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UNREGULATED MUNICIPAL MARKET PARTICIPANTS A CASE FOR REFORM

Prepared by the MUNICIPAL SECURITIES RULEMAKING BOARD



MSRB

Municipal Securities
Rulemaking Board

EXECUTIVE SUMMARY

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 plain-vanilla, 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 Municipal Securities Rulemaking Board (“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 either “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 is essential to protect investors and market integrity, and that the MSRB should have such authority. Moreover, the MSRB believes that its current regulatory structure for municipal securities dealers provides a ready model for oversight of financial advisors and investment brokers. The MSRB also believes that expanded oversight would best be employed in a dual regulatory structure with the U.S. Securities and Exchange Commission (“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.

REGISTRATION OF FINANCIAL ADVISORY FIRMS IN 2008

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.

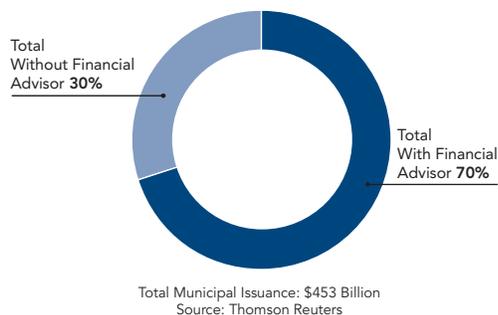


The MSRB has prepared this report describing the significant role of financial advisors and investment brokers in the municipal securities marketplace. In particular, the report highlights the following:

- Although MSRB regulation has proven effective historically, the complexity of the current municipal securities market makes regulation over a broader group of market participants critical.
- Based on the growth of the market, and the evident regulatory gaps, it is necessary for unregulated market participants to be subject to regulatory oversight that is similar to that mandated for dealers.
- Financial advisory and investment firms should be held to standards of conduct that protect municipal issuers, taxpayers, investors and other market participants.
- Much like the rules governing dealers today, the rules would be tailored to the business of financial advisors and investment brokers, based on the nature of their activities.
- 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.¹

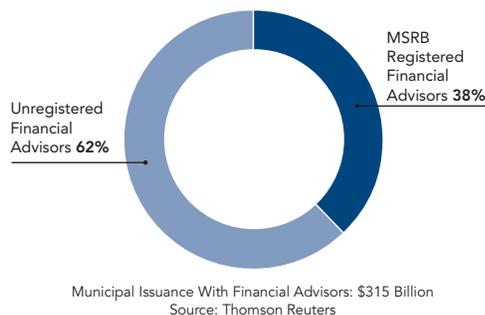
¹ Unless otherwise noted, percentages are based on the volume of offerings issued, by par amount in 2008, as reported by Thomson Reuters.

MUNICIPAL DEBT ISSUED IN 2008 WITH THE ASSISTANCE OF FINANCIAL ADVISORS



- 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.²

PERCENTAGE OF UNREGISTERED FIRMS THAT PARTICIPATED IN OFFERINGS IN 2008



- As the municipal derivatives market developed, many advisory firms developed expertise as swap advisors. Advisory firms were also formed to provide investment advice to issuers concerning funds that were available to invest. Neither swap advisors nor investment brokers are currently regulated at the federal level.
- Given the complexity of the municipal securities market, the variety of risks, and the reliance by many issuers on the expertise of these professionals, the MSRB is seeking authority to regulate financial advisors and investment brokers in order to protect investors and preserve market integrity.
- With the proposed expansion of its jurisdiction, the MSRB's composition should be reviewed by Congress to insure that investors in the municipal market are protected.

