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Statement of

Ronald A. Stack, Chair
Municipal Securities Rulemaking Board

on

Transparency and Regulation in the Municipal Securities Market

before

Committee on Banking, Housing and Urban Affairs
United States Senate

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Municipal Securities Rulemaking Board
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Good morning Chairman Dodd, Ranking Member Shelby, and Members of the Committee. I am Ronald Stack, Chair of the Municipal Securities Rulemaking Board ("MSRB" or "Board"). I am pleased to testify today on behalf of the MSRB at the Committee's second hearing on Enhancing Investor Protection and the Regulation of the Securities Markets. Part I of my testimony provides a summary of the MSRB's structure, authority, rules, information systems, and market transparency/ surveillance activities. Part II provides background on the municipal securities market. Part III is a discussion of what the MSRB is doing now to promote transparency in the municipal marketplace. Part IV points out significant gaps in the regulation of municipal market participants and discusses the manner in which the MSRB could further assist in enhancing investor protection and the regulation of the securities market, if its jurisdiction were expanded by the Congress. Finally, Part V is an executive summary of our major recommendations.

I. BACKGROUND ON THE MSRB'S STRUCTURE, AUTHORITY, RULES, INFORMATION SYSTEMS, AND MARKET TRANSPARENCY/ SURVEILLANCE ACTIVITIES

A. <u>MSRB Structure</u>

The MSRB is a self-regulatory organization ("SRO") established by the Congress in the Securities Acts Amendments of 1975 to develop rules for brokers, dealers, and banks (collectively "dealers") engaged in underwriting, trading, and selling municipal securities. In furtherance of our investor protection mandate, the

Board also operates information systems designed to promote transaction price transparency and access to municipal securities issuer disclosure documents. The MSRB stands as a unique SRO for a variety of reasons. The MSRB was the first SRO specifically established by Congress. Also unique is the fact that the legislation, codified in section 15B of the Securities Exchange Act ("Exchange Act"), dictates that the MSRB Board shall be composed of members who are equally divided among public members (individuals not associated with any dealer), individuals who are associated with and representative of banks that deal in municipal securities ("bank dealers"), and individuals who are associated with and representative of securities firms.[1] At least one public member serving on the Board must represent investors and at least one must represent issuers of municipal securities. Further, the MSRB was created as a product-specific regulator, unlike most other securities regulatory bodies.

Members of the MSRB meet throughout the year to make policy decisions, approve rulemaking, enhance information systems and review developments in the municipal securities market. Day-to-day operations of the MSRB are handled by a full-time independent, professional staff. The operations of the Board are funded through assessments made on dealers, including fees for underwritings and transactions.[2]

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1 Under MSRB Rule A-3, the Board is composed of 15 member positions, with five positions each for public, bank dealer, and securities firm members.

2 These fees are set forth in MSRB Rules A-12 through A-14.

B. MSRB Authority

The substantive areas of the MSRB's rulemaking authority are described in Section 15B(b)(2) of the Exchange Act, which lists several specific purposes to be accomplished by Board rulemaking with respect to the municipal securities activities of dealers in connection with their transactions in and provides a broad directive for rulemaking designed to:

> prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling and processing information with respect to and facilitating transactions in municipal securities, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

Like other SROs, the MSRB must file its proposed rule changes with the Securities and Exchange Commission ("SEC") for approval prior to effectiveness.

Although the MSRB was created to write rules that govern dealer conduct in the municipal securities market, the Exchange Act directs that inspection of dealers for compliance with, and the enforcement of, MSRB rules be carried out by other agencies. For securities firms, the Financial Industry Regulatory Authority ("FINRA"), along with the SEC, performs these functions. For bank dealers, the appropriate federal banking authorities, in coordination with the SEC, have this responsibility.[3] The MSRB works cooperatively with these regulators and maintains frequent communication to ensure that: (1) the MSRB's rules and priorities are known to examining officials; (2) general trends and developments in the market discovered by field personnel are made known to the MSRB; and (3) any potential rule violations are immediately reported to the enforcement agencies.

While Section 15B of the Exchange Act provides the MSRB with authority to write rules governing the activities of dealers in connection with their transactions in municipal securities, it does not provide the MSRB with authority to write rules governing the activities of other participants in the municipal finance market such as issuers and their agents (*e.g.,* independent financial advisors, swap advisors, guaranteed investment contract brokers, trustees, bond counsel, etc.). Municipal securities also are exempt from the registration and prospectus delivery requirements of the Securities Act of 1933 and are exempt from the registration and reporting requirements of the Exchange Act.

In adopting Section 15B of the Exchange Act, Congress provided in subsection (d) specific provisions that restrict the MSRB and the SEC from regulating the disclosure practices of issuers in certain ways. Paragraph (1) of subsection (d) prohibits the MSRB (and the SEC) from writing rules that directly or indirectly (*i.e.,* through dealer regulation) impose a pre-sale filing requirement for

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[3] These federal banking authorities consist of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the U.S. Treasury Department through its Office of the Comptroller of the Currency and Office of Thrift Supervision, depending upon the specific bank dealer.

issues of municipal securities. Paragraph (2) of subsection (d) prohibits the MSRB (but not the SEC) from adopting rules that directly or indirectly require issuers to produce documents or information for delivery to purchasers or to the MSRB. Paragraph (2), however, specifically allows the MSRB to adopt requirements relating to such disclosure documents or information as might be available from "a source other than such issuer." The provisions of subsection (d) commonly are known as the "Tower Amendment."

C. MSRB Rules Overview

The MSRB has adopted a substantial body of rules regulating dealer conduct that reflect the special characteristics of the municipal securities market and its unique regulatory needs These rules require dealers to observe the highest professional standards in their activities and relationships with customers. MSRB rules take into account the fact that rules for dealers in the municipal market – where issuers have significant discretion and non-dealer market professionals are unregulated – must sometimes be crafted in ways that differ from rules for dealers in the corporate securities market, where bond issuers and other market participants are subject to regulation.

MSRB rules represent a balance between broad, "principles-based" rules and specific prescriptive rules, depending on the nature of the specific subject of regulation. MSRB rules can generally be categorized as (1) fair practice rules (*e.g.*, requirements for dealers to provide affirmative disclosures of material facts to investors; to ensure the suitability of dealer recommendations of municipal securities transactions; to price transactions fairly; to avoid conflicts of interest; and to publish fair and accurate advertisements and price quotations); (2) uniform practice rules (*e.g*., rules to ensure that standard procedures are followed in underwriting, clearing, confirming, and settling transactions in municipal securities; helping to ensure the efficiency of market operations while accommodating the differences between municipal securities and other debt instruments); (3) professional qualification rules (*e.g*., requirements for dealer personnel to pass tests demonstrating competency; continuing education requirement); (4) operational standards (*e.g*., rules regarding recordkeeping; supervision of professionals); and (5) marketplace disclosure rules (*e.g*., rules requiring dealer real-time reporting of trade prices; underwriter filing of issuer disclosure documents; and dealer disclosure of political contributions to the MSRB for public dissemination). These rules significantly exceed the general anti-fraud principles that are embodied in the federal securities laws.

