation of a professional qualifications program for municipal advisors is a key step toward safeguarding the interests of state and local governments that engage the services of municipal advisors," said MSRB executive director Lynnette Kelly. "Individuals entrusted with providing financial advice to state and local governments will be required to demonstrate both an understanding of the business and regulatory requirements."

Kelly said the grace period is appropriate because of the major changes a brand-new regulatory regime brings. MAs are gradually coming under full MSRB regulation as the board rolls out rules based on the requirements of the Dodd-Frank Act, which imposes a fiduciary duty on advisors offering financial advice to municipal clients. The board has previously proposed rules laying out the core standards for MA conduct and supervision.

"The notice is generally consistent with our expectations," said Nathan Howard, general counsel to the National Association of Independent Public Finance Advisors. "However, the appropriateness of the timing of the notice and the effective date of the MA testing requirements will need to be analyzed carefully, particularly in light of the fact that the MSRB has not yet finalized the municipal advisor representative exam or otherwise provided any indication as to its contents.”

The MSRB said in a statement that it will conduct a survey of MAs to learn more about their activities before developing a study outline, which the board will submit to the Securities and Exchange Commission. The MSRB expects to begin a pilot exam program in 2015.

The board also proposes to eliminate the practice of apprenticeship, which required municipal securities representatives to shadow an experienced professional for 90 days before doing business. The board proposed this change to reflect a general regulatory attitude shift, the MSRB said in a release.

The board is requesting comments on the qualifications exam proposal by May 16. The MSRB is hosting an educational webinar on professional qualification requirements on April 3.

BY KYLE GLAZIER
MAR 17, 2014 11:36am ET

Clearing Firms Fear Wall Street Regulator's Data Proposal.

(Reuters) – A proposal by Wall Street’s industry-funded watchdog to ramp up oversight of securities brokerages could expose clearing firms to more enforcement actions and lawsuits, lawyers say.

The Financial Industry Regulatory Authority has said it wants to review, on a continuous basis, vast quantities of data from the clearing firms that brokerages hire to settle customers’ buy and sell orders.

But some clearing firms are raising concerns that the fledgling plan could ensnare them in legal hassles. As the data flows from brokerages to FINRA, the clearing firms could be held accountable for malfeasance buried in that information, they say. For example, FINRA could question why a clearing firm did not spot that a brokerage customer was laundering money.

“The clearing firm should not become another supervisor,” said Ira Hammerman, general counsel for the Securities Industry and Financial Markets Association, a trade group representing clearing firms as well as retail brokerages. SIFMA plans to voice its concerns in a letter this month.

Consumer investor lawyers agree that the proposed system could make clearing firms bear more responsibility for errant behavior. “For decades, clearing firms have buried their heads in the sand, saying they don’t have responsibilities for anyone,” said Andrew Stoltmann, a Chicago lawyer who represents investors. “I think that defies common sense.”

A FINRA spokesman declined to comment.

FINRA announced the plan, known as the Comprehensive Automated Risk Data System, or CARDS, in December, but recently extended the deadline for public input to March 21. The system could take years to put in place, as FINRA would have to develop a more formal proposal and get approval from the U.S. Securities and Exchange Commission.

The watchdog is exploring the idea as financial regulators try to expand their presence by mining data. The SEC, for example, has recently announced efforts to crunch trading data to detect insider trading and other illegal activity.

BIG DATA

FINRA already receives some data from clearing firms for its brokerage examinations, but they provide it voluntarily and often upon request, the regulator has said. For example, examiners may ask for data about trades in a certain security.

CARDS, however, would require clearing firms to be a pipeline for an “unprecedented” combination of data, said Joan Schwartz, chief legal officer of Bank of New York Mellon Corp’s Pershing LLC unit.

Clearing firms like Pershing would have to transmit an ongoing stream of data to FINRA about everything from securities transactions and asset movements to customers’ risk tolerances and time lines. At Pershing alone, those responsibilities would apply to millions of brokerage accounts.

FINRA recently said it would not require clearing firms to submit details, such as names and Social Security numbers, that would identify specific brokerage customers.

Nor will FINRA hold clearing firms responsible for the accuracy of the data, according to its plan, but that protection is limited, said Irwin Pronin, a New York lawyer who advises clearing firms. More risks could come later if the regulator looks back and says a clearing firm turned a blind eye to brokerage misbehavior revealed in its data, Pronin said.

Daniel Nathan, a Washington lawyer who advises brokerages on regulatory issues, said the plan could make clearing firms vulnerable to fines and other sanctions. The proposed system “will have the effect of dumping into FINRA’s lap a treasure trove of potential evidence” that could show what a clearing firm might have known about the brokerage firm’s activities, he said.

To be sure, FINRA requires brokerages and clearing firms to sign agreements that lay out which entities are liable for certain responsibilities. For example, retail brokerages are responsible for opening customers’ accounts and recommending securities that are in sync with their goals.

But even that may not be an ironclad defense. Pershing’s Schwartz, who is also vice chair of SIFMA’s clearing firm committee, pointed to a December enforcement case in which FINRA described a clearing firm as a “gatekeeper to the securities markets.” The term could signal a change in regulators’ expectations for these firms, Schwartz said.

“We’re generally concerned about the erosion of this concept that we’re 10 steps removed,” Schwartz said.

LITIGATION

FINRA’s proposal follows a spate of lawsuits and securities arbitration cases against clearing firms by investors.

Some cases were filed when an investor’s brokerage goes out of business, often because of a fraud. Others may involve brokerages that cannot make good on losses in a risky security. Pursuing the clearing firm may be the only way for investors to recoup money, lawyers say.

These are tough cases to win, but investors have sometimes prevailed. In 2010, creditors of Bayou Group LLC scored a $20.6 million arbitration award against a Goldman Sachs Group Inc unit that cleared the hedge fund’s trades. Bayou, which was bankrupt, turned out to be a Ponzi scheme.

The case hinged on Goldman’s ignoring data about the hedge fund’s losses, said Ross Intelisano, a New York lawyer who represented the creditors.

Goldman lost two efforts to overturn the ruling. A Goldman spokeswoman declined to comment.

In another case, a group of athletes filed a multimillion-dollar arbitration against Pershing last year, saying the clearing firm should have detected that private investments their adviser recommended in a failed casino project were fraudulent. The case is pending, and Pershing declined to comment.

At least several arbitration cases against other clearing firms were settled last year, according to a FINRA database.

BY SUZANNE BARLYN

March 18 Tue Mar 18, 2014 11:09am EDT

Municipal Time of Trade Disclosure & Suitability: A Paper Prepared by Lumesis Inc.

Prepared by BDA member firm Lumesis Inc., this paper focuses on the content and nuances of the new rules around time of trade disclosure, the amended rule regarding suitability and explores how technological innovation has and will impact compliance and business practices

Rules focused on time of trade disclosures to investors, dealers' dealings with sophisticated municipal market professionals and suitability of dealers' recommendations of municipal securities transactions will be effective July 5, 2014.

The executive summary is available here.
Lumesis is making this paper available to all BDA Member firms. It can be found in the Members Resources section under Best Practices.

WSJ: Finra Examining Trading in Puerto Rico Bonds.

Move Comes Just a Week After the Island Territory's $3.5 Billion Bond Sale.

The Financial Industry Regulatory Authority is examining trading in Puerto Rico's newly sold $3.5 billion bond issue, according to a spokesman for the Wall-Street-funded self-regulatory group that oversees broker-dealers.

The move comes amid concerns that the new bonds—which carry junk ratings—are being improperly sold to individual investors. The bonds' prospectus says the debt will be issued in minimum denominations of $100,000, unless Puerto Rico's credit rating is upgraded, but some recent activity shows the bonds trading in amounts as low as $5,000. Smaller trade sizes are more typical of individual investors.

Finra's inquiry also comes on the heels of similar scrutiny from the Securities and Exchange Commission over how broker-dealers allocate newly sold corporate bonds to investors. The SEC recently asked some banks for information on how they divvy up the new debt among buyers and how they traded those bonds after the sale.

"It's not shocking that there's a concerted focus on bonds and bond-related issues," said George Friedman, a former senior officer at Finra who left the organization last year. Thought of by investors as being safe and secure, municipal bonds are "going to get Finra's attention" given that Detroit filed for bankruptcy last year and the recent financial troubles in Puerto Rico.

Mr. Friedman said Finra could levy fines if broker-dealers were found to violate securities regulations. A rule from the Municipal Securities Rulemaking Board states that dealers "shall not effect a customer transaction" that is "lower than the minimum denomination of the issue," with certain exceptions.

The smaller Puerto Rico trades were reported earlier this week by [The Bond Buyer.]

Puerto Rico sold the debt last week to help prop up its budget, giving officials more time to jump-start the economy and deal with persistent budget deficits. Island officials had been laying groundwork for the sale for months, which was made more challenging after Puerto Rico's outstanding debt tumbled amid investor worries about the island's financial health.

Puerto Rico's bonds have traded lower this week after a frenzy of trading pushed the prices as much as 7.5% higher the day after the sale. The bonds on Friday traded at 92.5 cents on the dollar, below the offering price of 93 cents, according to the Municipal Securities Rulemaking Board's EMMA website.

Investors and lawyers said the typical minimum denomination for a municipal bond is $5,000, though it is not surprising that Puerto Rico, with its financial troubles, had a $100,000 minimum.

Since the minimum denomination was in the prospectus, "I don't think bonds smaller than that should trade in the secondary market," said Kathy Bramlage, a director at Treasury Partners, a unit of financial-advisory firm HighTower Advisors. "It does make you wonder" how the trades were completed, she said.

Making the trade size contingent on ratings is unusual, and suggests the writer of the documents intentionally meant to prevent trades to small investors, said Kenneth Potts, a portfolio manager at Samson Capital Advisors.

"It strikes me as a potential liability for dealers that traded it" in the smaller sizes, he said. "I think that an individual would have a strong case if they wanted that trade broken."

MIKE CHERNEY and
AL YOON
Updated March 21, 2014 4:32 p.m. ET

Write to Mike Cherney at mike.cherney@wsj.com and Al Yoon at albert.yoon@wsj.com

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MSRB Proposes Professional Qualification Requirements for Municipal Advisors.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today requested public comment on a proposal to establish qualification requirements for municipal advisor professionals. The Dodd-Frank Wall Street Reform and Consumer Protection Act charged the MSRB with developing professional standards for municipal advisors to enhance protections for state and local governments.

“The creation of a professional qualifications program for municipal advisors is a key step toward safeguarding the interests of state and local governments that engage the services of municipal advisors,” said MSRB Executive Director Lynnette Kelly. “Individuals entrusted with providing financial advice to state and local governments will be required to demonstrate both an understanding of the business and regulatory requirements.”

The MSRB’s proposal would amend its existing rule on qualification requirements for personnel of municipal securities dealers to incorporate requirements for municipal advisor professionals. The draft amendments to MSRB Rule G-3 add registration classifications for municipal advisors to distinguish between those who engage in municipal advisory activities—municipal advisor representatives—and those who engage in their management, direction or supervision—municipal advisor principals.

Under the draft amendments to Rule G-3, municipal advisor representatives would be required to take and pass a professional qualification test to demonstrate a minimum level of competency before providing or continuing to provide financial advisory services to state and local governments. The MSRB is proposing a one-year grace period for all individuals currently engaged in municipal advisory activities to take and pass the test.

“Given the significant changes that accompany a new regulatory regime, the MSRB believes it is important for all municipal advisor representatives, regardless of their years of experience or other certifications, to take the exam,” Kelly said.

Next steps in the development of the test include a survey of municipal advisors on their core activities to further inform the MSRB on the areas to be tested and the preparation of a study outline, which will be filed with the Securities and Exchange Commission (SEC). The MSRB anticipates implementing a pilot exam in 2015.

The MSRB earlier this year requested comment on a proposal to establish core standards of conduct for municipal advisors and supervisory and compliance obligations. Future MSRB rule proposals for municipal advisors will include measures to address the potential for pay-to-play activities by municipal advisors; limitations on gifts and gratuities to employees of municipal securities issuers and other market participants; and duties of municipal advisors acting as solicitors. The MSRB also plans to implement a per-professional fee of $300 for municipal advisors to begin to fairly distribute assessments across all regulated entities.

While the majority of the draft amendments to MSRB Rule G-3 are targeted toward municipal advisors, the MSRB also proposes to eliminate the practice of apprenticeship, which required municipal securities representatives to shadow an experienced professional for 90 days before conducting business with the public. This change aligns with trends in other regulatory regimes toward allowing firms to identify appropriate training and supervision for new employees.

Comments on the draft amendments should be submitted to the MSRB no later than May 16, 2014. The MSRB is hosting an educational webinar on the main aspects of the municipal advisor professional qualification requirements on April 3, 2014 at 3:00 p.m. ET. Register for the webinar.

Dealers Want More Best-Ex Guidance.

WASHINGTON — Dealer groups are happy that the Municipal Securities Rulemaking Board has exempted sophisticated municipal market professionals from its proposed best execution rule, but would like more guidance and economic analysis going forward.

The Securities Industry and Financial Markets Association made these points in comments on the MSRB's proposed Rule G-18, which would require broker-dealers to "use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions."

SIFMA said the group is largely on board with the MSRB proposal, and is hoping for guidance on how the rule interacts with the board's proposed pricing rule, G-30.

"Before the MSRB adopts a final rule, SIFMA requests additional information and guidance from the MSRB relating to the harmonization of Rule G-18 and G-30, as well as compliance issues," wrote SIFMA managing director and associate general counsel David Cohen.

Based on the Financial Industry Regulatory Authority's Rule 5310 for equities and corporate debt, the proposed rule goes a step beyond the current Rule G-18 on execution of transactions, which requires dealers to "make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions." If a best-execution standard was adopted, dealers would need to establish or revise compliance policies and written supervisory procedures, as well as implement additional monitoring and surveillance.