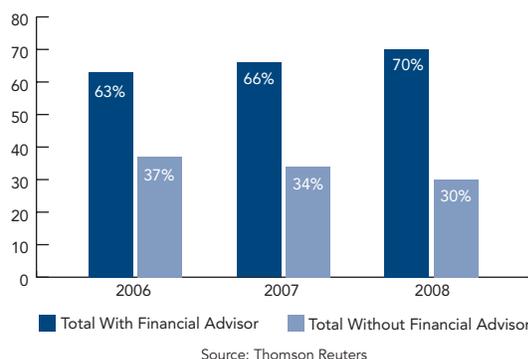
OVERVIEW

The MSRB is a self-regulatory organization established by Congress in 1975 under Section 15B of the Securities Exchange Act of 1934 ("Section 15B") to develop rules for securities firms and banks (collectively "dealers") that underwrite, trade and sell municipal securities. Section 15B provides that the MSRB rules shall be designed to protect investors and the public interest. The MSRB also operates information systems such as the Electronic Municipal Market Access System ("EMMA"), designed to promote transparency and access to information in furtherance of its investor protection mandate, and provides market leadership by raising awareness regarding important municipal securities issues and engaging in educational campaigns and outreach to market professionals, legislators, investors, and other interested parties.

The MSRB's statutory mandate is to establish a regulatory structure for dealers that protects investors and ensures a fair and efficient market, and also respects the role of state and local governmental issuers. The market, however, has grown significantly and the number and type of intermediaries in the municipal market now goes far beyond the dealer community. These intermediaries have significant influence with issuers, which are public entities, and earn significant fees. Approximately 70% of the total volume of municipal debt (by par amount) issued in 2008 was issued with the assistance of financial advisors.

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.

VOLUME OF MUNICIPAL DEBT ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



² The term "unregistered" financial advisors refers to those firms that are not registered with the MSRB or SEC for purposes of their municipal securities activities. The term "unregulated" refers to those firms that are not subject to SEC or MSRB regulation for purposes of their municipal securities activities.

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.

The MSRB recognizes that financial advisors play an important role in the market. The complexity of municipal securities offerings and their related derivative transactions, and the abundance of issuers, both large and small, that may lack internal expertise, have created a need for financial advisors. More than 2,000 issuers that brought just one small deal (\$10 million or less) to market in 2008 relied on the advice of financial advisors.

And yet, despite a thin patchwork of state and local laws, the majority of financial advisors is unregulated and operates in the public sphere without any legal standards or regulatory accountability. The MSRB does not have authority to regulate activities of any non-dealer professionals in the municipal finance market. These include independent financial advisors and swap advisors (collectively, "financial advisors"), and brokers of guaranteed investment contracts and other investment products purchased with proceeds from municipal bond offerings ("investment brokers"). The MSRB believes that regulation of these entities is essential for the reasons stated below and that a holistic, national regulatory approach is necessary.

Prior to the creation of the MSRB by Congress in 1975, the municipal securities activities of securities firms and banks were essentially unregulated, much like the activities of financial advisors and investment brokers today. Dealers were not required to register with the SEC in their municipal capacity, and there was no self-regulatory organization governing this market. The market had no comprehensive professional qualifications, operational standards, sales practice or disclosure rules, or conflict of interest rules at the federal level, other than general anti-fraud rules. Precisely the same environment now exists for "independent" financial advisors and investment brokers.

In 1975, abuses in the marketplace convinced Congress to grant oversight authority to the SEC and to establish the MSRB to promulgate rules for dealers in the municipal securities industry. The MSRB believes that, much like the reputable securities firms and banks in the 1970s who embraced regulation to allay concerns about fraud in the industry, reputable financial advisors and investment brokers will do the same now.

Although the MSRB model of regulation has proven effective historically for its regulated entities, the complexity of the current municipal securities market makes regulation over a broader group of market participants critical. This need has been underscored by an increased number of federal and state investigations into corruption and pay-to-play activities involving municipal securities transactions (beyond those covered by the MSRB's rules for dealers on pay-to-play), the ensuing media coverage and the resulting negative impact on investor confidence and market integrity.

The limited role of the MSRB to fully oversee all market participants has caused widespread confusion over how the market is regulated. There is a widespread assumption that all market participants are accountable to a regulatory authority. Based on the growth of the market, and the evident regulatory gaps, it is necessary for unregulated market participants to be subject to regulatory oversight that is similar to that mandated for dealers.