Maintaining municipal market integrity is an exceptionally high priority for the MSRB as it seeks to foster a fair and efficient municipal securities market through dealer regulation. The MSRB engages in an on-going review of its rules and market practices to ensure that the Board's overriding goal of protecting investors and maintaining market integrity is not compromised by emerging practices. As an example, the MSRB implemented rules to remove the conflict of interest that can arise when political contributions may be used by dealers to obtain municipal securities business. We also seek to coordinate our rules with FINRA rules in cases where similar requirements make sense.

The MSRB also reminds dealers of its rules in times of market stress when the pace of events might cause some to lose sight of their significance. For example, during 2008, as bond insurer ratings were reduced frequently and significantly, we reminded dealers of their disclosure obligations concerning credit enhancement.[4] We also issued an interpretive notice on transactions in auction rate securities that reminded dealers of their obligation to recommend investments that are suitable to their customers[5] and provided guidance on reporting dealer buybacks of auction rate securities.[6] When many issuers rushed to convert their high yielding auction rate securities to variable rate demand obligations, we reminded dealers of restrictions on underpricing of credit and tying the provision of letters of credit to the provision of underwriting services. [7]

D. <u>Information Systems and Market Transparency/Surveillance</u>

In furtherance of our investor protection mandate, the MSRB also operates information systems to improve the availability of information in the market about municipal issues. These systems ensure that investors have information necessary to make investment decisions, that dealers can comply with MSRB rules, and that the inspection and enforcement agencies have the necessary tools to do their work.

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4 MSRB Notice 2008-04 on Bond Insurance Ratings (January 22, 2008).

5 MSRB Notice 2008-09 on Application of MSRB Rules to Transactions in Auction Rate Securities (February 19, 2008).

6 MSRB Notice 2008-36 on Transactions Reporting of Dealer Buybacks of Auction Rate Securities: Rule G-14 (September 2, 2008).

7 MSRB Notice 2008-34 on Bank Tying Arrangements, Underpricing of Credit and Rule G-17 on Fair Dealing (August 14, 2008).

Since 1990, the Municipal Securities Information Library ("MSIL") system has collected issuer primary market disclosure documents (*i.e.*, official statements and advanced refunding documents) from underwriters and made them available to the market and the general public. The MSIL system also accepts and disseminates certain secondary market information provided by municipal issuers and trustees pursuant to SEC Rule 15c2-12. In order to further increase the accessibility of municipal market information by retail investors, the MSRB has developed a free, centralized database, named the Electronic Municipal Market Access system or EMMA, which is discussed further below and which will shortly replace the MSIL system.

In 2005, the MSRB implemented a facility for real-time transaction reporting and price dissemination of transactions in municipal securities (the "Real-Time Transaction Reporting System" or "RTRS").[8] RTRS serves the dual role of providing transaction price transparency to the marketplace, as well as supporting market surveillance by the enforcement agencies. Surveillance data is made available to regulators with authority to enforce MSRB rules, including FINRA and the SEC. The market surveillance function of the MSRB's transaction reporting system provides enforcement agencies with a powerful tool in enforcing the Board's fair pricing rules. The MSRB offers a market-wide real-time feed of trade information and provides the data free of charge on EMMA, as discussed below. In addition, in January of this year, the MSRB implemented an enhancement to the system with the

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8 The MSRB's transaction reporting rules require dealers to report transactions in municipal securities within 15 minutes of the time of trade execution.

addition of free public access to interest rate reset information on municipal auction-rate securities, including information on the success or failure of individual auctions. Free interest rate and related information on variable-rate demand obligations will be added to the system next week. And, beginning July 1 of this year, continuing disclosure filings made by state and local governments will be available as well. Once completed in July, 2009, the MSRB's EMMA system will provide the most comprehensive and free database of municipal securities information as exists in any of the fixed income markets.

Currently, EMMA does not contain information about the credit ratings of municipal securities, although they are of considerable importance to investors. The MSRB would welcome the submission by the rating agencies of such ratings on a real-time basis. Given the large number of bond insurer downgrades in the last year, investors should have access to underlying ratings as well as ratings on the municipal securities themselves.

II. BACKGROUND ON THE MUNICIPAL SECURITIES MARKET

A. Market Overview

When Section 15B of the Exchange Act was adopted in 1975, yearly issuance of municipal securities was approximately $58 billion.[9] Much of this total represented general obligation debt, which reflected the simple, unconditional promise of a state or local government unit to pay to the investor a specific rate of

[9] *See* The Bond Buyer/Thomson Financial 2004 Yearbook at 10. Approximately half of this figure represents short-term debt maturing in less than 13 months.

interest for a specific period of time. The investors in these bonds tended to be commercial banks and property/casualty insurers interested in tax-exempt interest.

The municipal securities market has grown into a much larger and more complex market. Annual issuance of municipal securities has averaged $458 billion in recent years[10] and a total of $2.7 trillion in principal value is outstanding.[11] In addition to providing capital for governmental projects and operations, the municipal securities market helps to fund a variety of other public purposes, including transportation and environmental infrastructure, education, housing and healthcare.

Most municipal securities come to market with investment grade credit ratings, *i.e.*, with ratings that are "BBB-" or above.[12] Historically, investment grade municipal securities have been considered relatively safe investments, because of the very low rate of default. A 2002 report by Moody's Investor Service concluded that the default rate for investment grade municipal securities debt over a 10 year period was .03%, compared to 2.32% for investment grade corporate debt.[13] A low rate of default for investment grade municipal securities also has been observed in studies by Standard and Poor's and Fitch Ratings.

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10 Source: Thomson Reuters (based on 2005-2008 data).

11 December 2008 estimates. *See* Federal Reserve Flow of Funds (March 2009) available at www.federalreserve.gov. As a comparison, the outstanding principal value of marketable U.S. Treasury Securities was $5.8 trillion.

12 Over 99% of rated long-term municipal securities coming to market in 2008 were rated investment grade by at least one rating agency.

13 Moody's Rating Service, "Special Comment: Moody's US Municipal Bond Rating Scale" (November 2002), available at http://www.moodys.com (also noting increased default risks for non-rated issues).

B. Issuers

Issuers of municipal securities include towns, cities, counties, and states, as well as other state and local government agencies and authorities that issue securities for special purposes (*e.g.*, hospitals and colleges). There are over 55,000 issuers of municipal securities that have outstanding approximately 1.23 million unique securities. Major issuer types, with the associated volume of issuance in 2008, are shown in Figure 1.