Throughout the rulemaking process, dealers have pointed to the unique nature of the muni market and stressed the need for a rule recognizing the market's lack of a single central pricing resource.

Cohen said in a brief interview that SIFMA members would like more instruction from the MSRB on how dealers might demonstrate compliance with the rule. The draft rule lays out possible factors examiners could review to see if dealers were meeting their obligations, including what information dealers looked at to determine the market for a municipal security.

Both SIFMA and the Bond Dealers of America said they were glad to see SMMPs exempted from the best execution requirements. SMMPs are generally considered to require less protection than other investors, particularly retail investors. But SIFMA urged a more detailed analysis of the costs the regulation would impose on dealers, and BDA urged additional opportunity for comment and a deliberate pace by the MSRB.

"It is critical that the MSRB strike the appropriate balance between investor protection interests and the efficient operation of the municipal markets," Cohen wrote. "SIFMA would be pleased to work with the MSRB to obtain reliable empirical data to assist it in quantifying such costs and benefits."

Costs to consider could include those of developing and maintaining a comprehensive compliance and supervisory system, procedures and training programs, and more, the SIFMA letter states.

"We appreciate that the proposed rule exempts sophisticated municipal market professionals, and that the MSRB has included acknowledgements that municipal securities can be very thinly quoted," said Bond Dealers of America senior vice president for government relations Susan Collet. "Translating an intent to honor the nature of the municipal market into a workable regime is easier said than done, however. We believe that the regulators need to work in a very measured, cautious pace when attempting to finalize these rules. A 30-day comment period seems rather brief for a rule that will require a very delicate balance, so I am hopeful there will be more than one comment opportunity and an iterative process for working with the MSRB on this rule."

The MSRB has requested that all comments on the proposal be submitted by March 21.

BY KYLE GLAZIER

MAR 13, 2014 3:20pm ET

SIFMA to SEC: Don't Approve MSRB Fair-Pricing Rule.

WASHINGTON — The Securities Industry and Financial Markets Association is urging the Securities and Exchange Commission not to approve the Municipal Securities Rulemaking Board's proposed fair-pricing rule, arguing it is too intertwined with another pending rule.

The proposed fair-pricing rule would consolidate MSRB Rules G-18 on execution of transactions and G-30 on prices and commissions, as well as incorporate existing guidance regarding fair pricing in interpretive guidance to MSRB Rules G-17 on fair dealing and G-30. The proposed changes would create a single general rule, G-30, on prices and remuneration.

The MSRB filed the proposal with the SEC earlier this year, but SIFMA managing director and associate general counsel David Cohen said in a letter to the commission and a brief interview Wednesday that it should go no further until the MSRB explains how the rule would overlap with a proposed best execution rule the board rolled out in February.

Draft Rule G-18 would require broker-dealers to "use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions." Based on the Financial Industry Regulatory Authority's Rule 5310 for equities and corporate debt, the proposal was recommended in the SEC's 2012 Report on the Municipal Securities Market and is part of an effort to protect retail muni investors from paying more than they should.

Cohen said Wednesday that the two rules must be viewed side by side and that the SEC should not allow a new G-30 to go through until market participants understand the interplay between the two.

"Best execution is about two things," Cohen said. "It's about an order handling process, and the resulting price for the customer. So they're related."

"We would like the MSRB to tell us how they believe the two rules interact," Cohen added.

SIFMA's comment letter also takes the MSRB to task for not being willing to consider its earlier comments in the context of this rulemaking. The letter expresses support for the MSRB's goal of more efficient regulation, but is critical of the board for declining to consider some rule changes during the consolidation of existing guidance, calling that "a lost opportunity."

SIFMA had sought incorporation of additional guidance on matters such as sophisticated municipal market professionals and clarification of certain terms which the MSRB did not agree were necessary, according to the SEC's request for comment.

"SIFMA believes that improvements should be considered whenever rules are being reviewed, amended, or created," the letter states. "This is especially true in view of the extensive process required in rulemaking. However, in response to a number of comments made by SIFMA, the MSRB dismissed them. The MSRB refused to consider the comments on the merits, and stated 'this request goes beyond the scope of this rule making, and the MSRB can consider this request as part of any substantive changes at a later date.'"

The MSRB was unable to immediately provide a comment in response to the SIFMA letter. The board has said the new fair-pricing rule will help dealers to understand and comply with their fair pricing obligations by organizing them together in a single location.

Cohen said that there is not likely to be any impact to the market in delaying approval of a new G-30 for the time being because dealers already have those obligations under existing guidance.

The MSRB asked that public comments on the best execution proposal be submitted by March 21. The SEC could choose to grant SIFMA's request, it could ask the MSRB to amend the fair pricing proposal, or it could decide to approve the proposal as it is.

BY KYLE GLAZIER

MAR 12, 2014 4:42pm ET

SEC Won't Rewrite Advisor Compliance Rules for Social Media.

ARLINGTON, VA. — As the SEC contemplates a framework for how advisors can incorporate online social tools into their practice, many of the established principles concerning compliance, record-keeping and anti-fraud will hold steady in the era of new media, according to a senior commission attorney.

Melissa Gainor, senior counsel at the SEC's Investment Adviser Regulation Office, explained that the commission isn't envisioning a complete rewrite of its rules to account for the increasing use of social media within advisory practices. In remarks during a panel discussion at the Investment Adviser Association's compliance conference, Gainor explained that advisors will be expected to keep records about the content they post on social sites just as they do with other materials on traditional channels.

"Broadly, firms that communicate through social media must retain records of those communications covered by the record-keeping rule. It's really the content that's determinative rather than the form of communication used," Gainor said.

SEC GUIDANCE

Similarly, she noted that the SEC's advertising rule has been interpreted broadly in the past, and much of the guidance for promotional materials will carry over to the use of online tools like blogs, Facebook, Twitter and LinkedIn.

"Generally it doesn't depend on the type of technology or device used," she said.

The SEC has produced guidance directly addressing the use of social media within the practice, but for compliance experts like Michael Sherman, a partner with the firm Dechert LLP, the area remains distressingly vague. The proliferation of social tools — and the freewheeling nature of comments on the Web — has introduced considerable uncertainty into areas like endorsements and testimonials, a confusion that the SEC could address with more detailed examples in its guidance.

"It's as though we got flying cars but we never revised the rules of the road for highways," Sherman said.

Incorporating social media into the practice has been the subject of considerable debate in advisor circles in recent years. Consensus has been in short supply, but advisors are increasingly coming to believe that as they pursue a younger generation of clients, it's no longer a viable strategy for firms simply to have in place a policy "saying don't use it," according to John Thomas, Jr., managing director at BNY Mellon Asset Management.

"They have to have a presence," Thomas said.

And there are a number of third-party tools such as PageFreezer, Socialware and Smarsh to help firms in regulated industries remain compliant, offering on-demand services like archiving and monitoring.

SETTING BOUNDARIES

Even with the aid of those services, compliance professionals say that they still need to set boundaries on what advisors can use within their practice. Marla Roeser, director of compliance and risk management with Convergent Wealth Advisors, suggested that it's a simpler exercise to keep a white list of social sites advisors can use rather than try to maintain a roster of sites that are off limits at a time when new social tools and applications are sprouting like weeds.

"Instead of prohibiting certain sites, I would list the sites that they're authorized to use," she said. "You have to have the resources to monitor this activity. You have to be prepared for that."

In Convergent's case, that leaves just LinkedIn and Twitter available for use inside the practice, but even limiting usage just to those two, Roeser still has to navigate how the content that her firm's advisors are pushing out meshes with the SEC's rules.

Gainor acknowledged that a risk alert on social media that the SEC's Office of Compliance Inspections and Examinations issued left considerable gray areas, and said that the commission's work in that area had been slowed by its push to enact regulations under the JOBS Act (which also touched on social media, but in a different context). In the meantime, in the absence of more explicit guidance, the SEC still expects RIAs to be diligent in monitoring the content they publish on social sites.

"One of the things that you need to consider when you're developing your compliance policies and procedures is your ability to monitor," Gainor said. "If you don't have the ability to monitor, it begs the question as to how broad you can allow social media use."

BY: KENNETH CORBIN
WEDNESDAY, MARCH 12, 2014

NYT: Financial Adviser Sidesteps Prison in Bond-Rigging Case.

The names read like signposts on the highway of financial hardship — Detroit; Jefferson County, Ala.; San

Bernardino and Vallejo, Calif.

All have gone bankrupt in the last few years. But they also have another thing in common: They were victims of a vast bid-rigging scheme engineered by a Beverly Hills businessman, David Rubin, who tainted hundreds of municipal bond deals across the country and helped global banks cheat cities out of millions of dollars.

Despite prosecutors' recommendation for a prison sentence of at least 19 years, however, Mr. Rubin was sentenced on Wednesday to two years of probation for his role in the scheme. About 20 former bankers from five financial institutions — JPMorgan Chase, Bank of America, GE Capital, UBS and Wells Fargo — are also being prosecuted on suspicion of taking part in the conspiracy.

Mr. Rubin, who pleaded guilty to three counts of conspiracy and conspiracy to restrain trade in 2011, was also ordered to pay $5.65 million in penalties and restitution, adding slightly to a pot of more than $740 million that has been recovered from some of the banks he worked with. The money is to go back to the local governments that have not been made whole for their losses.

Judge Kimba M. Wood of Federal District Court in Manhattan said that despite Mr. Rubin's crimes, sending him to prison would be "a gross injustice" because of extraordinary circumstances. His indictment coincided with his wife's learning she has pancreatic cancer.

Judge Wood added that Mr. Rubin and his wife have seven children, including three minors whom he "has to raise while his wife suffers."

Judge Wood also noted that Mr. Rubin had decided to cooperate with federal prosecutors and had spent time providing evidence and testimony in the trial of a former UBS banker, Peter Ghavami, who was convicted in August 2012. She took it as a sign that he was getting "back on the right path," adding, "Mr. Rubin's character is now strong." After hearing the sentence, Mr. Rubin broke down in tears frequently as he told the court how ashamed he was and how sorry he was that he had put his wife through a terrible ordeal.

"I am truly sorry," he said. "I do not want this to be my legacy, and I will spend the rest of my days working to restore myself in the eyes of my family and friends."

Much of the sentencing hearing was spent resolving differences between the prosecutors, led by Rebecca Meiklejohn, and Mr. Rubin's lawyers over whether the damage his actions had caused could be measured accurately. The law requires Mr. Rubin to make whole the municipalities that suffered losses, but some of them have already had recoveries from the payments made by the five banks.

To help calculate Mr. Rubin's share of the restitution, they gave the court a list of places where bond deals were rigged, kickbacks paid or other crimes committed. The list did not try to identify every place that was harmed, only those where the government said it believed it could measure the harm accurately.

Even so, Mr. Rubin's defense lawyers argued that many of the tainted deals were tailored to each community's needs, so there was no market where prices were set. As a result, it was impossible to say how Mr. Rubin's interference with the market had affected the prices, they said.

Although Mr. Rubin's firm, CDR Financial Products, is not a household name, he worked with some of the biggest names in banking and was embroiled in public finance episodes that later became notorious. The former governor of New Mexico, Bill Richardson, withdrew his name from consideration as commerce secretary in 2009 because federal agents were investigating his ties to Mr. Rubin, who had contributed $100,000 to two of Mr. Richardson's political action committees and was subsequently hired to work on state bond deals. Mr. Richardson was not charged with any wrongdoing.

And Jefferson County, Ala., hired Mr. Rubin to monitor its extraordinarily large derivatives portfolio, which collapsed, contributing to the county's $4 billion bankruptcy in 2011.

The criminal activity grew out of the fact that when cities and other local governments raise money by selling municipal bonds, they usually seek financial institutions to hold it for them safely, pay some interest and distribute the money to them when they need it.

Smaller municipalities find it hard to comparison-shop for such tailor-made investment contracts, so they often work with brokers who are supposed to find the best deals. Mr. Rubin was one such broker, but not a neutral one, according to the Justice Department's antitrust division. Instead, he held sham auctions and steered business to favored financial institutions, which then kicked back money to him. As the conspiracy matured, it became popular to sell municipalities on bond deals that supposedly saved them money by using variable-rate bonds that were then hedged by derivatives called interest-rate swaps. Mr. Rubin helped financial institutions win contracts as swap counterparties and laundered illicit payments as "swap fees."

A number of localities were left with more debt than they could easily pay, or with unexpectedly costly swap contracts that they could not get out of without paying onerous termination fees. In some places, the public works projects were failures but the local residents still had to pay back the bonds.

The cases involving the former bankers are being heard in other courts and are at various stages, with some pleading guilty, some awaiting trial, some convicted, and some of those convicted seeking new trials because of what they say are prosecutorial errors.

By MARY WILLIAMS WALSH

MSRB to Consolidate Key Fair-Dealing Obligations for Municipal Securities Dealers.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) has received approval from the Securities and Exchange Commission (SEC) to consolidate extensive interpretive guidance on the fair-practice obligations of municipal securities dealers into three new rules and amendments to an existing rule. The MSRB will establish rules focused on time-of-trade disclosures to investors, dealers' dealings with sophisticated municipal market professionals and suitability of dealers' recommendations of municipal securities transactions.

"As part of the MSRB's ongoing efforts to enhance regulatory efficiency, the MSRB examined the many interpretations that have been issued primarily under MSRB Rule G-17, its central fair dealing rule, and identified opportunities to better facilitate compliance," said MSRB Executive Director Lynnette Kelly. "Creating stand-alone rules on key principles of fair dealing serves to highlight their importance and ensure that dealers understand and comply with these obligations."

The MSRB will codify into a new MSRB Rule G-47 the existing requirement under Rule G-17 that municipal securities dealers disclose material information to customers, at or prior to the time of the municipal securities trade. The new time-of-trade disclosure rule does not substantively change the current obligations, but rather seeks to aid dealers and other market participants in understanding, complying with and enforcing these obligations.