CURRENT REGULATORY FRAMEWORK OF THE MUNICIPAL MARKET

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 MSRB has adopted a substantial body of rules for dealers that reflect the special characteristics of the municipal securities market and its unique regulatory needs, and that are designed to regulate dealer conduct. 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 differ from those rules for dealers in the corporate securities market, where bond issuers and other market participants are subject to regulation.

In general, MSRB rules are “principles-based,” with specific guidance given where appropriate. 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 fairly price transactions; 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’s disclosure documents; and dealer disclosure of political contributions to the MSRB for public dissemination). These rules require dealers to observe the highest professional standards in their activities and relationships with customers, and significantly exceed the general anti-fraud principles that are embodied in the federal securities laws.

RULES REGARDING PAY-TO-PLAY

Two MSRB rules of particular note, Rules G-37 and G-38, have been adopted to specifically address pay-to-play issues and the use of paid political operatives to obtain municipal securities business. These rules, which place strict limits on the ability of dealers to undertake municipal securities business for issuers if certain direct or indirect political contributions have been made to their elected officials, have been emulated by a number of state and local governmental entities to help in their efforts to control pay-to-play issues involving government contractors other than municipal securities dealers.

UNREGULATED PARTIES IN THE MUNICIPAL SECURITIES MARKET

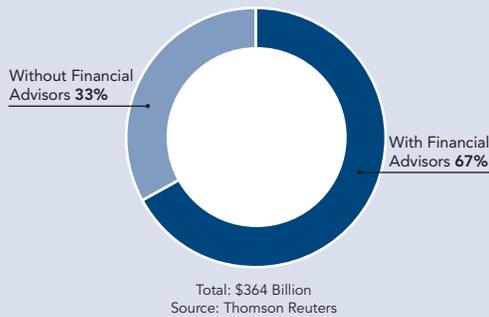
The MSRB’s jurisdiction extends to regulating the dealer community only. As municipal finance transactions have evolved and become more complex, advisors that work with municipal issuers and act as intermediaries between issuers and firms that provide necessary investment and other services are now commonplace. Moreover, many advisory firms provide a multitude of services including swap services, escrow structuring and defeasance services, reinvestment services, cash and debt management services, and traditional financial advisory services relating to bond offerings. One firm may, for example, provide advice to issuers regarding competitive or negotiated bond offerings, swap transactions, refunding or defeasance transactions, and investment of funds in products such as open market securities, forward delivery agreements, or collateralized and uncollateralized investment contracts. These largely unregulated participants have significant influence with issuers, earn significant fees and many times are not constrained by any prohibitions on political contributions, either participating in pay-to-play, or giving the appearance of a quid pro quo for attaining business. Given their integral role in municipal finance, these advisory and investment firms should be held to standards of conduct that already protect municipal issuers, taxpayers and investors in this market.

At a minimum, the new rules for financial advisors and investment brokers should include professional qualification and fair practice standards for firms and their associated persons. The rules would prescribe examinations testing a candidate’s knowledge of the municipal securities business, define the requirements for firm representatives and principals, and outline continuing education requirements. The rules would also establish criteria for sales practices and fair dealing with issuer clients, including obligations regarding sales literature and advertisements, disclosures, and conflicts of interest. Much like the rules governing dealers today, the rules would be tailored to the business of financial advisors and investment brokers, based on the nature of their activities.