Figure 1

Issuer Type	**2008 Issuance Volume** ($ billions)[14]	**Percentage of total volume**
State Agencies	144.8	32%
Local Authorities	81.4	18
Districts	64.8	14
Cities/Towns	60.2	13
States	55.9	12
Counties/Parishes	27.6	6
Colleges/Universities	10.1	2
Direct Issuers	7.2	2

Source: Thomson Reuters

The market is unique among the world's major capital markets because the number of issuers is so large—no other direct capital market encompasses so many borrowers. The issues range from multi-billion dollar financings of large state and city governments to issues less than $100,000 in size, issued by localities, school districts, fire districts, and various other issuing authorities. The purposes for which

14 Source: Thomson Reuters (includes issuance of both long-term and short-term securities).

these securities are issued include not only financing for basic government functions, but also a variety of public needs such as transportation, utilities, health care, higher education, and housing as well as some essentially private functions to enhance industrial development. In the last two decades debt issuance has become an important management tool for many municipalities, allowing flexibility in arranging finances and meeting annual budget considerations according to local needs and local priorities. The terms and features of some municipal securities have evolved over time into highly complex structures to meet a multitude of issuer borrowing and investment needs. Differences in laws among the fifty states, as well in local ordinances and codes among the tens of thousands of localities, that affect borrowing authority, lending of credit, powers to impose taxes and special assessments, contracting powers, budgeting restrictions, and many other matters result in an enormous variety of financing structures across the country that defies commoditization of the municipal securities market.

By contrast, there are only approximately 5,500 issuers of corporate debt and less than 50,000 corporate debt securities,[15] even though the amount of corporate debt outstanding is $6.3 trillion.[16]

C. Investors

The municipal securities market has one of the highest levels of participation by individual investors, either through direct investments or through mutual funds,

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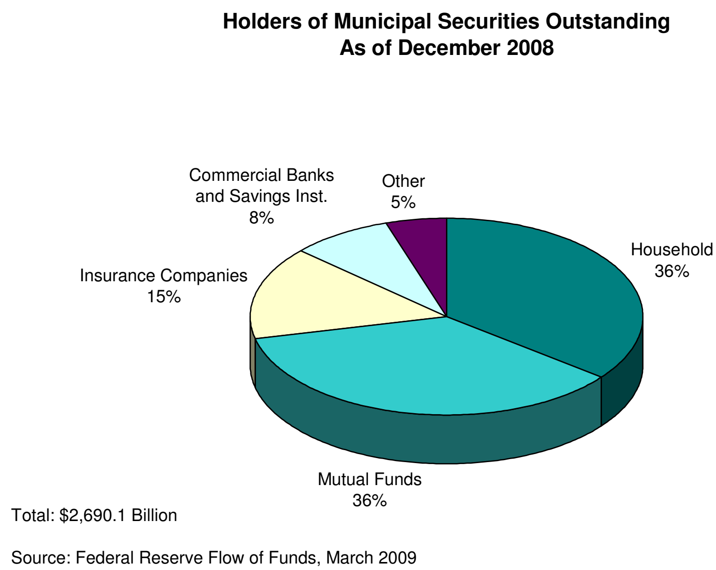
15 Source: FINRA. Includes all TRACE-eligible securities.

16 December 2008 estimates. *See* Federal Reserve Flow of Funds (March 2009), available at www.federalreserve.gov. Corporate debt outstanding excludes asset-backed securities and foreign issues held by U.S. residents.

together representing the majority of total municipal securities holdings. The other major categories of investors in municipal securities include property and casualty insurers and commercial banks. Figure 2 shows the percentages of direct investments in municipal securities in categories tracked by the Federal Reserve Board.

Figure 2



The "household" category in Figure 2 includes both direct investments by individual investors as well as trusts and other accounts (*e.g.*, some types of hedge fund accounts that do not fall into other tracked categories). The "mutual funds" category includes both municipal bond funds and money market funds.[17]

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[17] Data collected by the Investment Company Institute ("ICI") indicate that, as of September 24, 2008, the total net assets in tax-exempt money market accounts were approximately $482 billion, which would account for more than half of the Federal Reserve estimates of mutual fund holdings of municipal securities at this time. Of the $482 billion in tax-exempt money market funds tracked by the ICI in September, approximately $295 billion was held in retail money market funds and $187 billion was held in

D. Municipal Securities Dealers

The municipal securities market is an over-the-counter, dealer market. There are no central exchanges, specialists, or formal market maker designations. At the end of 2008, approximately 2,040 securities firms and banks were authorized to act as brokers and dealers in municipal securities (collectively, "dealers"). During a given year, approximately 1,430 dealers report transactions in municipal securities to the MSRB under its price transparency program. About 185 of these dealers serve as managing underwriters of new issues**.**

E. Market Activity

In general, municipal securities investors tend to be "buy and hold" investors. Trading patterns for municipal securities with fixed interest rates typically involve relatively frequent trading during the initial weeks after issuance, followed by infrequent or sporadic trading activity during the remaining life of the security. Issues with variable interest rates tend to trade more frequently. Of the approximately 1.23 million outstanding municipal securities, the likelihood of any specific security trading on a given day is about one percent. Less than 10% of outstanding municipal securities are likely to trade in any given month.[18]

Notwithstanding the thin secondary market trading in individual municipal securities, aggregate daily trading activity in the market is substantial. During the

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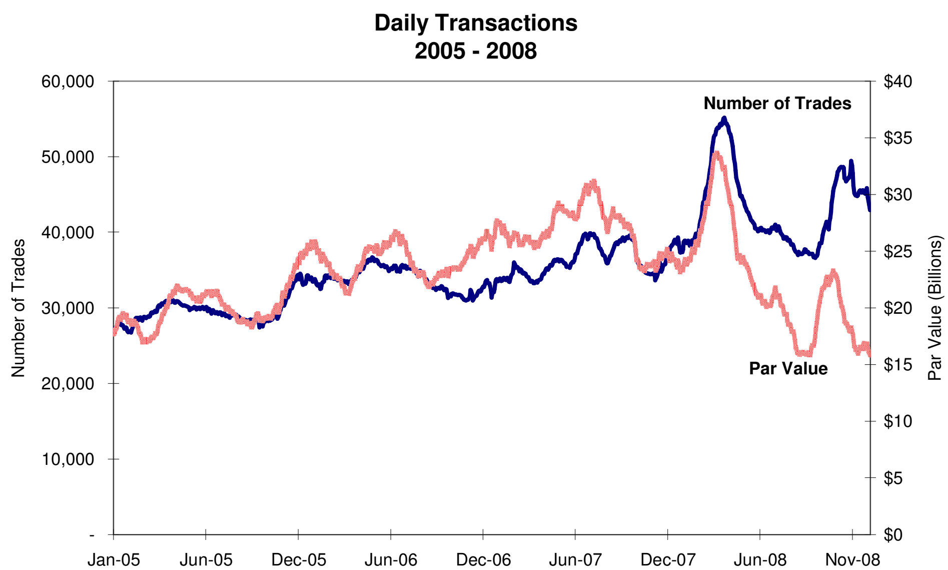
institutional money market funds. Source: ICI, "Weekly Total Net Assets (TNA) and Number of Money Market Funds," available at www.ici.org.