The MSRB also will establish two new rules to consolidate guidance for municipal securities dealers who deal with experienced investors called sophisticated municipal market professionals (SMMPs). MSRB Rule D-15 defines an SMMP and Rule G-48 provides the regulatory obligations of dealers to SMMPs, underscoring the differences in dealers' obligations to the more sophisticated professionals in the market.

Additionally, the MSRB revised MSRB Rule G-19 on suitability to more closely align with the Financial Industry Regulatory Authority's (FINRA) suitability provisions and consolidate existing MSRB interpretive guidance on the subject. The revised rule makes clear the specific factors that dealers must consider when recommending a transaction or investment strategy to municipal securities investors.

The new and revised rules will take effect July 5, 2014. Related interpretive guidance on these principles will be removed from the MSRB's Rule Book, but will be archived and available for review on the MSRB's website here.

SEC Urges Muni Issuers, Underwriters to Report Violations.

WASHINGTON — The Securities and Exchange Commission on Monday launched an effort to encourage issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws rather than wait for their violations to be detected.

Under the Municipalities Continuing Disclosure Cooperation Initiative, the SEC's Enforcement Division's Municipal Securities and Public Pension unit will recommend favorable settlement terms for muni issuers and underwriters who voluntarily report that there were inaccurate statements in bond documents about their prior compliance with continuing disclosure obligations. Rule 15c2-12 of the Securities Exchange Act of 1934 requires underwriters to reasonably determine that an issuer will comply with its continuing disclosure agreement before underwriting any new municipal securities. The rule also requires new offering documents to include descriptions of any continuing disclosure violations in the past five years.

"The Enforcement Division is committed to using innovative methods to uncover securities law violations and improve transparency in the municipal markets," said Andrew J. Ceresney, director of the Enforcement Division. "We encourage eligible parties to take advantage of the favorable terms we are offering under this initiative. Those who do not self-report and instead decide to take their chances can expect to face increased sanctions for violations."

The SEC has repeatedly indicated it is paying stricter attention to whether issuers are living up to their disclosure agreements and whether underwriters are doing their due diligence in making sure of that. Last year an SEC probe examined underwriters in California, and a July 2013 enforcement action targeted both West Clark Community Schools in Clark County, Ind. and Indianapolis-based City Securities Corp. with falsely claiming in bond documents that the issuer was meeting its secondary market disclosure obligations when it was not.

"Continuing disclosures are a critical source of information for investors in municipal securities, and offering documents should accurately disclose issuers' prior compliance with their disclosure obligations," said LeeAnn Ghazil Gaunt, chief of the Enforcement Division's Municipal Securities and Public Pensions Unit. "This initiative is designed to promote improved compliance by encouraging responsible behavior by market participants who have failed to meet their obligations in the past."

Bond Dealers of America president and chief executive officer Mike Nicholas said the SEC goal is sound but the details of the new program will have to be carefully examined.

"The BDA supports the SEC's goal toward self-reporting of violations to the extent an obvious violation of the securities law has occurred," Nicholas said. "We caution that there may be disproportionate administrative, reporting and other burdens on underwriters via the settlement obligation requirements and we will be examining those in more detail in the coming days."

Ben Watkins, Florida's bond finance director and the chair of the Government Finance Officers Association's debt management committee, said the new program isn't likely to provide much incentive for issuers to step forward.

"I don't see it," Watkins said, adding that issuers would probably end up with a cease-and-desist order whether they self-report or get caught by SEC investigators.

John McNally, a lawyer at Hawkins, Delafield & Wood LLP, said the SEC's announcement underscores a point the commission has already made. McNally said that the investigations currently being done by underwriters of an issuer's filing history are very comprehensive, and pointed out that the SEC issued a release in June 2010 warning underwriters that they should be diligent about looking into an issuer's filing history. The West Clark case made issuers sit up and take notice as well, McNally said.

"The SEC has already advised issuers and underwriters of their concerns, and all parties are paying careful attention to such advice," he said.

BY KYLE GLAZIER
MAR 10, 2014 2:28pm ET

Municipal Advisors Seek Changes, Clarifications on MSRB's MA Rule.

WASHINGTON — The Municipal Securities Rulemaking Board's proposed standards of conduct for municipal advisors would unnecessarily prevent banks from providing normal banking services as well as muni advice, the American Bankers Association is warning.

The ABA raised the concerns in one of more than 12 comment letters filed prior to Monday's deadline to provide input on the MSRB's proposed Rule G-42, called "Duties of Non-Solicitor Municipal Advisors."

The proposed rule codifies the language of the Dodd-Frank Act and the Securities and Exchange Commission's registration rule for MAs, which impose a fiduciary duty on them to put their client's interest first before their own. The draft rule says MAs owe both a duty of loyalty and a duty of care to their municipal entity clients. It would prohibit MAs and their affiliates from engaging in any other transaction in a principal capacity with a client, which some market participants read as barring MAs from engaging in any non-fiduciary business relationship running concurrent to the municipal advisory agreement.

“Draft Rule G-42 would prohibit a municipal advisor and any of its affiliates from acting as principal in any transaction with entities or obligated persons,” wrote ABA vice president and senior counsel Cristeena Naser. “We believe that the proposed complete prohibition is far too blunt an instrument to address any concerns the MSRB may have regarding principal transactions.”

“Such a ban would also force banking organizations’ municipal entity customers and obligated persons to decide to choose between receiving covered municipal advice or banking products and services from their banks, because banks would not be permitted to provide both,” her letter adds.

The ABA letter points out that other regulatory regimes imposing a fiduciary standard do not have similar requirements. Naser conceded that a ban on principal transactions might work in the case of firms that provide only MA services, but would be very disruptive to advisors with banking affiliates.

“Although a complete ban on principal transactions by affiliates might be feasible in the case of stand-alone advisors, it is entirely unreasonable and impractical in the context of the structure of the banking industry. Such a prohibition would necessarily force a banking organization to assess the value of providing advisory services to municipal entities and obligated persons as compared to the value of providing all other products and services to municipal entities and obligated persons.”

Leslie Norwood, associate general counsel and co-head of the municipal securities group at the Securities Industry and Financial Markets Association, called the prohibition on acting as a principal in other transactions “unworkable.”

“We support the MSRB’s effort,” Norwood said. “We oppose the blanket prohibition on principal transactions.

Susan Collet, senior vice president of government relations at the Bond Dealers of America, said the MSRB proposal and its ban on principal transactions is confusing in light of recent SEC guidance, which stated that an underwriting firm acting as an MA can not switch roles to underwrite bonds on the same transaction.

“The MSRB has an important opportunity with G-42 to add clarity to the framework created under the SEC municipal advisor rule,” Collet said. “The two rules need to work together, yet the proposed G-42 language on principal transactions makes very confusing something that the SEC rule made clear: the scope of a prohibition on ‘role switching’ is limited to the specific issuance or transaction for which a municipal advisor is engaged.”

The National Association of Independent Finance Advisors expressed support for the rule and its letter, signed by NAIPFA president Jeanine Rodgers Caruso, said the ban on principal transactions is appropriate but should be further clarified in any final rule. However, rule goes too far in some areas, such as the proposal to require MAs to disclose the scope and size of any professional liability insurance they carry, NAIPFA said. That proposal would put smaller firms at a competitive disadvantage since larger firms and those affiliated with broker-dealers would certainly carry larger and more expensive policies, she said.

“NAIPFA would welcome a revised provision that states in effect that municipal advisors must truthfully disclose, upon request, information related to any professional liability insurance maintained,” Rodgers Caruso wrote.

Another point of contention for commenters was the MSRB’s request for comment on whether the rule should impose a fiduciary duty on “obligated persons” such as conduit borrowers. The law explicitly places the fiduciary duty on MAs only with respect to municipal entities, which are issuers but not conduit borrowers. The draft of G-42 proposes a lesser duty of care for clients that are not municipal entities. NAIPFA said it would be supportive of such a measure, but the ABA and SIFMA both said that the MSRB should not impose a fiduciary standard on MAs providing advice to any client other than a municipal entity.

Illinois Finance Authority vice president and president of the National Association of Health and Educational Facilities Finance Authorities Pamela Lenane said many conduit issuers retain advisors who may also provide advice to municipal entities, and that the current system is efficient and should not be interfered with by the new rule.

"The association respectfully submits that imposing a fiduciary duty (whether implicitly or explicitly) on a municipal advisor that provides advice to an obligated person is contrary to the specific legislative intent expressed in the Dodd-Frank Act and unnecessarily complicates a municipal advisor's role in conduit financings," NAHEFFA said in its letter. The group, which represents certain conduit issuers, said the MSRB should clarify the differences between the duty of loyalty owed to municipal entities and the duty of care owed to other clients and perhaps create a separate rule governing the conduct of MAs with "obligated persons," meaning conduit borrowers. The MSRB could also clarify how the duties of MAs would apply to a conduit borrower in cases where the borrower retains its own MA in addition to the MA retained by the municipal entity issuing the bonds.

The American Council of Engineering Companies is also seeking clarification from the MSRB for any engineers who might find themselves ensnared by the regime. The SEC rule sought to provide an exemption for engineers providing normal engineering advice to municipalities, but some firms remain concerned that services such as feasibility studies evaluating the financial potential of a toll road or other revenue-producing asset could have to register as an MA. The group pointed out that engineers are already heavily regulated at the state level owe a high ethical duty to the public.

The MSRB must seek final approval from the SEC before any rule could take effect.

BY KYLE GLAZIER
MAR 10, 2014 4:36pm ET

New SEC Cooperative Enforcement Initiative.

The SEC today announced a new cooperation initiative out of its Enforcement Division to encourage issuers and underwriters of municipal securities to self-report certain violations of the federal securities laws rather than wait for their violations to be detected. Under the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative, the Enforcement Division will recommend standardized, favorable settlement terms to municipal issuers and underwriters who self-report that they have made inaccurate statements in bond offerings about their prior compliance with continuing disclosure obligations specified in Rule 15c2-12.

To be eligible for the MCDC Initiative, an issuer or underwriter must self-report by accurately completing a questionnaire and submitting it by 12:00 a.m. EST, September 10, 2014.

A detailed description of the initiative is available here.

The questionnaire is available here.

[A press release concerning the initiative is available here.]()

[BDA Members Meet with MSRB & SEC; Discuss SEC's Municipal Advisor Rule & MSRB's Regulatory Regime for Municipal Advisors.]()

Yesterday, BDA members and staff met with the MSRB and the SEC's Office of Municipal Securities to discuss ongoing concerns and further clarifications with the SEC's Final Municipal Advisor Rule as well as the MSRB's approach to their regulatory regime for municipal advisors.

Meeting with the MSRB

BDA members primarily discussed concerns with MSRB proposed Rule G-42 on duties of non-solicitor municipal advisors. Specifically, we discussed the following items:

- Principal Transactions – We expressed our concern that the language contained in proposed Rule G-42 creates a potentially unworkable paradigm, which may cause an underwriter to be precluded from certain principal transactions by inadvertently becoming a municipal advisor;
- Obligated Persons – The BDA believes MSRB's Rule G-17 on fair dealing protects obligated persons in a sufficient manner while recognizing that obligated persons are different from public entities and that the fiduciary duty standard should not be extended to obligated persons;
- Official Statements – The BDA believes the issuer should be positioned to determine the scope for review by a municipal advisor of its official statement and agreed with the MSRB that the ultimate goal should be that all parties to a transaction understand one another's obligations.

Regarding ongoing work by the MSRB in developing their regulatory framework for municipal advisors, we can expect further proposals on the following:

- Core duties of non-solicitor municipal advisors (G-42);
- Supervision of municipal advisors (G-44);
- Municipal Advisor Fees;
- Political Contributions;
- Gifts and Gratuities; and
- Solicitation Activities.
- Meeting with the SEC's Office of Municipal Securities

The BDA focused primarily on four areas of concern in its discussion with John Cross and other staff from the Office of Municipal Securities. Our desire is to have further clarification on the items below which include:

- Whether a firm can be a municipal advisor for the purpose of investment of proceeds without being precluded from underwriting the bonds;
- Navigating the municipal advisor rule when providing investment advice to municipal entities such that advice on bond proceeds can be avoided;
- Use of the language, "rely upon," under the Independent Registered Municipal Advisor (IRMA) exception; and
- The scope of the two-year "cooling off" period for municipal advisors, under the IRMA exclusion.

The BDA will be submitting another round of requested clarifications to the the SEC and hope to see a second round of FAQs released this spring. We will also be submitting a comment letter to the MSRB on their proposal for Rule G-42 and we encourage all of our member firms to do the same.

The comment period expires on March 10, 2014.

Piowar Wants to Improve Muni Price Transparency.

WASHINGTON — Securities and Exchange Commission member Michael Piwowar has asked the staff of the Office of Municipal Securities to give him some proposals that he can push through the SEC to improve price transparency in the municipal market.

Piwowar, a Republican who joined the commission last year, replacing Troy Paredes, suggested in a speech in January that dealers should be required to disclose markups and markdowns in riskless principal transactions, But he told The Bond Buyer in an interview that he is looking for other ideas as well.

It was Piwowar's first post at the SEC that kindled his interest in the muni market. He was working as an economist in what was then called the Office of Economic Analysis in 2002 when he was approached by the SEC's chief economist and offered the chance to go in a different direction.

"I came here and thought I was going to work on equity market structure issues," Piwowar said. "That was my area of research. Literally my second day here our chief economist at the time, Larry Harris, said, 'Do you realize we have every transaction in municipal bonds for a one year period?' I said 'No.' He said, 'Do you want to work on a research project?' I said 'Yes.' He said, 'Good, because if you had said no I would have fired you.' So I spent basically a year learning as much as I could about the muni market."