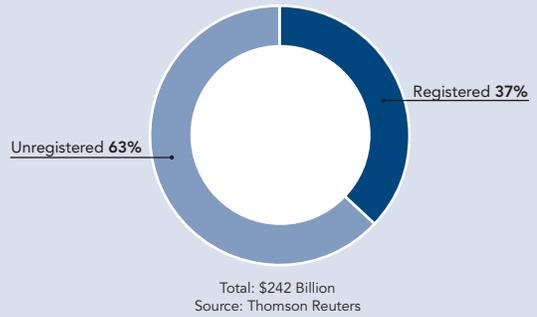
COMPARISON OF FINANCIAL ADVISOR ASSISTANCE IN NEGOTIATED AND COMPETITIVE OFFERINGS

In negotiated offerings, financial advisors participated in 67% of the volume of the offerings and in competitive offerings, financial advisors participated in 86% of the offerings.³ In negotiated offerings assisted by financial advisors, 63% of the advisors were unregistered. Similarly, in competitive offerings assisted by financial advisors, 60% of the advisors were unregistered.

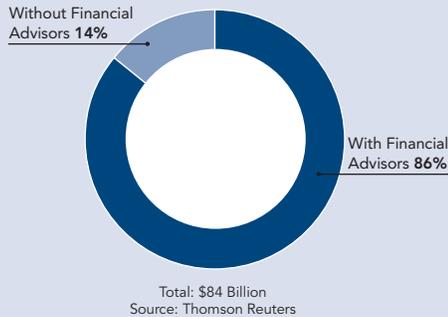
**MUNICIPAL SECURITIES ISSUANCE
NEGOTIATED OFFERINGS — TOTAL
2008**



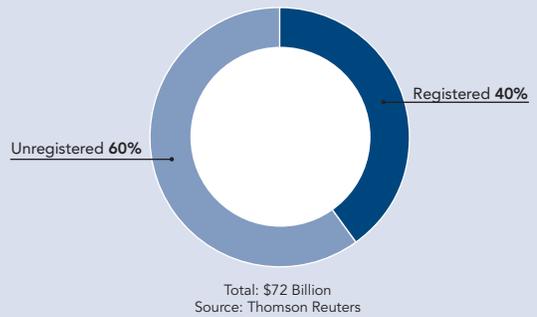
**MUNICIPAL SECURITIES ISSUANCE
NEGOTIATED OFFERINGS WITH FINANCIAL ADVISORS
REGISTERED vs. UNREGISTERED
2008**



**MUNICIPAL SECURITIES ISSUANCE
COMPETITIVE OFFERINGS — TOTAL
2008**



**MUNICIPAL SECURITIES ISSUANCE
COMPETITIVE OFFERINGS WITH FINANCIAL ADVISORS
REGISTERED vs. UNREGISTERED
2008**



³ A negotiated sale is the sale of a new issue of municipal securities by an issuer directly to an underwriter or underwriting syndicate selected by the issuer. A negotiated sale is distinguished from a sale by competitive bid, which requires public bidding by the underwriters. Among the primary points of negotiation for an issuer are the interest rate, call features, and purchase price of the issue. The sale of a new issue of securities in this manner is also known as a negotiated offering or underwriting.

CURRENT REGULATION OF INDEPENDENT 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 actual or apparent conflict of interest that exists when a municipal securities professional acts as both financial advisor and underwriter with respect to the same issue. Given the current oversight by the MSRB over dealers who act as financial advisors, it is appropriate for unregistered, "independent" financial advisors to be regulated by the same regulatory authority that has particular expertise regarding advisory activities and the municipal markets in general.

With respect to these "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 (some overlap with the prior group) 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 nature of these state and local laws has not been effective in stopping the possibility and appearance of pay-to-play activities in the unregulated portions of the municipal securities market. It is time for a coordinated and comprehensive approach to regulating "independent" financial advisors.

NUMBER OF FINANCIAL ADVISORS ACTIVE IN THE MARKETPLACE

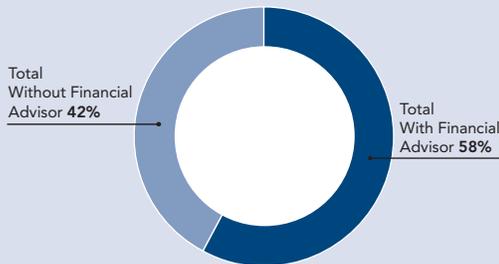
Given the unregulated nature of this market, it is difficult to identify with precision the number of financial advisors, the number of offerings in which they participated, or the nature and scope of their advice. Nevertheless, the MSRB has reached out to market participants and has reviewed data on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

The following charts highlight the distribution of regulated and unregulated financial advisors in various states and various sectors of the market.