18 Source: MSRB transaction data.

period 2005-2008, an average of approximately 36,000 transactions in municipal securities was reported to the MSRB each business day, resulting in par values averaging about $23.2 billion per day. For the same period, nearly two-thirds of par value traded was variable rate securities, while fixed-rate securities accounted for almost 30%. Figure 3 shows the 30-day trailing average of daily transaction activity and volume in par (principal) amount traded for all types of municipal securities.[19]

Figure 3



Source: MSRB
Note: 30-day trailing average

III. MSRB ACTIONS TO PROMOTE TRANSPARENCY IN THE MUNICIPAL MARKET

A. Primary Market Disclosure

As noted above, since 1990, the MSRB has sought to improve the availability of municipal securities issuer disclosure documents to investors through its MSIL system.

19 The MSRB provides statistical data on market activity on its web site at www.msrb.org and through EMMA.

At that time, the SEC adopted its Rule 15c2-12 to, among other things, require the underwriter for most offerings of municipal securities to receive and review the issuer's official statement before underwriting the issue. In turn, MSRB Rule G-36 requires underwriters to submit such official statements to the MSIL system. The MSIL system was the first comprehensive library of primary market disclosure documents in the municipal securities market. The MSRB developed the MSIL system to serve as a repository of disclosure documents and a "wholesaler" of these documents to market participants and information vendors. Since most disclosure documents in 1990 were made available in paper form, the MSIL system received such documents, scanned them, and provided electronic versions to subscribers for a minimal fee for use in information products provided to the market. More recently, many primary market disclosure documents are available in electronic form and the MSRB receives such documents and provides them directly to subscribers.

In March 2008, the MSRB launched its Electronic Municipal Market Access ("EMMA") pilot. EMMA is an Internet-based disclosure portal that provides free public access to primary market disclosure documents and real-time municipal securities trade price data for the municipal securities market, in a manner specifically tailored to retail investors. The EMMA website is accessible at www.emma.msrb.org. EMMA currently provides an easily navigable integrated display of primary market disclosures and transaction pricing data for a specific security, incorporating detailed user help and investor education information designed to make the information easily understood by retail investors. EMMA currently provides free access to the MSRB's full collection of issuer disclosure documents dating back to 1990, as well as to trade price information since January 2005.

On Monday of this week, the MSRB filed with the SEC a proposal to continue operation of EMMA on a permanent basis and to provide for more rapid dissemination of primary market disclosures through a centralized electronic submission and public access service. The MSRB expects that this new phase of EMMA will be fully operational by the end of May of this year. At that time, all underwriters will be required to submit official statements and related documents and information to EMMA electronically for immediate free public access through the EMMA website portal. Users of the website will be able to sign-up for free optional e-mail alerts to be notified of new and updated postings of disclosure documents and other information offered on EMMA. These documents will continue to be displayed in conjunction with real-time trade price information so that users viewing trading data for a specific municipal security will have immediate access to key disclosure information about that security. EMMA's search engine is designed to assist retail investors in quickly finding the right document and information for a particular security.

EMMA is the central force in moving the municipal securities market from the old paradigm where only the buyer of a specific new issue municipal security could be assured of receiving a copy of the disclosure document for that security when the trade is completed to a new marketplace where the general public will have free on-going immediate access to disclosure documents for all issues as soon as the documents become available. To further ensure broad access to the disclosures provided in official statements and advance refunding documents, the MSRB will make these documents available by subscription to information vendors and other bulk data users on terms that will promote the development of value-added services by subscribers for use by market participants.

B. Continuing Disclosure

The SEC revised its Rule 15c2-12 in 1995 to require underwriters to ensure that issuers have contracted to provide certain continuing disclosure information, including annual financial and operating data and material events notices, to certain private-sector information services designated as Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs"). In these amendments, the MSRB was included as an alternative recipient of material event notices only.

During the last few years, however, the MSRB grew concerned about investor access to continuing disclosure documents through the current NRMSIR system. As a result, after consultation with the SEC and review of the SEC's White Paper to Congress on the municipal securities market,[20] the MSRB began to plan for a continuing disclosure component of EMMA. This enhancement will combine continuing disclosure information with the primary market disclosure and trade information currently available to provide a central location for all such municipal securities market information.

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[20] July 26, 2007, available at http://www.sec.gov/news/press/2007/2007-148wp.pdf.

On December 5, 2008, the SEC approved amendments to its Rule 15c2-12 to make the MSRB the central location for issuer continuing disclosure documents, effective July 1, 2009. EMMA's continuing disclosure service will provide a user-friendly interface for free electronic submission of continuing disclosure documents by issuers, other obligated parties and their agents. As with official statements, these continuing disclosure documents will become immediately available for free to the general public through the EMMA website portal. Free optional e-mail alerts relating to new postings will also be made available in connection with continuing disclosure documents. In addition, the continuing disclosure documents will be integrated into the existing official statement and trade data display to produce an all-encompassing view of the relevant primary market, secondary market, and trade price information for each security in the marketplace easily accessible through EMMA's powerful search engine.

The MSRB expects to file with the SEC next week a proposed rule that would permit EMMA to accept voluntary filings of continuing disclosure by issuers and obligors. We hope that this will encourage disclosure beyond that which is currently required by SEC Rule 15c2-12, such as quarterly financial information and information about related municipal derivative transactions.

C. Auction Rate Securities/Variable Rate Demand Obligation Transparency

In 2009, the MSRB implemented its Short-term Rate Transparency ("SHORT") System to increase transparency of municipal ARS and VRDOs. The SHORT System is the first centralized system for collection and dissemination of critical market information about ARS and VRDOs. Information collected by the SHORT System is made available to the public, free of charge, on EMMA.

The SHORT System will be implemented in phases. The first phase, which became operational on January 30, 2009, collects and disseminates interest rate and related information about municipal ARS, including information about the success or failure of each auction. The SHORT System is scheduled to become operational for VRDOs on April 1, 2009. This interest rate information allows market participants to compare ARS and VRDOs across issues and track current interest rates. Included in this information is the current interest rate, the length of the interest rate reset period as well as characteristics of the security, such as the identities of broker-dealers associated with the operation of the securities.

Later phases of this initiative to increase transparency of ARS and VRDOs include the collection and dissemination of ARS bidding information. This information will allow market participants to obtain important information about the liquidity of ARS and greater granularity into the results of the auction process. In addition, the MSRB plans to collect ARS documents that describe auction procedures and interest rate setting mechanisms as well as VRDO documents that describe the provisions of liquidity facilities, such as letters of credit and standby bond purchase agreements.