Harris, who is now a professor at the University of Southern California, remembers Piwowar as playing an important role in helping to shed light on the understudied bond market.

"He was a very promising young economist," Harris said. "He was already quite accomplished when he came to the SEC."

Harris and Piwowar's study, eventually published in a financial research publication, was an examination of spreads and markups in the bond market. Piwowar said the goal was to figure out why investors paid additional costs in some cases, and to determine what might affect those costs.

"What we wanted to try to do was figure out was what were the effects of adding transparency to the market," he said. "I just looked at the spreads in this market and I thought, 'There is something wrong here.' It must be off by a decimal place, the spreads are just too wide. Especially at retail sizes."

Unfortunately for the researchers, data available from the Municipal Securities Rulemaking Board didn't allow them to isolate the effects of adding transparency to the market, Piwowar said. But they observed a decrease in spread size correlating to transparency in the corporate bond market. Piwowar said his work during this time demonstrated to him that while institutional muni investors could call around to different broker-dealers and find the best prices, retail investors generally could not do that and might not even be aware of where they could find data available.

Harris said Piwowar really dove into the project and learned a lot of difficult muni-specific concepts in a hurry. Harris said the study was influential in helping the SEC to decide to require real-time trade reporting, and said Piwowar deserves much credit for that work.

“Mike was instrumental in making that happen,” Harris said.

Piwowar said more can be done.

“Now I’m back, so there is an opportunity I think to continue doing some work in this area,” he said.

Piwowar moved around both before and between his stops at the SEC, staying no more than four years in any one place – nothing new for the product of a Navy family who moved from coastal city to coastal city in California, Virginia, and elsewhere before earning a B.A. in foreign service and international politics from the Pennsylvania State University, an M.B.A. from Georgetown University, and a Ph.D. in Finance also from Penn State.

The economist said he began his college career believing he would be a diplomat and perhaps ambassador to a foreign country, but jokingly recalled that he was soon disabused of the idea.

“I did an internship at the State Department,” he said. “What I learned is that if you work really hard in the foreign service, you get to be an ambassador to a country that hates us. If you want to be an ambassador to a country that likes us, you go out and you make a bunch of money and donate it to the guy that becomes president.”

He taught finance courses at Iowa State University from 1998 to 2002, prior to his first stop at the SEC. After leaving the commission, Piwowar worked as a principal at the Securities Litigation and Consulting Group, which provides assistance to law firms and others involved in complex securities litigation. During and just after the financial crisis, he served for one year at the White House as a senior economist at the President’s Council of Economic Advisers under both Presidents George W. Bush and Barack Obama. While there, Piwowar also served as a staff economist for the Financial Regulatory Reform Working Group of the President’s Economic Recovery Advisory Board. Most recently, he was the chief economist for Republican members of the Senate Banking Committee and worked on the Dodd-Frank Act.

Piwowar won Senate confirmation for a five-year term as commissioner in August 2013, and created a stir at his first public meeting by criticizing SEC chairman Mary Jo White for not giving him enough time to review the municipal advisor registration rule. He voted with his fellow commissioners to approve that major muni rule unanimously, but many observers commented that Piwowar’s comments were unusual. Piwowar is outspoken about the need for detailed economic analysis of market rulemaking. He is the only current commissioner who is not an attorney. When it comes to specific muni issues, Piwowar shows interest, but is not strongly opinionated.

“I don’t have a particular view on broker’s brokers,” he said when asked about them. The SEC’s 2012 Report on the Municipal Securities Market recommended broker’s brokers and alternative trading systems be required to start making some of their pricing information publicly available in order to improve price transparency. The SEC’s Office of Compliance Inspections and Examinations, possibly as a prelude to that, is examining the extent to which dealers using alternative trading systems and broker’s brokers are engaged in anti-competitive practices such as blocking or filtering out competitors from being able to bid on their municipal securities. Piwowar said he previously wondered if more market transparency would eliminate the need for brokers’ brokers.

“They obviously seem to be filling a role that the dealers think is useful, or else they wouldn’t use them,” Piwowar said. “Maybe there is a particular niche that they are filling.”

The commissioner said he views the pricing question as a very difficult one for the muni market. Some muni securities trade so infrequently, it is difficult to benchmark the price, he said.

He has gone public with his view that money market mutual funds need to be reformed and that investors should possibly be able to choose whether to invest in funds that have either a floating net asset value or funds that have fixed NAVs but can restrict redemptions to prevent runs during times of economic panic.

Piwowar said the time to act on some muni reforms is now, whether they are those included in the commission's muni market report or new ideas developed up by the muni office. Aging baby boomers will be shifting their investments away from equities and towards less risky bonds, he said. Interest rates are going to rise, further complicating the landscape for investors who may not understand the effect that has on their investments.

Piwowar said if the muni office can identify three or more pieces of "low-hanging fruit" that the commission could coalesce around, there is a chance to get things done quickly.

"Here's a real opportunity where we could work together," he said.

BY KYLE GLAZIER

MAR 7, 2014 11:13am ET

FINRA Limits Data Collection Plan, Citing Investor Privacy.

Bowing to industry concern, regulator won't collect account names, addresses, tax IDs

Nodding to public criticism, Finra announced it would limit the type of data that it plans to collect as part of its proposed Comprehensive Automated Risk Data System.

The program, which is designed to help the Financial Industry Regulatory Authority Inc. monitor firms by automatically collecting data on account activity, will not require firms to submit sensitive client information including the account name, address or tax identification number, according to a notice posted to the regulator's website Tuesday.

"Finra has concluded that the CARDS proposal will not require the submission of information that would identify to Finra the individual account owner," the notice said.

Finra would still collect trading information and other data, including building out customer profiles based on investment objectives and date of birth, according to the proposal. The goal was to identify potential trouble spots such as churning or unsuitable investments.

The original proposal, which was released for comment on Dec. 23, drew more than 40 comments from investors and people in the industry, many of whom voiced concerns over what kind of information would be collected and how it would be secured.

The Financial Services Institute Inc., which represents more than 100 independent financial services firms, lauded the change.

"While we still have concerns with data security, costs and other unintended consequences of the proposal, we applaud Finra's response to industry concerns," FSI president and chief executive Dale Brown said in a statement. "We will continue to work with them as this proposal is considered."

The comment period for the proposed design of the CARDS system was previously extended to

March 21.

By Mason Braswell

Mar 4, 2014 @ 2:33 pm

MSRB to Implement Streamlined Registration Process for Municipal Securities Dealers and Municipal Advisors.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) has received approval from the Securities and Exchange Commission (SEC) to consolidate its multiple registration requirements and forms for municipal securities dealers and municipal advisors. The change will make it easier for regulated entities to meet the new and ongoing registration requirements.

MSRB rules require firms under its regulatory jurisdiction to register with the MSRB and provide certain identifying and contact information before engaging in municipal securities and advisory activities. The MSRB amended its rules to create a simplified electronic registration process under a single rule, MSRB Rule A-12.

"As part of the MSRB's ongoing effort to enhance regulatory efficiency, the MSRB developed this streamlined registration process to make it easier for municipal securities dealers and municipal advisors to identify, understand and comply with MSRB registration requirements," said MSRB Executive Director Lynnette Kelly. The new process also improves the efficiency with which the MSRB collects necessary information about regulated entities.

The MSRB's consolidated registration rule becomes effective on May 12, 2014 for all municipal securities dealers and municipal advisors seeking to register with the MSRB. New registrants will access electronic Form A-12 through MSRB Gateway, the secure access point for all MSRB Market Transparency submission services, applications and the associated forms.

Also beginning May 12, firms that are currently registered with the MSRB under the previous requirements will have 90 days to verify, update and complete their registration information, which will be transferred to the new form automatically by the MSRB. The MSRB will provide these firms with additional information and resources to assist them in transitioning their registration information to the new form by the compliance deadline of August 10, 2014.

View the Regulatory Notice:

http://www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2014-05.ashx?n=1

MSRB Proposes Supervision Rule for Municipal Advisors.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today requested public comment on proposed supervisory and compliance obligations for municipal advisors when engaging in municipal advisory activities. Establishing a supervision rule is a key step in the MSRB's development of a regulatory framework for municipal advisors, as directed by Congress in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

“Establishing baseline supervisory requirements for municipal advisors will help ensure that they and their personnel comply with all applicable securities laws, with an emphasis on the critical goal of preventing compliance issues in the first place,” said MSRB Executive Director Lynnette Kelly. “The regulatory framework the MSRB is developing is aimed at protecting state and local governments and other municipal entities that rely on the services of municipal advisors, and a supervision rule lays the foundation for the rest of that framework.”

The MSRB’s supervision proposal, draft Rule G-44, draws on the strengths of analogous supervision rules for other areas of the securities industry but takes into account the diversity of the municipal advisory population, including small or single-person firms. The draft rule takes a primarily principles-based approach, applying the standard that policies be reasonably designed to achieve compliance with the rules applicable to municipal advisors. The rule specifically requires that municipal advisor firms have written supervisory procedures and that they designate a chief compliance officer to be responsible for compliance functions and personnel to be responsible for supervision, but also provides detailed supplementary material to accommodate and guide the application of the rule for small and single-person firms.

The Dodd-Frank Act charged the MSRB with developing standards of conduct and qualification for municipal advisors to help safeguard the interests of state and local governments that engage the services of municipal advisors. The MSRB earlier this year requested comment on a proposal to establish core standards of conduct for municipal advisors. Future MSRB rule proposals for municipal advisors will include measures to address the potential for pay-to-play activities by municipal advisors; limitations on gifts and gratuities to employees of municipal securities issuers and other market participants; and duties of municipal advisors acting as solicitors. The MSRB also is developing a comprehensive professional qualifications program, as well as appropriate fees to be charged to municipal advisors.

The MSRB’s draft supervision rule for municipal advisors incorporates the MSRB’s preliminary economic analysis of the benefits, burdens and potential regulatory alternatives, and the MSRB requests comment on that analysis in addition to all aspects of the proposed rule.

View the Request for Comment here:

http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-04.ashx?n=1

Comments on the draft supervision rule should be submitted to the MSRB no later than April 28, 2014.

The MSRB is hosting an educational webinar on the main aspects of the proposed supervisory and compliance requirements on March 20, 2014 at 3:00 p.m. ET.

Register for the webinar:

https://www2.gotomeeting.com/register/535817330

Why's the SEC's New Municipal Advisor Rule So Confusing?

What governments need to know about where they should go to seek financial advice.

When the federal government creates totally new regulations, it can generate a fair amount of confusion. That’s what’s happening with the definition for Municipal Advisors, a new category of financial advisors specifically tailored for municipalities.

The backstory to this regulation is a long one. The condensed version is that the 2008 financial crisis showed regulators that governments needed someone looking out for their interests in financial transactions with Wall Street – and only their interests.

Historically, it’s common for those orchestrating the trransaction to also dish out advice and counsel to the municipality entering into the deal. The problem with this model is that while most underwriters or brokers are fair and reasonable, there are many who are not.

Among the more famous bad examples, Jefferson County, Ala., officials were wooed in 2008 into entering into a complicated interest rate swap deal. The deal was orchestrated by a J.P Morgan Chase banker who (along with some county officials) later pleaded guilty to corruption charges related to the deal. The swap plan ultimately backfired and led Jefferson County into bankruptcy in 2011.

Regulations in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, passed as a response to the recession, establilshed that municipalities would have their own advisors who were regulated. The act left it up to the Securities and Exchange Commission to actually define what a municipal advisor is and is not.

Fast forward to today, and it’s becoming apparent that idea is easier said than done. After a long wait, the SEC this past fall issued its definition for who constitutes a municipal advisor. Essentially, a municipal advisor is a qualified financial professional (i.e., a banker or financial consultant) who counsels municipalities on financial deals like bond offerings. That person must be registered through the SEC as a municipal advisor and cannot have any other interest in the deal. The problem? Well, even with nearly 800 pages of explanation, there is still a lot of room for questions. (Originally slated for January, the SEC delayed implementation of this rule unil July.)

For one, notes federal securities lawyer Paul Maco, municipal advisors are a new class of advisors. But because governments have so often sought advice from other financial professionals, making them defacto municipal advisors, creating a new line in the sand can be confusing. “This is a new group of regulated people dropped into a regulated area with different categories among them,” says Maco, an attorney with the internatinonal firm Bracewelll & Giuliani. “So [for example], there’s naturally some overlap between investment advisors or between broker/dealers.”

The rule seeks to eliminate that overlap with this key difference: municipal advisors have an explicit fiduciary responsibility to solely their government clients. In other words, they are looking out only for the government’s interests and have no other connection to a deal. In the same way a prospective homeowner would want her own real estate agent and wouldn’t want to use the seller’s agent, municipalities now must get advice on a transaction from someone who won’t benefit financially in any way from the deal.

The concept seems to make sense but in practice it’s proving to be difficult; governments are accustomed to getting advice from those assisting them in a financial deal. Issuers that are used to calling up their banker and asking her opinion about a transaction must seek counsel elsewhere. That banker can communicate market trends, ideas and issues. But anything considered actionable is off the table. “There’s a lot of misunderstanding about what a financial advisor does or what a broker-dealer does,” says Susan Munson, founder of the Fixed Income Academy, an online school that seeks to educate buyers and sellers in the bond (fixed income) market. “How they get compensated – that’s where their allegiances are,” she said.

Munson, who was an account executive with Merrill Lynch's Institutional Advisory Division before founding the academy, added that brokers or financial service providers may only be selling investments their company wants them to focus on. While they may still offer up unbiased advice in that realm, their view is limited.

"It boils down to, if people [have] a fiduciary duty, they have to behave in a certain away," she said. "There's [now] a standard of care you have to put ahead of your own – you can't advise them of anything not in their best interests."