PERCENTAGE OF OFFERINGS BY SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS

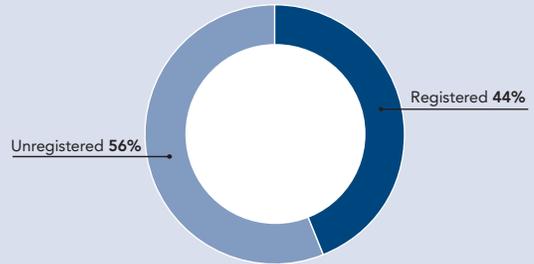
Financial advisors participated in approximately 60–90% of the offerings by sector in 2008. For example, financial advisors participated in 58% of the education bonds, 71% of the healthcare bonds, and 91% of the transportation bonds. There were a few sectors that deviated from this range. In housing, for example, financial advisors participated in only 35% of the offerings in 2008, and in environmental facilities, financial advisors participated in only 18% of the offerings. With regard to the education, healthcare, and transportation bonds, of the offerings in which financial advisors participated, the unregistered firms represented the following respective percentages of the market: 56%, 59%, and 49%.

PERCENTAGE OF OFFERINGS IN EDUCATION SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



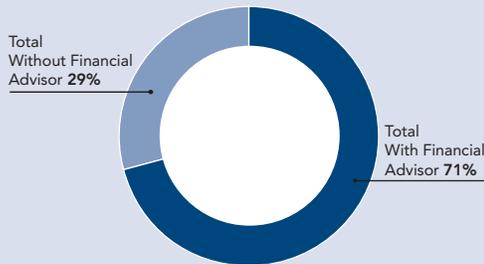
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN EDUCATION SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED



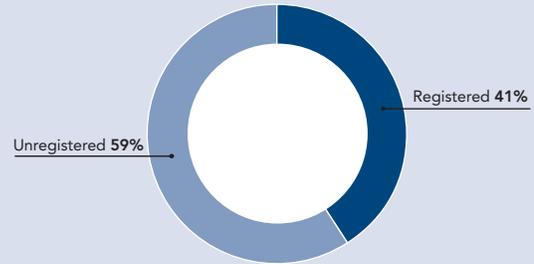
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN HEALTHCARE SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



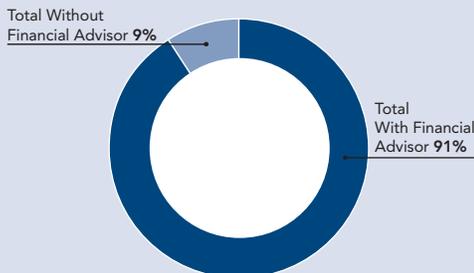
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN HEALTHCARE SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED



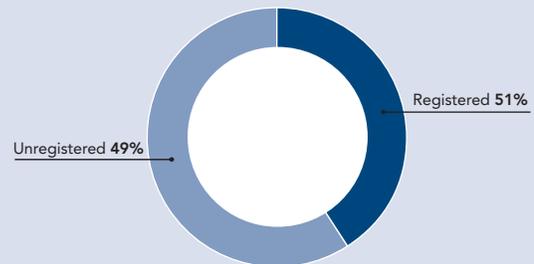
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN TRANSPORTATION SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN TRANSPORTATION SECTOR ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED

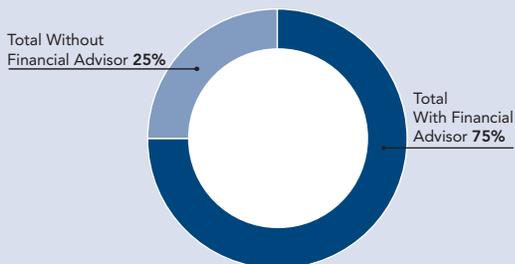


Source: Thomson Reuters

PERCENTAGE OF OFFERINGS BY STATE ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS

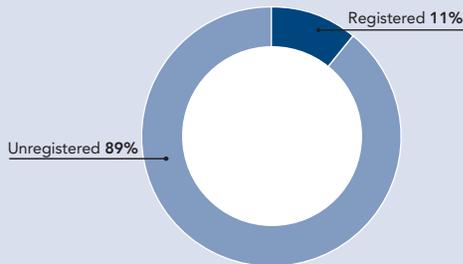
Financial advisors participated in approximately 60–80% of the offerings in the states with the largest volume of offerings in 2008. For example, financial advisors participated in 75% of the offerings in California, and 76% of the offerings in New York. One notable exception was Massachusetts where financial advisors participated in only 38% of the offerings. Of the offerings in these states in which financial advisors participated, unregistered firms constituted the overwhelming majority: 89% in California, 70% in New York, and 71% in Massachusetts.

PERCENTAGE OF OFFERINGS IN CALIFORNIA ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



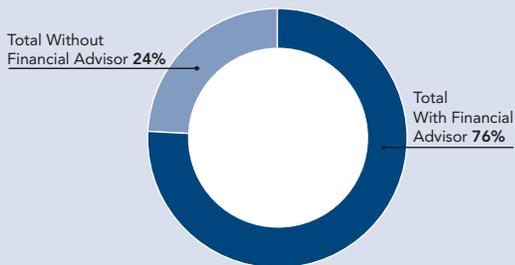
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN CALIFORNIA ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED



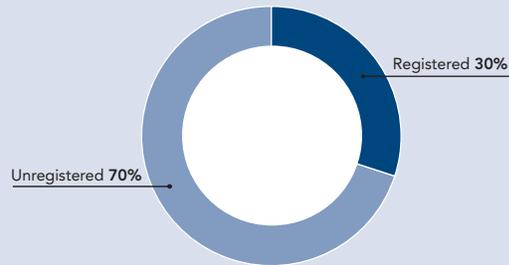
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN NEW YORK ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



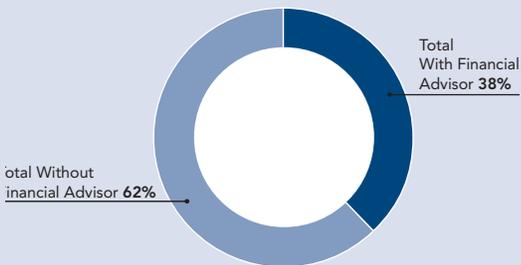
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN NEW YORK ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED



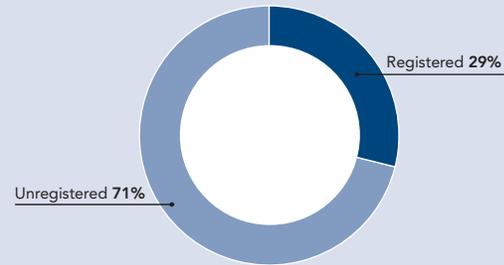
Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN MASSACHUSETTS ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS



Source: Thomson Reuters

PERCENTAGE OF OFFERINGS IN MASSACHUSETTS ISSUED WITH ASSISTANCE OF FINANCIAL ADVISORS REGISTERED vs. UNREGISTERED

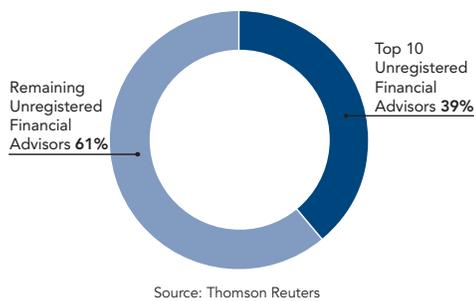


Source: Thomson Reuters

A SNAPSHOT OF THE FINANCIAL ADVISOR MARKET

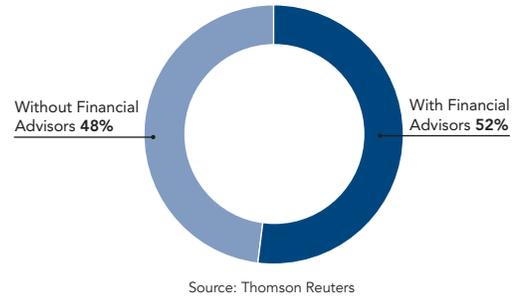
Approximately 50% of the total financial advisory business is conducted by the top ten firms in terms of offering volume, only three of which are registered dealers. The top ten provided advice on approximately \$166 billion of the total \$315 billion of municipal debt issued with the assistance of financial advisors in 2008. Of the unregistered financial advisors, the top ten in terms of offering volume represented 39% of the market. By contrast, 194 of the 358 financial advisors were generally small firms that participated in 5 or fewer offerings. Small financial advisors that participate in few offerings each year may not have established codes of conduct or robust internal controls to prevent conflicts of interest. The proliferation of small, intermittently active firms provides further support for a regulatory scheme that would standardize, among other things, professional qualifications, continuing education requirements, and disclosure obligations.

UNREGISTERED FINANCIAL ADVISORY BUSINESS CONDUCTED BY LARGEST FINANCIAL ADVISORS BY DOLLAR VOLUME
2008



Of the 4,446 issuers that had cumulative issuance of \$10 million or less in 2008 and issued only one deal, 52% used the services of a financial advisor. These are typically smaller, less sophisticated issuers that are the most likely to rely on the advice of financial advisors.

UNIQUE MUNICIPAL ISSUERS (CUMULATIVE ISSUANCE OF \$10 MILLION OR LESS AND ONLY ONE DEAL)
2008



THE NEED FOR REGULATION

Financial advisors play a significant and growing role in the municipal securities market. Approximately 70% of the offerings last year, by volume, were issued with the assistance of a financial advisor, which is an increase from 63% just two years ago. Their role is even greater in competitive offerings, where 86% were issued with the assistance of a financial advisor. The majority of offerings issued by small issuers were brought to market with the assistance of financial advisors who typically play a larger role in such offerings.

Financial advisors were unregistered, in approximately two thirds, by par amount, of the offerings in 2008 in which financial advisors provided assistance. Given the current role of unregulated financial advisors in the municipal marketplace, the lack of reliable statistics regarding their participation in municipal transactions, and the critical need for investor protection in light of recent market events, the MSRB believes that regulation of all financial advisors is necessary at this time.

THE ROLE OF SWAP ADVISORS

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. Even 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, financial advisors, 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 and, hence, in addition to SEC registration, swap advisors should be required to register with the MSRB and abide by appropriate conduct and marketplace rules.

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, the 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, the MSRB believes that its rules, which go beyond the anti-fraud provisions of the federal securities laws, provide an appropriate model for regulation of these market professionals.

CONCLUSION

Recent market events have exposed regulatory gaps in the municipal securities market and the capital markets in general. These gaps permit unregulated participants to avoid critical restraints on professional conduct, such as prohibitions on pay-to-play. Regulatory gaps and inconsistencies also undermine the confidence of investors in the capital markets and contribute to market destabilization. Measures must be taken to regain investor trust and ensure that all municipal market intermediaries are subject to the most basic regulatory obligations.

These market intermediaries must be subject 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) restrict real and perceived conflicts of interests, (iv) ensure rigorous standards of professional qualifications, and (v) promote market efficiencies. In addition to the anti-fraud authority of the SEC, existing MSRB rules provide a ready model for the types of rules that could be developed for these market intermediaries. This expanded authority should be employed in a dual regulatory structure with registration of the firms required with the SEC, yet making the more prescriptive rules of the MSRB also applicable to these firms and their activities.