D. Market Statistics and Data

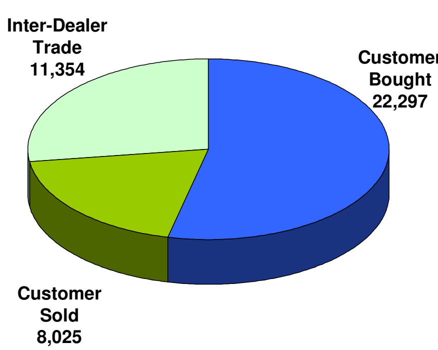
EMMA provides market activity information, including transaction price data for the most recent daily trades and a daily summary of trading activity throughout the municipal securities market. EMMA's daily trade summary provides the type of trade (*i.e.*, customer bought, customer sold or inter-dealer trades), the number of securities and the number of trades for each trade type and the par amount of the trades for all published trades disseminated by the MSRB for every trading day since May 2006. This information is provided on EMMA's market statistics pages and provides municipal securities investors with a market-wide view of the municipal securities market. An example of such information follows:

Daily Trade Summary By Trade Type – February 20, 2009

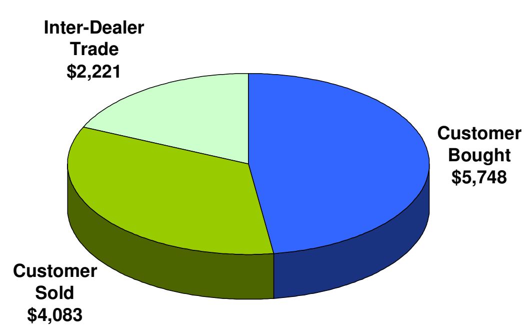
Trade Type	Number of Securities	Number of Trades	Par Amount ($ Millions)
Customer Bought	9,623	22,514	$6,077
Customer Sold	6,268	7,425	$3,661
Inter-Dealer Trade	4,941	10,333	$2,322
All Trades	13,587	40,272	$12,060

30-Day Average Trade By Trade Type – January 08, 2009 to February 20, 2009

Number of Trades: 41,676



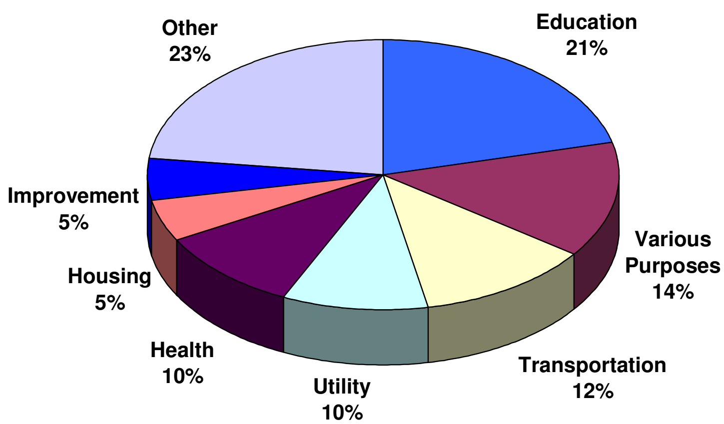
Par Amount: $12,052 Million



Market statistics on EMMA also include the par amount traded for the most active sectors of the municipal securities market and trading volume by trade size, maturity, and source of repayment.

Par Amount Traded for Most Active Sectors – February 20, 2009

Total Par Amount: $12,060 Million



E. Investor Outreach and Education

The MSRB is conducting an aggressive campaign to reach out to investors about all the information that is easily available to them through EMMA. We have also added important educational materials to the EMMA site to assist investors in their understanding of the municipal securities market. The MSRB is gratified that we have had over 53,000 visitors to EMMA in its 12 months of pilot operation who have downloaded almost 4.0 terabytes of files and data. Messages we have received through the EMMA feedback and contact pages indicate a very positive response from users, which include retail and institutional investors, brokers, investment advisors, issuers, information services, researchers, media, and others. We plan to continue diligently to improve EMMA's service to both investors and issuers.

The MSRB has long sought to improve investor access to municipal securities disclosure as well as to require, through its dealer regulation, that the municipal securities market continue to be fair to investors and efficient for all market participants. Once fully operational, EMMA will allow for more timely and accurate disclosures, valuations, and information regarding municipal securities, which will benefit all market participants. EMMA's free public access to real-time trade price information and to the key disclosure documents has already provided unprecedented transparency to this market. As we complete each new phase of EMMA, the MSRB will provide increasing levels of transparency that will greatly benefit both investors and issuers alike and which is unparalleled in other markets.

IV. An Expanded Role for the MSRB to Enhance Investor Protection and Regulation of the Securities Markets

A. Unregulated Parties in the Municipal Securities Market.

The current financial crisis has exposed gaps in the regulatory structure that governs U.S. financial institutions and the products they offer. It is clear that regulatory reform is necessary to address changes in the capital markets, such as the creation of new financial products and the emergence of firms providing advice regarding these products. The municipal securities marketplace has evolved from one in which states and municipalities offered traditional, fixed rate bonds to finance specific projects into a market that involves the use of complex derivative products and intricate investment strategies.

Current federal law does not permit the MSRB to regulate the swap firms that assist in the creation of these derivative products for municipal issuers. The law also does not permit the MSRB to regulate other non-dealer municipal market participants, such "independent" financial advisors that provide advice to issuers regarding bond offerings or investment brokers that assist issuers with investing bond proceeds. The MSRB believes regulation of these entities and other municipal advisors is essential to protect investors and ensure market integrity, and that the MSRB is in the best position to provide this regulation and therefore should be given such authority. The MSRB believes that its current regulatory structure for municipal securities dealers provides a ready model for oversight of municipal advisors, including financial advisors and investment brokers. The MSRB also believes that expanded oversight would be most effective in a dual regulatory structure with the SEC. Under this approach, firms would be required to register with the SEC, and the MSRB would provide more prescriptive rules applicable to these firms and their activities. With the expansion of its jurisdiction, the MSRB's composition should be reviewed to provide for appropriate representation of all types of regulated parties as well as to ensure expanded public representation.

1. Financial Advisors and Investment Brokers and Other Municipal Market Participants

As federal lawmakers and policymakers are looking into unregulated participants throughout the financial markets such as mortgage brokers, so too should attention be paid to these participants in the municipal market. As municipal finance transactions have evolved and become more complex, there are many more advisors who work with municipal issuers, and brokers who act as intermediaries between issuers and others who provide necessary investment and other services. These participants have significant influence with issuers, earn significant fees, and many times, are not subject to any constraints on pay-to-play, as dealers have been since 1994. Unfortunately, the regulatory structure over the municipal market has not kept up with the evolving marketplace and nearly all of these participants are unregulated. At a minimum, municipal advisors such as financial advisors and investment brokers should be held to standards of conduct that protect municipal issuers, taxpayers, and investors in this market. The existing MSRB rulebook provides a ready model for the types of rules that could be developed for these market participants -- particularly in light of the fiduciary nature of many of the advisory services they provide. Preventing pay-to-play throughout the municipal market is even more important now as the Congress has recognized the importance of rebuilding the nation's infrastructure and has supported that goal through the stimulus bill. Also, as Treasury seeks to find solutions to assist the municipal bond market through the financial crisis, ensuring that all market participants adhere to the highest professional standards is essential.