There are exceptions. One applies to the Request for Proposals process – professionals who are not a government's municipal advisor can offer up advice in a proposal response. Another exception: If a government already has an advisor in place for a transaction, and that is made clear in writing, underwriters and other professionals involved in that same transaction can also give advice. But here, there has been yet another snag – according to the rule, issuers in this situation must still "rely on" the advice from their municipal advisor.

"So people are now saying what does 'rely on' mean?" says Susan Gaffney, who served as the Government Finance Officers Association's Federal Liaison Center director for more than a decade. "Does it mean always use? Mostly use? Everybody's struggling with what does this all mean and does this change how I approach an issuer?"

The gray areas are getting much of the attention (and consternation) now from municipalities and financial professionals tasked with living in the confines of the new rule come this summer. But the goal of the rule – to create a bright line between what constitutes advice and what doesn't and who really should be providing that to the issuer – is one that ultimately has government's best interest at heart.

"There's going to be near-term pain over the understanding and getting this in place," says Matt Posner, an analyst for Municipal Market Advisors. "But it's for long-term good. We should have responsible advisors and we should be able to educate those advisors and make them better."

BY LIZ FARMER | FEBRUARY 25, 2014

lfarmer@governing.com @LizFarmerTweets

MSRB to Implement Fee Changes for Data Subscription Products and Services.

The Municipal Securities Rulemaking Board (MSRB) has made fee changes to several of its data subscription products and services and made other technical amendments. The changes, which take effect April 1, 2014, relate to the MSRB's Electronic Municipal Market Access system (EMMA®), Real-time Transaction Reporting System (RTRS) and Short-Term Obligation Rate Transparency System (SHORT System).

View the Regulatory Notice at:

http://www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2014-06.ashx?n=1

SEC Approves New Rule on 529 Plan Disclosures.

WASHINGTON — The Securities and Exchange Commission has approved a new rule that will require underwriters of 529 college savings plans to submit more in-depth financial information to the Municipal Securities Rulemaking Board twice a year.

New Rule G-45 on reporting of information on municipal fund securities will require primary distributors or underwriters of 529 plans to submit information including assets, contributions, distributions, fees and expenses, and performance data to the board within 60 days of June 30 and December 31 each year.

These are college savings plans are established by states under Internal Revenue Code section 529 that allow parents or other individuals to invest in state trusts to accumulate funds to pay for the expected higher education expenses of beneficiaries.

The SEC decided that the new rule passed muster, and approved it Feb. 21, with an effective date of Feb. 24, 2015. Implementation of the rule will occur with the first submission of Form G-45 due by August 30, 2015, which is 60 days after the end of the reporting period of January 1 – June 30, 2015.

The MSRB originally filed the proposed rule with the SEC in June 2013, along with proposals to amend its Rules G-8 on books and records and G-9 on preservation of records to require underwriters to maintain the information required to be reported on new Form G-45 for six years. The board said the rule would help it better oversee the characteristics and risks of the 529 plan market. The MSRB currently collects some information about 529 plans such as preliminary offering documents and continuing disclosure information, but not the information on assets, fee structure, performance data, and other aspects required under the newly-approved G-45.

The rule went through some changes by the MSRB, in response to comments that the definition of underwriter was not acceptable. The Investment Company Institute argued that a plan's program manager, record-keeper, investment manager, custodian or state sponsor generally are not broker-dealers and would not qualify as underwriters under the rule. ICI requested that the MSRB clarify that those entities would not be considered underwriters if they provide services to the plan on behalf of it or its state sponsor. The College Savings Plan Network, an affiliate of the National Association of State Treasurers, also specifically requested in comments that a state sponsor not be treated as an underwriter.

The MSRB amended the proposal last month to clarify that state sponsors would probably not be underwriters, and that other entities would have to determine based on their own unique circumstances whether they are underwriters or not.

Dealers said they were concerned that underwriters might be required under the rule to report information they had no ability or no legal right to collect, and that some of the information might be proprietary in nature and damaging to a plan if made public.

The MSRB responded to those comments, seeking to assure underwriters that they would not be required to submit any information that was illegal for them to collect and that the MSRB would study the new disclosures internally. A new request for comment will go out if the MSRB seeks to publish such information, the board said.

View the Regulatory Notice:

http://www.msrb.org/~/media/Files/Regulatory-Notices/Announcements/2014-03.ashx?n=1

BY KYLE GLAZIER

FEB 24, 2014 2:42pm ET

Bond Dealers of America Holds Legal and Compliance Meeting in Memphis.

The Committee discussed Municipal Advisor Rule and FINRA Proposed Margining Amendments.

On Friday, February 21, 2014, the BDA held a Legal & Compliance meeting at the offices of Raymond James in Memphis, TN from 12:30 – 4:30pm. At the meeting, member firms gathered to foster discussion as each separately drafts written supervisory procedures in order to meet the parameters of certain topical rules and proposed regulations. Specifically, the committee discussed:

- SEC Final Municipal Advisor Rule
- FINRA's Proposed Amendments to Rule 4210 on Margining
- MSRB Proposed Rule G-42 on duties of municipal advisors and
- MSRB Proposed Rule on Best Execution

The L&C meeting attendees discussed the ongoing challenges they are up against in the face of these proposed and final rules. They agreed to craft a document for distribution among all BDA member firms so they may use it as a resource while drafting internal procedures.

Regarding the Muni Advisor Rule, L&C Committee Members:

- Discussed recurring questions stemming from the first round of SEC FAQs;
- Shared ongoing concerns at individual firms and discussed submission of questions to the SEC for their anticipated second round of FAQs;
- Discussed the rule's exceptions and the positives and negatives for each;
- Discussed timing for being able to rely on an exception and what to do if there is none in place and
- Made a decision that the BDA would produce a checklist for firms to use when looking for additional resources to assist in your compliance efforts.

Regarding the FINRA Proposed Margin Amendments, L&C Committee Members:

- Reviewed documents containing a summary of the rule, including outstanding questions for consideration as we draft BDA's comment letter;
- Discussed outstanding "problem areas" we foresee if the rule were to go into effect as is;
- Discussed what firms should be looking at while doing an internal assessment regarding their compliance needs in implementing the rule;
- Review of what our firms have done to date as far as either putting a system in place or subscribing to a third party system;
- Discussion of the impact at the retail level and especially as that relates to the sub-account level;
- Made a decision to create a checklist for firms to use as they consider how they will comply with the rule when it goes into effect and
- Decided also to distribute an internal document related to the outstanding third party vendor options which are available, including detailed information about each.

With regard to their discussion surrounding MSRB Proposed Rule G-42 and Best Execution, L&C

members:

- Reviewed their past comment letters;
- Discussed their approach and process for the next set of comment letters, including the decision to host additional issue-specific conference calls to dig deeper into these issues as the comment letter deadline approaches.

The BDA Legal & Compliance Committee will take the information learned at this meeting and produce an internal document so that all BDA firms can be on the same page with what they believe are integral components of the rule(s) and to be sure member firms are considering certain specific and high level elements as they draft internal procedures.

Bank, Trust Officers Warned Of Dodd-Frank Surprises.

Banks and trust officers could get tripped up over several pending regulatory developments as Dodd-Frank Act rule-making winds down, Phoebe Papageorgiou, senior counsel of the American Bankers Association, said today.

New requirements to register as municipal advisors, money market reform, and concerns from the Consumer Financial Protection Bureau over senior designations might catch the banking industry by surprise, Papageorgiou said at the ABA's Wealth Management and Trust Conference in San Diego.

Banks may have to register as municipal advisors if they advise municipal entities on the issuance of securities or "municipal financial products," she said.

A municipal advisor is a new registration category arising from Dodd-Frank, Papageorgiou said.

Municipal entities could be local governments, school boards, as well as universities and hospitals that receive bond proceeds, she said. "Thousands of entities could be municipal entities" under the law.

Banks need to be careful managing proceeds of municipal bond offerings, Papageorgiou said, including proceeds of pension obligation bonds if a bank advises a municipal plan.

"The act of managing those proceeds could capture you" under municipal advisor rules and subject banks to additional SEC and MSRB oversight, she said.

The ABA is asking the SEC to carve out an exception for pension obligation bonds. "We say, once [the money] is in a pension plan, it's no longer a proceed, and you no longer have to register," Papageorgiou said.

Banks already get exemptions from the municipal advisor rules for deposit accounts, extensions of credit, or bond indenture trustee services provided to municipal entities.

Trust departments could also be impacted by the SEC's pending money market reform, Papageorgiou said.

Bank trust departments use money market funds for pooled trust accounts and want to continue offering the funds for cash balances, Papageorgiou said. But banks may not be able to use the SEC's proposed retail money funds in trust accounts unless they could track individual withdrawals to ensure compliance with the $1 million limit on daily redemptions. Banks anticipate that the accounting would be too complex to accomplish that oversight, she said, so may have to use government money market funds, which would have no withdrawal limits under the SEC plan.

"The question is, are there enough of those [government funds] out there," Papageorgiou said. "We have a lot of concerns here."

Separately, a CFPB report on senior designations recommended that the SEC establish some standards for certifications aimed at older investors and add some enforcement capability for their misuse.

"It's interesting that [the CFPB] put out a number of recommendations to the SEC, but not to banking agencies," Papageorgiou said, even though people in the banking industry are using senior designations.

The CFPB has an office focused on vulnerable populations—students, retirees and military personnel, she added.

FINANCIAL ADVISOR

FEBRUARY 27, 2014 • DAN JAMIESON

Municipal-Debt Rules Proposed to Ensure Brokers Seek Best Prices: Bloomberg.

U.S. securities regulators proposed stricter rules on brokers in the $3.7 trillion municipal-debt market designed to prevent investors from being shortchanged when trading state and local government bonds.

The rules, released today by the Municipal Securities Rulemaking Board, would require that brokers seek to trade at the most favorable prices possible for clients in the municipal-bond market, which lacks a centralized exchange. Brokers would have to check prices on various platforms before trading.

The Alexandria, Virginia-based board, known as the MSRB, said the step may boost competition among brokerage firms and lower trading costs for investors. Similar requirements already exist in the corporate bond market.

The proposal would need to be approved by the Securities and Exchange Commission. The SEC said in 2012 that stricter rules could lead to fairer prices for buyers and sellers of state and local government bonds.

The municipal-bond market is dominated by individual investors seeking the tax-exempt income generated by state and local government debt. Such investors hold $1.6 trillion, or 44 percent, of outstanding municipal bonds, according to the Federal Reserve Board.

Many such securities, sold by local school boards and other infrequent borrowers, aren't often traded, which can make it difficult for individuals to determine what the market price should be.

The existing rules in the municipal market require brokers trade with their customers at “fair and reasonable” prices, the MSRB said. The proposed regulations would require that brokers seek prices that are “as favorable as possible under prevailing market conditions” by gauging trading on electronic platforms with firms that act as middlemen for brokers, and other potential buyers, before executing trades.

The rule wouldn’t apply to certain institutional investors, such as money-management firms that are better equipped than individuals to monitor prevailing prices.

To contact the reporter on this story: William Selway in Washington at wselway@bloomberg.net

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Dealer Groups Unsure About Best Ex Rule Proposal.

WASHINGTON — Dealer groups are unsure whether the Municipal Securities Rulemaking Board’s proposed best execution rule is tailored enough for the municipal market, but are pleased it would exempt sophisticated professionals.

Draft Rule G-18, which the MSRB released Wednesday, would require broker-dealers to “use reasonable diligence in seeking to obtain for their customer transactions in municipal securities the most favorable terms available under prevailing market conditions.”

Based on the Financial Industry Regulatory Authority’s Rule 5310 for equities and corporate debt, the rule goes a step beyond the current Rule G-18 on execution of transactions, which requires dealers to “make a reasonable effort to obtain a price for the customer that is fair and reasonable in relation to prevailing market conditions.”

The proposal also seeks to alter the MSRB’s proposed Rule G-48 on sophisticated municipal market professionals to make clear that the best execution obligations would not apply to sophisticated municipal market participants, which need less protection.

“That’s something right off the bat we were happy to see,” said Bond Dealers of America senior vice president of government relations Susan Collet. BDA among others suggested an SMMP exemption be included in any best execution proposal.

Although the SEC recommended in its 2012 comprehensive report on the municipal market that the MSRB adopt a best execution rule, dealers have said attempting to impose a “trade-by-trade” pricing mandate on them would be unreasonable in a market as illiquid and opaque as the muni market. The muni space does not have a single location where all pricing information is quickly available.

Collet said BDA is not yet sure whether the MSRB’s efforts to create a rule with aspects more unique to the muni market are sufficient. The MSRB proposal notes the rule must be tailored for the muni market, so a dealer could demonstrate it met its obligations for specific munis by reviewing information to determine the current market for them or similar munis. That wording is not included in the FINRA rule.

Another muni-specific aspect of the proposed rule is its treatment of broker’s brokers. Unlike the FINRA rule, draft Rule G-18 would not require dealers to show why it was reasonable to use a broker’s broker.

The Securities Industry and Financial Markets Association last year floated an “execution with diligence" proposal that would have required dealers to use "reasonable diligence" to get a "fair and reasonable" price for customers. Randy Snook, SIFMA's executive vice president of business policies and practices, thanked the MSRB for considering that proposal but said SIFMA shares BDA's uncertainty about the rule's suitability for the muni market.

"Developing a higher standard is in the best interest of investors and the municipal market, and is something SIFMA has been focused on for the past year," Snook said. "SIFMA appreciates the MSRB's consideration of our 'execution with diligence' proposal. We also appreciate that the MSRB, in its proposal, noted that a failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence. We are reviewing the MSRB's best-execution proposal, particularly with regard to the extent it reflects the unique characteristics of the municipal securities market as FINRA 5310 is, at its core, an equity market rule. SIFMA is committed to working with the MSRB on this issue and will provide more substantive comments after a full review with our members."