Investors in the municipal securities market would be best served by subjecting unregulated market professionals to a comprehensive body of rules that (i) prohibit fraudulent and manipulative practices, (ii) require the fair treatment of investors, issuers, and other market participants, (iii) mandate full transparency, (iv) restrict real and perceived conflicts of interests, (v) ensure rigorous standards of professional qualifications, and(vi) promote market efficiencies. The municipal securities dealer community undertook the transition from being unregulated to becoming subject to such a body of rules and standards beginning in 1975 with the creation of the MSRB. The MSRB believes it is now time for the unregulated professionals in this market to undertake this same transition, and that the MSRB is the most appropriate regulatory body to provide this regulation.

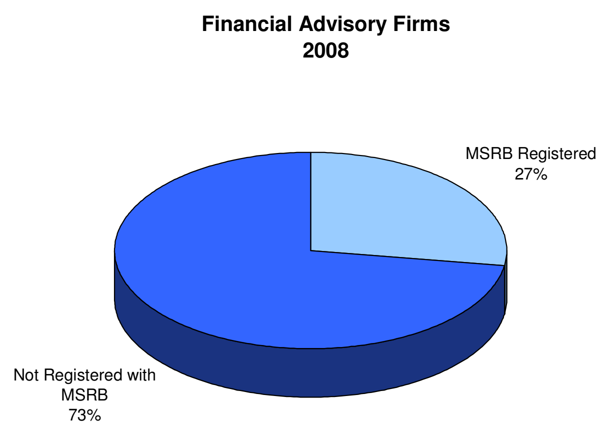
2. Current Regulation of Financial Advisors

It should be noted that many financial advisory firms are registered as broker-dealers or municipal securities dealers and are, therefore, subject to MSRB rules, including Rules G-23 and G-37. Rule G-23 is a disclosure rule designed to minimize the apparent conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue. With respect to financial advisors that are not dealers (known as "independent" financial advisors), approximately fifteen states have some form of pay-to-play prohibition. Some states have very broad pay-to-play rules that cover most state and local contracts, including those for financial advisory services. Other states have very narrow rules that apply only to specific situations. Some municipalities also have enacted such rules. Additionally, certain states and municipalities and agencies have disclosure obligations. While some states and localities have such pay-to-play laws, in many cases based on MSRB Rule G-37, the limited and patchwork nature of these state and local laws has not been effective in addressing in a comprehensive way the possibility and appearance of pay-to-play activities in the unregulated portions of the national municipal securities market. It is time for a coordinated and comprehensive approach to regulating municipal advisors, including "independent" financial advisors.

3. Number of Financial Advisors Active in the Marketplace

Given the unregulated nature of this market, it is difficult to identify with precision the number of financial advisors, the number of offerings in which they participated, or the nature and scope of their advice. Nevertheless, the MSRB has reached out to market participants and has reviewed data on financial advisors supplied by Thomson Reuters. The MSRB believes that this information provides a reasonable estimate of the size of the market, but does not capture the entirety of it.

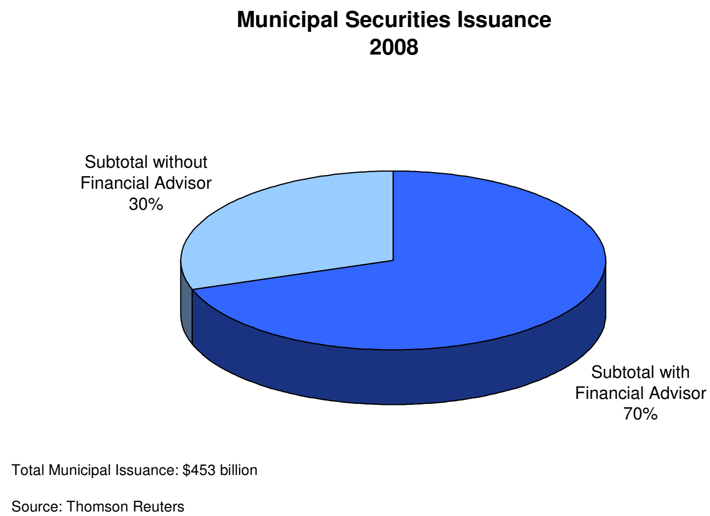
Based on the MSRB's review, of the 358 financial advisory firms that participated in at least one primary market transaction in 2008, only 98 were registered with the MSRB as dealers. It appears that the vast majority of active financial advisory firms currently are not regulated by the MSRB or, in general, anyone else.



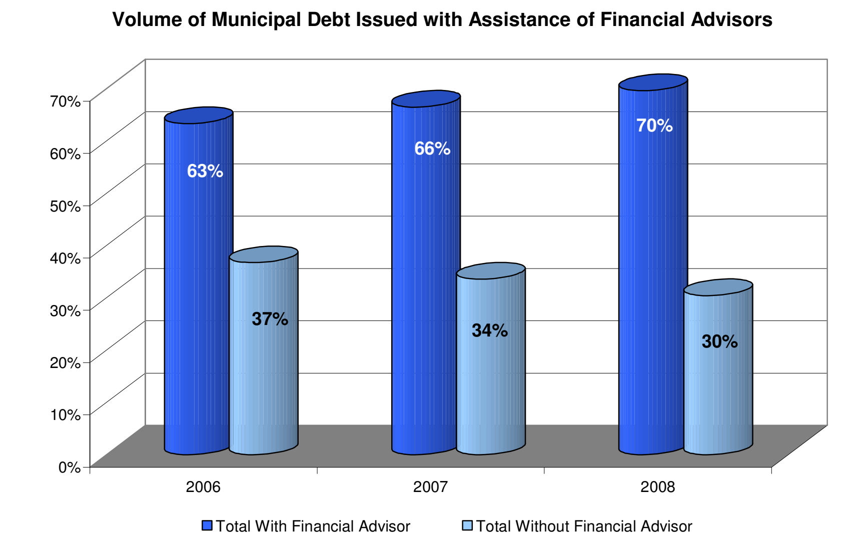
Source: MSRB; Thomson Reuters

4. <u>Volume of Municipal Debt Issued with the Assistance of Financial Advisors</u>

According to data obtained by the MSRB, approximately 70% of the total volume of municipal debt (by par amount) issued in 2008 was issued with the assistance of financial advisors. The total amount of municipal debt issued in 2008 was $453 billion, and financial advisors provided advice in offerings that accounted for $315 billion of this total.



This percentage has increased over the last two years. In 2007, financial advisors participated in 66% of the total volume of offerings and, in 2006, financial advisors participated in 63% of the total volume of offerings.



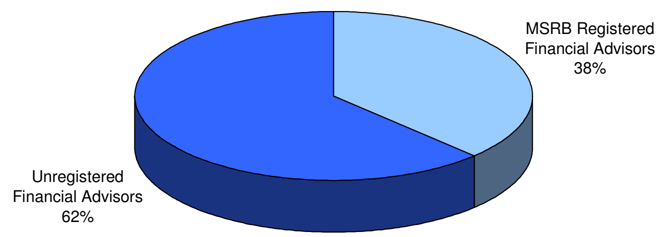
Source: Thomson Reuters

The length of maturity of the offerings did not change the percentages significantly. In short-term offerings (maturities of less than 13 months) in 2008, financial advisors participated in 69.3% of the offerings, and in long term offerings, financial advisors participated in 69.7% of the offerings. Hence, an overwhelming percentage of short and long term offerings were issued with the assistance of financial advisors.

5. <u>Percentage of Unregistered Firms that Participated in Offerings</u>

Dealers participated as financial advisors in 38% of the total volume of offerings in which financial advisors provided assistance. Correspondingly, unregistered financial advisors participated in 62% of those offerings, which represented $196 billion of the $315 billion total.

Municipal Issuance With Financial Advisors
2008



Municipal Issuance With Financial Advisors: $315 Billion

Source: Thomson Reuters

6. <u>The Role of Swap Advisors</u>

The municipal securities derivatives market emerged in the 1980s and is still evolving. This market is very complex, with a variety of derivative products such as floating-to-fixed rate swaps, fixed-to-floating rate swaps, basis swaps, and swaptions. According to market participants, the vast majority of transactions are floating-to-fixed swaps, which are used to create synthetic fixed rate structures. These derivative products carry numerous embedded risks that may not be easily understood by less financially sophisticated issuers. Some such risks are interest rate risk, basis risk, tax risk, termination risk, and counterparty risk. Recent market conditions highlight this concern. Many sophisticated issuers face large swap termination fees due to changes in short-term interest rates. The extent to which many of these issuers may have underestimated the potential termination fees is of great concern to the MSRB.

To assist issuers in understanding the characteristics, risks, and potential benefits of these products, many firms developed expertise as swap advisors. These firms, of which there are approximately four dozen, according to the Bond Buyer's Municipal Marketplace Directory 2008, provide financial advice to issuers regarding swap policy development, transaction structuring, documentation, and pricing. Swap advisors now include boutique firms, registered broker-dealers, and banks. While many firms adhere to their own standards of professional conduct, their swap advisory services are, for the most part, unregulated.

Also problematic is the lack of available public information regarding the size of the municipal securities derivative market. Market participants have suggested that the market is between $100 billion and $300 billion, annually, in notional principal amount, but until these derivative transactions are formally tracked, the figures will be unreliable. Given the complexity of municipal derivative transactions, the variety of risks, the growth of the market, and the reliance by issuers on the expertise of swap advisors, the MSRB believes these municipal market professionals should also be regulated. Moreover, the MSRB believes that its rules provide an appropriate framework for such regulation.

7. The Role of Investment Brokers

A small group of advisory firms also provide investment advice to issuers concerning funds that are available to invest. These funds are typically bond funds, construction funds, escrow funds, debt service reserve funds, or capitalized interest funds. Advisory firms may recommend a variety of investments to the issuer, including bank investment agreements, guaranteed investment contracts, repurchase agreements, or forward delivery agreements. These investments may be offered by banks, insurance companies, or broker-dealers, and are bid competitively. Firms that offer such investment advice to issuers are not, for the most part, regulated. Given the complexity of these investments, their integral relationship to the municipal securities transactions, and the investment advice provided by these firms, MSRB believes that these municipal market professionals should be regulated as well. At a minimum, given the investment advice they provide to clients, these firms should be registered as investment advisors with the SEC. Additionally, MSRB believes that its rules, which go significantly beyond the anti-fraud provisions of the federal securities laws, provide an appropriate model for regulation of these market professionals.

8. Municipal Issuers

When considering a new regulatory structure for the municipal securities market, it is important to recognize that the municipal market is distinct from other securities markets due to the role of sovereign municipal issuers, the diversity of issuer types, federal tax law and state law requirements and restrictions that relate to the issuance and sale of municipal securities. As the regulator of municipal securities dealers, the MSRB is keenly attuned to its role at the boundary between the federal government (establishing an efficient national marketplace and uniform investor protections) and states and municipalities exercising their public trust to meet the unique needs of their citizens. In the service of these goals, the MSRB has sought to provide rulemaking that is based on an understanding of the products that are being created and sold, and the dynamics driving decisions and market practices of the issuers, investors, and dealers. This requires careful tailoring of basic securities regulation principles to achieve key investor protection objectives without unduly imposing direct or indirect restraints on municipal issuers.

The SEC 's current jurisdiction includes authority to enforce anti-fraud laws with respect to issuers of municipal securities, and the SEC has brought enforcement actions in a number of high profile cases in the past few years. In addition, the associations representing state and local municipal issuers (Government Finance Officers Association and National Association of State Treasurers, in particular) also have an extensive body of recommended practices and an impressive educational outreach effort to help municipal issuers adhere to the highest standards of conduct. The MSRB is not suggesting the need for any additional federal regulation governing municipal issuers.

We believe that the MSRB's new EMMA system is a key turning point in moving forward with considerably improved disclosure practices in the municipal securities market, and the issuer community wholeheartedly supports this evolution. The current system of continuing disclosure based on a limited number of private enterprises, through which disclosures are available for a fee and in most cases only through a laborious process that does not promote public access, fails to provide the sunshine on disclosure practices that EMMA soon will. Good and bad disclosure practices alike are largely obscured in the current restrictive continuing disclosure scheme. This will no longer be the case with the advent of the MSRB's continuing disclosure service through EMMA. The EMMA system will serve as a red flag for poor disclosure by issuers, while revealing good disclosure practices. It also will remove existing impediments to ensuring that investors buy and sell in securities based on the most up-to-date disclosures. The EMMA website will make it abundantly clear to investors when disclosures are less than satisfactory, as opposed to the current restrictive system. If investors are not satisfied with an issuer's disclosure standards, or if they are alerted to information of concern through disclosures, they will extract a penalty, and the issuer eventually will pay the price through higher borrowing costs. In partnership with the state and local government issuer community, the MSRB believes that recent improvements in the quality and timeliness of disclosures in the municipal securities market will accelerate.