The MSRB said it was shooting for a principles-based rule that will protect investors without imposing a strict pricing standard on dealers. The board is seeking public comments on several questions related to the rule proposal. Among these are whether the same goal could be better achieved through alternative regulatory measures, whether a best execution standard is a worthwhile goal, what effect the rule might have on the efficiency of transactions, and what additional costs the rule might impose on dealers.

If a best-execution standard was adopted, dealers would need to establish or revise compliance policies and written supervisory procedures, as well as implement additional monitoring and surveillance. Dealers who are not subject to the FINRA rule would probably be the most affected and bear the highest costs, the MSRB said in the notice on its proposal.

The MSRB asked that public comments on the proposal be submitted by March 21. The rule would have to be filed with, and approved by, the SEC before it could take effect.

BY KYLE GLAZIER

FEB 19, 2014 3:33pm ET

MSRB Receives SEC Approval to Collect Information on Municipal Fund Securities.

The Municipal Securities Rulemaking Board (MSRB) has received approval from the Securities and Exchange Commission to adopt new MSRB Rule G-45, on reporting by 529 college savings plan underwriters of information on municipal fund securities. The SEC also approved electronic Form G-45, as well as associated amendments to MSRB Rules G-8, on books and records, and G-9, on preservation of records.

View the SEC approval order:

http://www.sec.gov/rules/sro/msrb/2014/34-71598.pdf

The effective date for the rule change is February 24, 2015. Accordingly, 529 plan underwriters will be required to first submit Form G-45 by August 30, 2015, which is 60 days after the end of the reporting period of January 1 – June 30, 2015. Thereafter, reporting must be made by no later than

60 days following the end of each semi-annual reporting period ending on June 30 and December 31 of each year. Performance data, however, will be submitted annually by no later than 60 days following the end of the reporting period ending on December 31.

SEC Approves Two Rule Changes Related to FINRA Rule 8312 (FINRA BrokerCheck Disclosure).

The SEC approved two rule changes related to FINRA Rule 8312 (FINRA BrokerCheck Disclosure). First, the SEC approved amendments to permanently make publicly available in BrokerCheck information about former associated persons of a FINRA member firm who were registered on or after August 16, 1999, and who have been the subject of an investment-related civil action brought by a state or foreign financial regulatory authority that was dismissed pursuant to a settlement agreement. Second, the SEC approved amendments to include in BrokerCheck information about member firms and their associated persons of any registered national securities exchange that uses the Central Registration Depository (CRD) for registration purposes. Both rule changes will become effective on June 23, 2014.

The text of the rule amendments is set forth in Attachment A.

Questions concerning this Notice should be directed to FINRA's Gateway Call Center at (301) 590-6500.

View the full Notice:

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p447595.pdf

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MSRB Requests Comments on First Best-Execution Rule for Municipal Securities Transactions.

The Municipal Securities Rulemaking Board (MSRB) today requested public comment on a proposal to establish for the first time explicit requirements for municipal securities dealers to seek the most favorable price possible when executing transactions for retail investors. If ultimately approved, the proposed "best-execution" standard would provide benefits for investors, promote competition among dealers and enhance market efficiency.

Comments on the best-execution rule proposal should be submitted to the MSRB no later than March 21, 2014.

The MSRB is hosting an educational webinar on the main aspects of the proposed rule on March 6, 2014 at 3:00 p.m. ET.

Register for the webinar:

http://www.msrb.org/~/media/Files/Regulatory-Notices/RFCs/2014-02.ashx?n=1

[SIFMA Statement on the MSRB's Proposal to Establish Best-Execution Rule for Municipal Securities Transactions]

New York, NY, February 19, 2014-SIFMA today released the following statement from Randy Snook, executive vice president, business policies and practices, SIFMA, on the MSRB's proposal to establish a best-execution rule for municipal securities transactions:

"SIFMA appreciates the proposal issued by the MSRB today. We and our members share the MSRB's goal of improving execution standards for dealers and promoting fair and reasonable pricing for investors. Developing a higher standard is in the best interest of investors and the municipal market, and is something SIFMA has been focused on for the past year. SIFMA appreciates the MSRB's consideration of our 'execution with diligence' proposal. We also appreciate that the MSRB, in its proposal, noted that a failure to have actually obtained the most favorable price will not necessarily mean that the dealer failed to use reasonable diligence. We are reviewing the MSRB's best-execution proposal, particularly with regard to the extent it reflects the unique characteristics of the municipal securities market as FINRA 5310 is, at its core, an equity market rule. SIFMA is committed to working with the MSRB on this issue and will provide more substantive comments after a full review with our members."

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

Release Date: February 19, 2014

Contact: Katrina Cavalli, 212.313.1181, kcavalli@sifma.org

For more information, visit http://www.sifma.org.

[Fitch Expects Unwinding, Restructuring of TOB Programs.]

WASHINGTON — Fitch Ratings said Thursday that it expects a gradual unwinding or restructuring of tender option bond programs over the next few months since they were not exempted from the Volcker Rule.

The rating agency said it will continue to monitor developments in the $70-$80 billion TOB market as market participants try to find alternative structures of financings before the rule goes into effect on April 2014, and conformance is required by July, 2015.

TOB programs have historically been used to provide short-term tax-exempt munis to money market funds.

In a typical TOB program, the sponsor will deposit a fixed-rate bond or note into a trust, which will issue two new certificates — a floating rate certificate and a residual certificate.

The floating rate certificate will have a tender option, through a liquidity facility that is typically issued by the program's sponsor or an affiliate and shortens the maturity of the bond or note so it becomes eligible to be purchased by a tax-exempt money market fund.

TOB programs account for about 25% to 30% of the assets of muni money market funds.

But under the Volcker Rule, banks and their affiliates will no longer be able to sponsor a TOB program, own a residual certificate issued by a TOB trust, or provide credit enhancement, liquidity, or remarketing services these programs.

"Fitch expects a gradual unwinding of the programs as liquidity facilities expire," the rating agency said. "Under this scenario , there would likely be some increase in supply side pressure arising from tax-exempt money market funds tendering their floating rate certificates to liquidity banks and the liquidity banks looking to sell the previously deposited bonds or notes into the market."

The Securities Industry and Financial Markets Association is talking to members about the impact of TOB programs not receiving an exemption, David Cohen, SIFMA associate general counsel said Thursday. SIFMA has formed a working group, comprised of both buy- and sell-side members, to explore ways in which municipal financings can be done in compliance with the final Volcker Rule, he said, adding, "We are in the preliminary stages and are hopeful that a compliant structure can be effected with minimal market impact."

SIFMA had urged federal regulators to exempt TOB programs from the definition of a "covered fund" like a hedge fund, arguing that because the underlying asset in the trust is a state or local bond, a TOB should be treated as such.

BY LYNN HUME

FEB 6, 2014 6:03pm ET

Fed Rule May Curb Bank Buying After Holdings Double: Bloomberg Muni Credit.

U.S. banks poured more than $200 billion into state and local-government debt since the onset of the financial crisis six years ago, boosting their share of the $3.7 trillion market to a two-decade high.

Now, if federal regulators have their way, California Treasurer Bill Lockyer says banks next year will have more incentive to buy debt sold by Saudi Arabia or Botswana than U.S. municipalities. The result, he says: higher costs for taxpayers.

California, Georgia and New York City are among issuers pressing regulators, including the Federal Reserve, to ease a rule that may curb buying by banks. The regulation, intended to guarantee that banks have enough easy-to-sell assets during a cash crunch, wouldn't let them use munis to satisfy the requirements, giving the companies less reason to hold the debt.

"Anything that reduces demand for our bonds could have a negative impact," said Diana Pope, who oversees debt sales for the Georgia State Financing and Investment Commission in Atlanta. "Banks are a big part of our market and anything that limits what they can invest in affects us."

Banks propped up demand last year as Detroit's record bankruptcy filing and bets that interest rates were set to rise led investors to pull money from local-debt mutual funds. Munis logged their biggest annual loss since 2008, pushing benchmark 10-year yields to a two-year high of 3.15 percent in September. The yield was 2.67 percent yesterday.

Growing Share

In the first nine months of 2013, banks added $41 billion of munis, Fed data show. That left them with $404 billion as of Sept. 30, or about 11 percent of the market. It was their biggest share since 1990 and double their holdings at the end of 2007, when they accounted for about 6 percent of the total.

"The bank bid has played a very important role in the market's performance since the credit crisis," said Matt Posner, an analyst who tracks regulatory issues for research firm Municipal Market Advisors, based in Concord, Massachusetts. "If this rule is put in place, many of these banks would have to curb their purchases."

The proposed rules are pending before the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corp. They are part of the broader overhaul of securities oversight ushered in by the 2010 Dodd-Frank law, intended to prevent a repeat of the credit crunch.

Changes Possible

The regulators are reviewing public comments on the proposal, which may result in changes.

Greg Hernandez, an FDIC spokesman; and Eric Kollig, a spokesman for the Fed, declined to comment. Bill Grassano, a spokesman at the OCC, said the agency "doesn't comment on proposed rules, but keep in mind that we do consider all comments."

Separate regulations released last year, aimed at curbing banks' speculative bets, will also bar investments known as Tender Option Bond programs, which use borrowed money to buy debt and have spurred demand for munis. Banks have been trying to figure out how to overhaul such funds to keep them operating.

The reserve rules have yet to be decided on and would be phased in starting on Jan. 1. They mandate how much the largest banks must hold in what regulators view as high-quality, liquid assets during times of financial stress.

Not Munis

Such assets would include Treasuries, bonds of foreign governments and other securities, including some stocks and corporate bonds. Municipal obligations wouldn't count because regulators said they didn't consider them easy enough to sell.

That exclusion may cause banks to reduce munis in favor of securities that meet the requirements, Fitch Ratings said on Jan. 30. The New York-based company said banks that operate as dealers, the market's middlemen, may hesitate to commit money to trading of local debt, potentially making it harder for investors to transact in the securities.

In a Dec. 27 letter to regulators, Citigroup Inc.'s Howard Marsh, head of munis for the New York-based bank, said the rule would result in unnecessary "and in many instances unbearable" increases in financing costs for public works.

Danielle Romero-Apsilos, a bank spokeswoman, declined to comment.

Upheaval Potential

Kenneth Naehu, who oversees bonds for Banyan Tree Asset Management in Los Angeles, said the rule hasn't gotten enough attention from investors.

"This is a real thing that I don't think the market understands yet," he said. "There is a potential for serious upheaval."

Michael Decker, who lobbies on municipal bond issues for the Securities Industry & Financial Markets Association, a Wall Street trade group, echoed the concern.

"I don't think there would be an instantaneous sell-off," he said. "But I think it would be a discouragement, and over time you'd see banks play a less significant role in the market."

In letters to regulators, state and local officials urged reconsideration of the muni exclusion.

New York City Comptroller Scott Stringer argued in a letter that the market is broad enough to meet regulators' requirements, and that muni prices fell less than top-rated corporate debt during the credit crisis.

Banks bought $145 million of an $896 million New York bond sale completed last month, Stringer said.

Lockyer, whose state is the largest issuer of munis, also wrote to regulators last month asking for the proposed regulation to be amended. In an interview yesterday, he said the rules may raise risk at banks.

"The rule would provide greater incentives for U.S. financial institutions to do business with foreign governments than with more creditworthy U.S. municipal issuers," he said in his letter. Keeping it "would increase borrowing costs for municipal issuers" and heighten volatility in the market for their debt.

By William Selway Feb 12, 2014 5:00 PM PT

To contact the reporter on this story: William Selway in Washington at wselway@bloomberg.net

To contact the editor responsible for this story: Stephen Merelman at smerelman@bloomberg.net

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Former Bank of America Executive Pleads Guilty for Role in Conspiracy and Fraud Involving Investment Contracts for Municipal Bonds Proceeds.

Washington, DC—(ENEWSPF)—February 10, 2014. A former Bank of America executive pleaded guilty today for his participation in a conspiracy and scheme to defraud related to bidding for contracts for the investment of municipal bond proceeds and other municipal finance contracts, the Department of Justice announced.

Phillip D. Murphy, the former managing director of Bank of America's municipal derivatives products desk from 1998 to 2002, pleaded guilty today before U.S. District Judge Max O. Cogburn Jr. in the U.S. District Court for the Western District of North Carolina to participating in a fraud conspiracy and wire fraud scheme with employees of Rubin/Chambers, Dunhill Insurance Services

Inc., also known as CDR Financial Products, a broker of municipal finance contracts, and others. Murphy also pleaded guilty to conspiring with others to make false entries in the reports and statements originating from his desk, which were sent to bank management.

Murphy was indicted by a grand jury on July 19, 2012. According to the indictment, Murphy participated in a wire fraud scheme and separate fraud conspiracies that began as early as 1998 and continued until 2006.

"By manipulating what was intended to be a competitive bidding process, the conspirators defrauded municipalities, public entities and taxpayers across the country," said Brent Snyder, Deputy Assistant Attorney General of the Antitrust Division's Criminal Enforcement Program. "Today's guilty plea reaffirms the Antitrust Division's continued efforts to hold accountable those who corrupt and subvert the competitive process in our financial markets."

Public entities seek to invest money from a variety of sources, primarily the proceeds of municipal bonds that they issue, to raise money for, among other things, public projects. Public entities typically hire a broker to conduct a competitive bidding process for the award of the investment agreements and often for other municipal finance contracts.

According to the charges, Murphy conspired with CDR and others to increase the number and profitability of investment agreements and other municipal finance contracts awarded to Bank of America. Murphy won investment agreements through CDR's manipulation of the bidding process in obtaining losing bids from other providers, which is explicitly prohibited by U.S. Treasury regulations. As a result of the information, various providers won investment agreements and other municipal finance contracts at artificially determined prices. In exchange for this information, Murphy submitted intentionally losing bids for certain investment agreements and other contracts when requested, and, on occasion, agreed to pay or arranged for kickbacks to be paid to CDR and other co-conspirator brokers.

Murphy and his co-conspirators misrepresented to municipal issuers that the bidding process was competitive and in compliance with U.S. Treasury regulations. This caused the municipal issuers to award investment agreements and other municipal finance contracts to providers that otherwise would not have been awarded the contracts if the issuers had true and accurate information regarding the bidding process. Such conduct placed the tax-exempt status of the underlying bonds in jeopardy.

"Mr. Murphy's actions undermined the public's trust when he conspired to manipulate a competitive bidding process," said Richard Weber, Chief, IRS Criminal Investigation (IRS-CI). "IRS-CI has experienced great success in unraveling significant and complex financial frauds as we work in close collaboration with our law enforcement partners."

"Mr. Murphy ripped off hard working American taxpayers and cash-strapped municipalities all in pursuit of his own lucre," said George Venizelos, Assistant Director in Charge of the FBI's New York Field Office. "Let this serve as a reminder to others who are entrusted to act in the public's best interest; your lack of candor won't go without notice."

Murphy pleaded guilty to two counts of conspiracy and one count of wire fraud. The fraud conspiracy carries a maximum penalty of five years in prison and a $250,000 fine. The wire fraud charge carries a maximum penalty of 30 years in prison and a $1 million fine. The false bank records conspiracy carries a maximum penalty of five years in prison and a $250,000 fine. The maximum fines for each of these offenses may be increased to twice the gain derived from the crime or twice the loss suffered by the victims of the crime, if either of those amounts is greater than the statutory maximum fine.

Including Murphy, a total of 17 individuals have been convicted or pleaded guilty. Additionally, one company has pleaded guilty.

The prosecution is being handled by Steven Tugander, Richard Powers, Eric Hoffmann, Patricia Jannaco and Stephanie Raney of the Antitrust Division. Assistant U.S. Attorneys Kurt Meyers, Michael Savage and Mark Odulio of the U.S. Attorney's Office for the Western District of North Carolina have also provided valuable assistance in this matter. The guilty plea announced today resulted from a wide-ranging investigation conducted by the Antitrust Division's New York office, the FBI and the IRS-CI. The division coordinated its investigation with the U.S. Securities and Exchange Commission, the Office of the Comptroller of the Currency and the Federal Reserve Bank of New York.

Today's guilty plea is part of efforts underway by President Obama's Financial Fraud Enforcement Task Force (FFETF) which was created in November 2009 to wage an aggressive, coordinated and proactive effort to investigate and prosecute financial crimes. With more than 20 federal agencies, 94 U.S. attorney's offices and state and local partners, it's the broadest coalition of law enforcement, investigatory and regulatory agencies ever assembled to combat fraud. Since its formation, the task force has made great strides in facilitating increased investigation and prosecution of financial crimes; enhancing coordination and cooperation among federal, state and local authorities; addressing discrimination in the lending and financial markets and conducting outreach to the public, victims, financial institutions and other organizations. Over the past three fiscal years, the Justice Department has filed more than 10,000 financial fraud cases against nearly 15,000 defendants including more than 2,700 mortgage fraud defendants. For more information on the task force, visit www.stopfraud.gov .

Anyone with information concerning bid rigging and related offenses in any financial markets should contact the Antitrust Division's New York Field Office at 212-335-8000, the FBI at 212-384-5000 or IRS-CI at 212-436-1761, or visit www.justice.gov/atr/contact/newcase.htm.

10 Feb 2014 12:30 Written by Press Release Category: Federal and International

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FINRA Agrees to Dump Expungement Agreements.

Rule change would stop brokers from placing conditions on settlements stipulating that customers agree not to oppose brokers' move to clear record

It may become harder for financial advisers and brokerage firms to expunge investor complaints from their disciplinary records.

Finra Rule 2081, which was approved by the Financial Industry Regulatory Authority Inc. on Thursday, will prevent firms and brokers from placing conditions on settlements stipulating that customers agree not to oppose an expungement request, the regulator said. The rule will now go to the SEC for further review.

"While we are committed to providing an effective means for a registered person to expunge allegations that are false — which is something I strongly believe in — Finra feels that expungement of dispute information shouldn't be bargained for through settlement negotiations or otherwise," said Finra chairman and chief executive Richard Ketchum in a summary video posted to Finra's website.

Finra does not disclose how often expungement is used as a condition of settlement, but the rule comes as pressure had been mounting from investor plaintiffs' attorneys and Congress.

The concern was that it was too easy for brokers to scrub customer complaints from Finra's Central Registration Depository, which maintains a record of such complaints and regulatory and disciplinary actions. Much of the database is publicly available through Finra's BrokerCheck database, the regulator said.

The Public Investors Arbitration Bar Association, which represents investors in arbitration cases, published a highly publicized study last October that claimed brokers are able to obtain expungement in around nine out of 10 cases resolved by settlement or a stipulated award.

Several senators, including Sen. Jack Reed, D-R.I., and Sen. Charles Grassley, R-Ia., had also chimed in with letters to Finra seeking more information about the frequency of expungements granted in settlements.

But others in the industry felt that the controversy was overblown, saying that expungements were difficult to obtain.

During the five-year period from 2007 to 2012, Finra erased disputes in less than 5%, or 838 cases, of the total 17,765 customer disputes filed, the self-regulator said.

Those who seek expungement must obtain court approval validating any arbitration award granting expungement before an event can be erased.

Some attorneys who help brokers obtain expungements felt that the process could inconvenience customers and brokers who are legitimately pursuing expungement. Marc Dobin of the Dobin Law Group P.A. said that many times the agreement not to oppose expungement was tacked onto a settlement after the terms, including the monetary amount, had been negotiated.

"They're actually going to inconvenience the customer more if the customer's now going to be a constant player after the settlement of the case," he said.

The proposal will be sent to the Securities and Exchange Commission, where it will be subject to public comment before a final decision on adoption will be made.

By Mason Braswell

Feb 13, 2014 @ 2:35 pm EST

FINRA Seeks to Beef up use of BrokerCheck.

Revives proposal that would require brokerages to link to regulator's database, including disciplinary background info

Finra on Thursday advanced a revised proposal that would require brokerage firms to include a link on their websites and other online communications to BrokerCheck, the database that includes broker disciplinary records.

The Financial Industry Regulatory Authority Inc. would require brokerage firms to display links to BrokerCheck, “on any member firm’s website that is available to retail investors” and, in many other cases, when a firm displays a broker’s profile or contact information.

The rule proposal, which has moved to a public comment period, came as part of a trio of decisions by Finra’s 24-member Board of Governors that could reshape how investor disputes with brokers are settled and publicly reported.

Finra has been looking to pass a rule that would more widely publicize BrokerCheck for more than a year.

At issue is more than an Internet hyperlink. The proposal reignites a contentious debate between brokerage firms and Finra, the regulator whose operations they finance. Many brokers consider BrokerCheck to be a scarlet-letter repository, presenting the public with a distorted picture of their professional lives and cataloguing years of marginal details and meritless grievances by clients.

But some groups have been pushing for more information to be disclosed on BrokerCheck, and say a clear and comprehensive disciplinary history helps consumers make an informed decision when choosing an adviser. Groups such as the Public Investors Arbitration Bar Association, which represent investors in litigation against brokers, say not enough consumers know that BrokerCheck exists.

David Neuman, a lawyer who represents investors at Stoltmann Law Offices, said the revised rule is good news.

“Just putting that info in the customer’s hand will certainly be helpful, and maybe they’ll think twice if their broker has a number of complaints or other remarks on his record,” he said.

In April, facing industry pressure, Finra withdrew a proposal that would have required Finra members to include a link to the individual’s BrokerCheck page.

Some securities lawyers said the rule was too vague and costly to implement and monitor, saying that brokers could not, for instance, include a link to BrokerCheck in a Twitter post, given the platform’s space limitations.

But the rule announced on Thursday did not mention including a link to an individual’s BrokerCheck page, and it excluded “an online interactive electronic forum … such as a … Twitter feed.”

Bryan M. Ward, a partner at Sutherland Asbill & Brennan, said the rule is likely to increase compliance costs and requests for expungement, a process that erases brokers’ disciplinary history from BrokerCheck.

“There’s so many different media and so many different ways and it’s ever changing, in terms of how brokers are communicating with clients,” he said. “Twitter is not anything like what it was five years ago.”

BrokerCheck tracks basic information about brokers, as well as records from disciplinary hearings, allegations of misconduct by clients and the result of arbitration or court cases relating to their work. Unless they are expunged, the records include allegations that were settled or dismissed.

Currently, brokers are required to provide to customers annually in writing the BrokerCheck hotline number and Finra website address.

By Trevor Hunnicutt

Feb 13, 2014 @ 12:28 pm EST

SEC Plans To Act on Many Muni Report Recommendations.

WASHINGTON — The Securities and Exchange Commission plans to take action on many of the recommendations in its 2012 municipal market report as well as strengthen its oversight of municipal advisors, according to its draft strategic plan released Monday.

The 42-page document lays out the SEC's "mission, vision, values, and strategic goals" for fiscal years 2014 through 2018. Among the topics covered is the nearly two year-old comprehensive muni market report, which was written after a lengthy examination of the market spearheaded by then-commissioner Elisse Walter. That 165-page report recommended a number of both legislative and regulatory changes that Congress and the SEC could make to strengthen transparency in the market.

Among the recommendations for the SEC and the Municipal Securities Rulemaking Board were to require muni dealers to disclose to customers markups and markdowns of riskless principal transactions, and to encourage the use of alternative trading systems.

"The SEC plans to pursue many of the recommendations highlighted in the July 2012 Report on the Municipal Securities Market through a combination of SEC, MSRB, and [Financial Industry Regulatory Authority] initiatives, in an effort to enhance the market structure for all fixed income securities, including taxable and tax-exempt securities," the draft plan states. "This effort will include initiatives aimed at promoting transparency and the development of new mechanisms to facilitate the provision of liquidity, as well as initiatives to improve the execution quality of investor orders."

SEC commissioner Michael Piwowar said last week that he is working with the commission's Office of Municipal Securities on the need to disclose markups and markdowns in riskless principal transactions. The MSRB is working on some other aspects of the report, such as the expansion of MSRB's EMMA website to become a comprehensive central transparency platform and the development of a best execution rule requiring dealers to seek the best price for their customers. The SEC has oversight of the MSRB and must approve its rule proposals.

The plan notes the SEC's mandate, under the Dodd-Frank Act, to regulate municipal advisors, and states that the commission will focus on getting MA's properly registered. The plan is open for public comment until March 10.

BY KYLE GLAZIER

FEB 3, 2014 4:14pm ET

Groups Urge Bank Regulators To Make Munis High Quality Liquidity Assets.

WASHINGTON — The Public Finance Network, elected public officials and dealer groups are urging bank regulators to categorize municipal securities as high quality liquid assets in a proposed rule, warning the failure to do so would significantly harm the municipal market and state and local governments.

The rule, as currently proposed, “will have significantly negative effects on the municipal securities market and communities across the country,” warned the Public Finance Network, which consists of 17 muni market groups.

“Failing to qualify municipal bonds as HQLA would significantly reduce the appeal of municipal securities for banks to underwrite these securities and investors to purchase them, resulting in increased borrowing costs for state and local governments and [public sector entities] to finance desperately needed infrastructure projects,” said a letter sent by the groups, which include the National Association of State Treasurers and National League of Cities.

The groups’ concerns stem from a rule that the Federal Reserve System’s Board of Governors, the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency proposed in October to strengthen the liquidity positions of large financial institutions so they can better withstand periods of economic and financial stress.

The proposed rule would require large banks to maintain a minimum liquidity coverage ratio, defined as the ratio of HQLA to total net cash outflows. Assets would qualify as HQLA if they could be easily and immediately convertible to cash with little or no loss of value during a period of liquidity stress.

The regulators proposed three classes of HQLA: Level 1, which would include sovereign securities, including U.S. government securities and U.S. government-guaranteed securities; Level 2A, securities issued by U.S. government-sponsored enterprises and certain other sovereign entities; and Level 2B, investment-grade corporate debt with certain characteristics and equities in the Standard & Poors 500 Index.

The regulators said they did not include munis in any of these categories because they “these assets are not liquid and readily-marketable in U.S and thus do not exhibit liquidity characteristics necessary to be included in HQLA under this proposed rule.”

But the groups strenuously disagreed. Michael Decker, managing director and co-head of munis at the Securities Industry and Financial Markets Association, urged the banking regulators to include investment-grade munis as Level 2A liquid assets. “While it is true that not all municipal securities trade every day, which is also the case for investment-grade corporate and … GSE debt securities, the municipal market is nonetheless liquid in that it is always possible to obtain executable price quotes from dealers for any transactions of virtually any size,” he said in a letter to the regulators.

In 2012 daily trading volume in the U.S. muni market averaged $11.3 billion, compared to $22.6 billion for corporate bonds. However, on the basis of average daily trading volume in relation to total volume outstanding, 0.31% of total outstanding munis traded each day versus 0.25% of outstanding corporate bonds, Decker said. Trading volume in the muni market tends to remain fairly constant within a range, while subject to some seasonality and variation based on issuance activity and other factors, he added.

Bond Dealers of America chief executive officer Michael Nicholas said, “We disagree that municipal bonds are not readily marketable in U.S. markets.”

“Municipal securities are known as the second safest available investment, aside from U.S.

Treasuries, with state and local governments having nearly a zero default rate, and meeting the agencies' qualifications for limited price volatility, high trading volumes and deep and stable funding markets," the network said. The proposed rule "favors foreign debt securities over U.S. state and local debt securities, and in doing so threatens to increase costs for national infrastructure development, three-quarters of which is financed through tax-exempt bonds," it said.

New York City Comptroller Scott Stringer warned, "The proposed rule will likely result in decreased bank appetite for investment grade municipal securities" and hurt the city because large banks are significant purchasers of its debt. In a $896 million bond sale completed last month, bank purchases totaled $145 million or 16.2% of its fixed-rate offering, Stringer said.