B. Financial Markets Regulatory Structure

The MSRB supports the concept of a multi-layered regulatory framework as a starting point for consideration of a new regulatory structure for the financial markets, as has been proposed by a number of governmental and nongovernmental bodies in recent months.[21]

Such a multi-layered regulatory framework would consist of (1) a market stability regulator to address overall conditions of financial market stability that could impact the general economy; (2) a prudential financial regulator; and (3) a business conduct regulator (linked to consumer protection regulation) to address

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21 *See, e.g.*, U.S. Government Accountability Office, "Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System (GAO-09-216)," January 8, 2009, available at http://www.gao.gov/new.items/d09216.pdf; Group of Thirty, "Financial Reform: A Framework for Financial Stability," January 15, 2009, available at http://www.group30.org/pubs/pub_1460.htm; U.S. Department of the Treasury, "Blueprint for a Modernized Financial Regulatory Structure," available at http://www.treas.gov/press/releases/reports/Blueprint.pdf.

standards for business practices. The MSRB stands ready to work closely with any systemic regulator to gather and analyze data about the municipal market as it relates to systemic risk in the financial markets. As well as a repository for municipal market data, the MSRB can be even better equipped to proactively monitor market activity and assist aggressively in enforcement activities.

A multi-layered regulatory approach, or in fact any scenario, requires that the regulatory entities have deep and extensive knowledge of all financial markets. The lack of municipal finance expertise at the federal level became apparent during the past year and resulted in a very late and limited recognition of the impact of the credit crisis on state and local municipal finances, and the failure of federal programs intended to alleviate the economic impact of the credit crisis to address the needs of state and local governments.

To this end, the MSRB strongly recommends the creation of a Treasury Department office or other significant federal position charged with representing the unique needs of the municipal securities market. We have proposed to President Obama's Administration, as an alternative to such a federal position, the development of a senior level group to coordinate municipal finance issues among the White House, Department of the Treasury, Federal Reserve, SEC, MSRB, and other federal agencies and stakeholders.

C. Self-Regulatory Organizations

The MSRB also believes that there is an important role for market-specific, self-regulatory organizations in any comprehensive regulatory framework. These SROs would continue to adopt rules and standards, establish market mechanisms and systems and standards of operations, and adopt market-specific rules and standards for investor protection. These SRO activities can far exceed the anti-fraud standards of the federal securities laws and can extend to the regulation of the behavior of market intermediaries, thereby ensuring the goals of investor protection and integrity of the securities markets. SROs are also uniquely situated to work with the industry to develop effective rules and information systems, and can be vital links between the industry and the broader regulatory community. SRO jurisdiction must be flexible and broad enough to encompass new products, market developments, new market entrants, market movements, and other changes.

D. Enforcement

Enforcement is key to an effective system of municipal regulation. Traditionally, enforcement activities have been spread across numerous federal and state governmental entities and self-regulatory organizations, consisting of the SEC, FINRA, various bank regulatory agencies, and state attorneys general, creating a patchwork of overlapping jurisdiction and inconsistent and uncoordinated enforcement activities. The SEC can be more effective if given additional resources for municipal enforcement. Further, while some coordination of enforcement activities currently exists, the MSRB strongly recommends that each of the entities that are charged with the enforcement of securities laws – regardless of the genesis of those laws – develop a more formal process to coordinate their regulatory and enforcement activities. Coordinated actions could avoid regulatory gaps, provide clearer statutory authority and promote an efficient and consistent enforcement mechanism for the industry.

Finally, we recommend that Congress modify the MSRB's regulatory authority to include an enforcement and examination support function that would further strengthen enforcement in the municipal securities market. With an increased statutory mandate, the MSRB could better analyze the large amount of data that we collect to assist in surveillance of the market. The MSRB and its staff have a depth of expertise in all aspects of the municipal market that is found nowhere else in the federal government, and we stand ready to further assist, if given the congressional mandate.

E. Derivative Products

While derivatives can be an important risk management tool, they can be dangerous if the state and local government issuers who purchase them do not understand the risks they may create. The current state of the law as articulated in the Commodities Futures Modernization Act of 2000 prohibits regulation of swap agreements (which are broadly defined) with the exception of anti-fraud, and the issue of whether and how to regulate credit default swaps ("CDS") and other derivative instruments remains controversial. While municipal derivatives play an important risk management role in the overall municipal securities market, municipal derivatives are only a fraction of the overall derivatives markets. The MSRB recognizes that the question of whether to regulate municipal derivative instruments should be answered by Congress in the context of the broader derivatives market and that, should Congress choose to place such derivative products under new regulations, the regulatory structure should encompass municipal derivatives as well.

In particular, consideration should be given to the inclusion of municipal CDS in the types of CDS covered by central counterparties and clearinghouses. The application of central counterparties and clearinghouses to municipal CDS would address concerns about the problems of lack of minimum capitalization of CDS protection sellers. It would also address the lack of transparency in CDS pricing, which currently may disadvantage certain investors and dealers. Furthermore, it would provide municipal issuers with information about whether dealers who underwrite their securities are also selling CDS on their debt. Issuers who considered such a dual role to pose a conflict of interest could then take whatever actions they deemed appropriate. Should enhanced disclosures in derivative instruments be a part of any regulatory scheme, the MSRB is well poised with its EMMA system to provide disclosures of municipal derivative contracts and provide the necessary transparency for our market.

V. EXECUTIVE SUMMARY

Since its creation in 1975, the MSRB has worked diligently to foster and preserve a fair and efficient municipal securities market that serves the public interest. The dual goals of investor protection and market integrity have guided this mission. However, the increased sophistication of our market, changing financial markets generally, and the importance of investor protection in the market require a review of the regulatory structure of this market.

To that end, we make the following recommendations:

- We believe that financial advisors, investment brokers, and other intermediaries in the municipal market should be brought under a comprehensive regulatory scheme. Further, we believe that the MSRB is the appropriate regulatory body to regulate these unregulated municipal market participants, as part of a dual regulatory structure with the SEC.

- We support a multi-layered overall regulatory framework for the financial markets consisting of a market stability regulator, a prudential financial regulator, and a business conduct regulator.
- We believe that there is an important role for market-specific SROs that are charged with adopting rules and standards, market mechanisms, information systems, and standards of operations that embody and expand upon the basic anti-fraud standards of the federal securities laws.
- We recommend the creation of a Treasury Department office or other significant federal position charged with representing the unique needs of the municipal securities market, or alternatively, a senior-level multiple-agency group to coordinate municipal finance issues among all market stakeholders.
- We strongly recommend that federal and state entities charged with the enforcement of securities laws develop a more formal process to coordinate their regulatory and enforcement activities.
- We believe that derivative instruments based on municipal securities should be subject to the same comprehensive regulatory framework that may be developed for swaps and other types of derivative financial products in other markets. The rules governing dealer activity developed by the MSRB over its

history provide an appropriate model for the comprehensive regulation that should apply to all financial intermediaries active in the municipal market.

We stand ready to assist in this important work and are certain that investor protection will be served by increasing our mandate.