"Banks have also made direct purchases and/or provided necessary liquidity support for the city's variable rate demand bonds, providing lower-cost funding to make our capital program more affordable," he added.

Connecticut Treasurer Denise Nappier said the proposed rule would "make the holdings of municipal debt by large banks less attractive and have a negative impact on the demand for municipal bonds."

"The availability of bank credit and bank direct purchase alternatives for state and local governments will likely decrease and grow more costly," she added.

John Pranckevicious, chief financial officer of The Massachusetts Port Authority, also called for munis to be treated as Level 2A HQLA, saying this would be necessary to "avoid any unintended and unnecessary increases in the cost of improving municipal infrastructure and engaging in new public works projects, which are vital not only to the authority and the New England region, but to the health of the U.S. air transport system."

SIFMA's Decker also said it makes no sense to assume that, in a financial crisis, such as the one in 2008, there would be 100% outflows for liquidity facilities extended to tender option bond financing and deposits collateralized by munis. Experience shows they should instead be 30% and 25%, respectively he said.

BY LYNN HUME

FEB 3, 2014 5:07pm ET

EMMAs New Look Coming Tomorrow.

To make it easier for investors and other municipal market participants to find important information about municipal securities, the Municipal Securities Rulemaking Board (MSRB) tomorrow will unveil an improved design and organization of its Electronic Municipal Market Access (EMMA®) website. The MSRB considered input from a broad spectrum of stakeholders to inform the changes. EMMA's updated homepage and navigation should help all municipal market participants discover ways to use the website to make more informed decisions in the municipal market.

Learn more at:

http://msrb.org/msrb1/EMMA/pdfs/EMMA-Homepage-2014.pdf

MSRB Enhances Design of EMMA Website to Improve Access to Municipal Market Information.

Alexandria, VA – The Municipal Securities Rulemaking Board (MSRB) today unveiled improvements to the navigation and design of its Electronic Municipal Market Access (EMMA®) website, making it easier for investors and other municipal market participants to find important information about municipal securities.

"Since 2008, EMMA has served as the official, free source of data and disclosure documents for virtually all municipal bonds," said MSRB Executive Director Lynnette Kelly. "EMMA's new look is designed to help users access information more easily and discover new ways to use EMMA to make more informed decisions in the municipal market. In the coming months, we will be making additional changes that will further enhance the market's ability to evaluate trade prices for municipal securities."

Enhanced features available on the EMMA website today include:

- Easier Browsing. A pilot feature allows investors and other market stakeholders to browse a searchable directory of all state, city, county and other municipal securities issuers in a particular state. Clicking on any issuer name will display a consolidated view of all available information about that issuer's securities, including trading activity, disclosure documents and contact information for investors.
- Goal-Based Approach to Navigation. Many EMMA users know what they are looking for but not how to find it on the website. EMMA now features a rotating carousel that spotlights key ways to use EMMA, from finding trade prices for a specific municipal security to exploring data on market-wide trends for the $3.7 trillion municipal market.
- Daily Market Recap. A snapshot of the most actively traded fixed rate municipal securities from the previous trading day provides a glimpse of the dynamic municipal market, which averages 40,000 trades a day. In the coming months, this feature will be updated with interday trade information.
- Clean, Modern Design. EMMA's new look streamlines the overall appearance of the website and integrates new multimedia resources such as videos about the municipal market.
- One-Click Access to Essential Tools. The new EMMA homepage maintains popular features such as the Quick Search function and direct links to EMMA Dataport, the secure application through which issuers and municipal finance professionals submit data and documents to EMMA in compliance with MSRB rules.

Many of the MSRB's enhancements to EMMA align with the recommendations of the Securities and Exchange Commission's July 2012 report on the municipal securities market. The MSRB also considered feedback from EMMA users and conducted a series of focus groups to ensure all changes to EMMA support the MSRB's ongoing effort to improve the usability of the website.

The MSRB recently expanded its user engagement through the formation of the EMMA Development Advisory Group, a panel of volunteers from across the municipal marketplace that will offer regular input on potential enhancements to EMMA.

"The MSRB welcomes feedback from EMMA users and other municipal market stakeholders on the latest changes to the website and how we can continue to improve the transparency of the municipal market," Kelly said.

Date: February 7, 2014

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SEC Examining Muni ATS', Broker's Brokers For Anti-Competitive Practices.

WASHINGTON — The Securities and Exchange Commission is examining the extent to which dealers using alternative trading systems and broker's brokers are engaged in anti-competitive practices such as blocking or filtering out competitors from being able to bid on their municipal securities.

The SEC's Office of Compliance Inspections and Examinations has sent letters to the ATS', broker's brokers and dealers seeking trade information, sources said.

Thomas Vales, chief executive officer and chairman of TMC Bonds, formerly TheMuniCenter, an alternative or non-exchange, trading system for municipal bonds, confirmed that he received a letter from the SEC but declined to comment further.

Officials from the other two biggest muni ATS' — Tradeweb Direct, whose parent company is Tradeweb Markets, which acquired BondDesk Group in November, and KCG BondPoint, a division of KCG Americas, a subsidiary of KCG Holdings, Inc. — would not comment. SEC officials also would not discuss the letters or exams.

The exams may be a precursor to efforts by the SEC and Municipal Securities Rulemaking Board to get ATS' and broker's brokers to play a major role in improving muni price transparency.

In its report on the municipal securities market, released in July 2012, the SEC recommended it amend its Rule ATS, and the MSRB consider proposing rules, that would require ATS' and broker's brokers to publicly disseminate their best bid and offer prices. The report said they also should be required to disseminate, on a delayed and non-attributable basis, responses to "bids wanted" auctions. Ideally, the information would be posted on the MSRB's Electronic Municipal Market Access of EMMA system, which provides disclosure and trade data to retail investors and other market participants for free.

But any anti-competitive activity would skew the pricing information from ATS' and broker's brokers. The fewer the bids for a muni bond, the less likely the buyer will get the best price.

The SEC said ATS' and broker's brokers are key to pre-trade price transparency because they most often are used by dealers trying to buy munis for retail customers.

Retail investors who want to buy munis typically ask a dealer to identify bonds with credit, payment, tax, maturity or other characteristics that meet their needs, the SEC said in its report. A dealer may recommend munis from its own inventory or try to obtain munis from other dealers, through a broker's broker that brokers transactions between dealers, or through an ATS, an electronic trading platform that has participating dealers.

"To the extent there is pre-trade price transparency in the municipal securities market, the staff understands that it tends to be provided through electronic networks operated by broker's brokers, ATS' or similar trading systems," the SEC report said.

These platforms account for a substantial portion of muni trades, but represent only a small percentage of dollar volume, which suggests they are used primarily for smaller-retail-size orders, the SEC said. Larger institutional trades tend to be executed through more traditional means, such as direct-voice negotiations with a muni dealer or voice brokerage and do not generate any pre-trade price transparency apart from the negotiation process, it said.

ATS' and broker's brokers tend to be 'inventory-based,' providing information only on the municipal securities their participating dealers would like to sell, and perhaps the prices sought (i.e. offers)," the SEC said. "Unlike a limit order book on an equities exchange or equity ATS, municipal securities ATS' typically provide no information on the participants who would like to buy or the prices at which they would be willing to do so (i.e. bids)."

Legitimate Uses

Dealers sometimes block, screen or filter out other dealers for legitimate credit, regulatory or legal reasons. For example, a dealer putting out bids for bonds through an ATS might not want to sell to another dealer that historically doesn't follow through on its bid or has a bad reputation or legal issues.

But when a dealer merely wants to block other dealers from seeing its inventory and the munis it's offering, that's seen as anti-competitive.

The SEC noted these limitations in its muni report. The information from ATS' and broker's brokers is not widely accessible to the public for several reasons, the commission said. First, the trading interest reflected on these systems is generally only available to their participating municipal bond dealers and is not available or transparent to non-participants such as retail investors, it said. While some participating dealers may share information with certain customers, this is done solely at their discretion.

Second, these systems may allow participating dealers to limit the dissemination of their trading interests only to a subset of other muni bond dealer participants, the SEC said.

"For example, some ATS' permit a participant to apply filters so that their interest in a particular municipal security is conveyed only to its preferred trading partners," the commission said.

The MSRB raised similar concerns in interpretative guidance it issued in December 2012 on its Rule G-43 on broker's brokers and warned these firms that regulators will be on the lookout for anti-competitive practices.

The MSRB noted that G-43 "permits a broker's broker to limit the audience for a bid-wanted at the selling dealer's discretion, a practice sometimes referred to as 'screening' or 'filtering,' because the MSRB recognizes there may be legitimate reasons for this practice."

However, the MSRB noted, "such screening may reduce the likelihood that the high bid represents a fair and reasonable price" and warned, "Selling dealers should therefore be able to demonstrate a reason that is not anti-competitive (e.g., credit, legal, or regulatory concerns), rather than trying to eliminate access by a competitor, for directing broker's brokers to screen certain bidders from the receipt of bid-wanteds or offerings."

The board suggested, as a compliance measure, that a selling dealer might want to maintain a list of firms it would be unwilling to accept as a counterparty and the reasons why.

Broker's Brokers Consortium

Meanwhile, 10 broker's brokers have formed a consortium, called Municipal Bond Information Services, to provide pre-trade pricing information — offers and bids — on an anonymous basis to customers. Representatives of that group said they recently met with SEC officials to describe what they are doing and get some feedback.

Ron Valinoti, founder of Triangle Park Capital Markets Data, an information services company that is managing business operations for MBIS, said the group was incorporated in August, has been collecting pricing data for several weeks, and is currently lining up customers to sign contracts to take the data.

Valinoti says he expects customers will include: institutional investors; firms on the buy-side such as mutual funds, which must calculate net asset values on a daily basis; and firms that provide research services to retail investors either directly or through investment advisors, such as Morningstar and Yahoo Finance.

The trade data, which can be captured every five minutes and made available as often as every 30 minutes, can provide pricing transparency and be used to check information from pricing services or other sources, he said.

"We're trying to help address the concerns that were raised in the SEC's muni report to Congress. We're trying to take a proactive approach" by making pre-trade pricing information available, Valinoti said.

The broker's brokers in the group include: Associated Bond Brokers, Inc.; Butler Muni; Hartfield, Titus & Donnelly; RW Smith and Associates; Regional Brokers, Inc.; Sentinel Brokers Company, Inc.; Stark Municipal Brokers; Tradeweb Markets; Tradition Asiel (North America) Inc.; and Tullett Prebon Financial Services.

BY LYNN HUME

FEB 7, 2014 3:09pm ET

FINRA Moves to Allow Arbitrators to Call for Enforcement Midcase.

A proposed rule could give arbitrators more authority in referring cases for disciplinary action

A hotly debated rule change that the Financial Industry Regulatory Authority Inc. has proposed to the Securities and Exchange Commission could allow arbitrators to direct cases to Finra's enforcement division before the case has closed.

Currently, arbitrators must wait until the case has concluded before they can report concerns to Finra's Department of Enforcement, which is responsible for suspending, sanctioning or taking other disciplinary action against firms and individuals.

But Finra said that making arbitrators wait could delay the ability to take action against a bad actor or hamper its ability to collect evidence.

"Finra is concerned that the current rule's requirement that arbitrators in all instances must wait until a case is concluded before making a referral could hamper Finra's efforts to uncover threats to investors as early as possible," according to the proposed rule change. "Finra is proposing, therefore, to broaden the arbitrators' authority under the Codes to make referrals during the hearing phase of an arbitration in those extremely rare circumstances in which investor protection requires that the referral not be delayed."

All initial pleadings for arbitration cases are also filed with and reviewed by Finra's enforcement department, but in a small number of cases, new evidence can come up during a hearing that may warrant immediate disciplinary action, according to Marc Dobin of the Dobin Law Group PA.

The self-regulator has spent the past four years in a back-and-forth with the industry over how to handle those instances where an arbitrator learns information that could present a clear and present danger.

Finra submitted two similar proposals in 2010 and 2011, but they were withdrawn or replaced after drawing significant opposition from commenters, who took issue with the implementation.

The concern is whether an arbitrator's disclosure of a possible investor protection issue could unnecessarily bias the rest of the panel against the respondent, Mr. Dobin said.

"It's similar to a jury where they tell you not to discuss anything about the case until it is over," he said. "It makes it harder to settle case if you're on the respondent's side if your arbitrators have said, 'Oh by the way, we think what we've heard so far is so bad that we're telling enforcement about it.'"

The original proposal, filed with the SEC in 2010, would have required the entire three-person arbitration panel to withdraw if one of the arbitrators made a mid-case referral. But commenters voiced concerns that this could unfairly affect the investor or claimant who would have to make their case a second time and incur additional expenses.

The latest proposal seeks to limit the disruption of a midcase referral.

According to the most recent draft, arbitrators will refer their claims to the director or president of enforcement, and then the director is required to notify the parties involved in an arbitration proceeding that the referral had been made.

The parties would then have the opportunity to request the recusal of that individual arbitrator.

But in an effort to add another layer of protection for the claimant, Finra stated that an arbitrator's referring a claim for disciplinary action shouldn't be considered proof of bias, and it is still up to the arbitrator whether to resign from the panel even after a party has filed a motion for recusal.

"This means that the entire panel could remain after a party's recusal motion, and the case could proceed as normal," the proposal stated. "The investor would be less likely, therefore, to experience procedural disadvantages, significant delays, and increased costs, because Amendment No. 1 minimizes the possibility that the arbitration would start anew."

Final action could still be a way off. This proposal will go before the SEC where it will be on display for public comment, and then it will be subject to additional review by the commission before a final vote there on whether to approve the rule change.

By Mason Braswell

Feb 3, 2014 @ 1:30 pm