



MSRB Discussion Paper on Disclosure in the Municipal Securities Market

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Discussion Paper

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- This paper reviews perspectives on disclosure by different market participants. It then describes the current state of disclosure in the primary and secondary municipal securities market, including what rules apply and how voluntary industry efforts are seeking improvements. Finally, the paper proposes certain MSRB disclosure initiatives.

I. Introduction

The Municipal Securities Rulemaking Board (MSRB) was created by Congress in 1975 to write rules to govern the municipal securities activities of brokers, dealers and municipal securities dealers. Its mission is to protect investors and foster a fair and efficient municipal securities market. The MSRB seeks to accomplish these goals through dealer regulation and by working with other market participants on common issues and concerns. Disclosure is one of the most important issues in the municipal securities market because of the variety of issuers and issues in the market, the nature of the investor base and unique trading patterns.

There are over 80,000 governmental units that may issue municipal securities.¹¹ These issuers include not only states and local governments, but also many “authorities” that are created to carry out special functions and to issue municipal debt. These issuers have outstanding approximately 1.4 million different municipal securities, ranging from simple, non-callable general obligation debt to conduit financings involving complicated credit structures and multiple call features. Characteristics such as these distinguish municipal securities from U.S. treasuries and corporate bonds, in which far fewer types of securities are issued and the securities have more standardized features.

As of the end of 1999, out of \$1.5 trillion outstanding municipal securities, households exclusive of mutual funds held \$527.5 billion, comprising over one third of the total. Mutual funds held \$241.5 billion and money market funds held \$210.4 billion.¹²¹ Thus, the retail ownership of municipal securities, both directly and through funds, represents a significant portion of the market.

From information gathered by the MSRB's Transaction Reporting System, we know that the vast majority of municipal securities trade infrequently after they are issued. Investors typically buy and hold the securities until their maturity. Less than one percent of outstanding municipal securities trade each day and less than one-third trade even once a year.

While information about the features of a security, credit structure and financial health of the issuer is important for any securities transaction, the unique characteristics of the municipal securities market make such information even more vital. The MSRB has undertaken a number of projects, from specific dealer regulation to the creation of the Municipal Securities Information Library[®] (MSIL[®]) system,¹³¹ to improve dissemination of disclosure information. The MSRB hopes to continue its efforts, along with other market participants, to bring about even more improvements in this area. To that end, the MSRB will host its second Disclosure Forum in Washington, D.C., on January 11-12, 2001. The MSRB urges all interested municipal market members to attend and participate with a group of distinguished panelists to discuss the current state of disclosure in the municipal securities market and what more should be done. Through this Discussion Paper, the MSRB hopes to generate interest in and support of MSRB and industry efforts on disclosure. The MSRB requests comment from all market participants.

This paper reviews perspectives on disclosure by different market participants. It then describes the current state of disclosure in the primary and secondary municipal securities market, including what rules apply and how voluntary industry efforts are seeking improvements. Finally, the paper proposes certain MSRB disclosure initiatives.

II. Perspectives on Disclosure

Issuers, investors and dealers have different perspectives on disclosure. Some are producers of information and others function primarily as users and/or intermediaries. In its disclosure initiatives, the MSRB attempts to recognize and balance these differences, keeping in mind its primary obligation to protect investors and promote the integrity, fairness and efficiency of the market. It may be worthwhile at the outset of the discussion to review the perspectives of the different principals in the disclosure process – issuers, investors and dealers.¹⁴¹

A. Issuers

Issuers are responsible for the disclosure documents that allow buyers and sellers to understand and properly evaluate the issuer's securities. State and local governmental entities obviously have very different purposes and obligations than do commercial enterprises. Municipal issuers' perspective thus vary considerably from that held by corporate issuers of stock and bonds. The legal and regulatory structure of the municipal securities market also reflect these differences. Compared to the detailed disclosure requirements contained in the Securities Act of 1933, as amended (the "Securities Act") and

the Securities Exchange Act of 1934, as amended (the “Exchange Act”), there is little federal regulation governing the timing, format and content of municipal securities disclosure. Instead, the law governing disclosure by municipal issuers is grounded in antifraud concepts, which generally provide only retrospective guidance.

Historically, the focus on disclosure documents by municipal issuers was market-driven and limited to the initial sale of their securities, with relatively little concern for continuing disclosures designed for the secondary market. As discussed below, this began to change in 1995 with the adoption of the continuing disclosure amendments to Exchange Act Rule 15c2-12 promulgated by the Securities and Exchange Commission (SEC).

B. Investors

From an investor’s perspective, the broadest meaning of “disclosure” encompasses the information needed to make an informed investment decision. This includes information bearing upon the credit quality (*e.g.*, ongoing financial results of obligors) and information about the terms of the instrument (*e.g.*, call provisions). An informed investment decision requires not only an assessment of the possibility of default in the payment of interest and principal, but also an assessment of price of the securities compared to other similar securities. For example, the underlying financial condition of an obligor, or the likelihood of a partial or in-whole call of an issue, may be materially relevant to an investment decision even though the securities carry bond insurance from a highly rated insurance company and are AAA rated.

Different kinds of investors may have different perspectives on accessing and using disclosure information. Professional financial analysts working for institutional investors typically focus on information collected from issuers, issuer representatives (such as bond trustees), dealers and third parties. Retail investors are more likely to look exclusively to the dealer for any disclosure information they receive. While there may be some self-directed retail investors in municipal securities who independently obtain disclosure information and evaluate it without help from dealers, the MSRB believes that this phenomenon is significantly less prevalent for municipal securities than it is for Exchange- or NASDAQ- listed securities. A variety of factors may explain this difference, one of which is the relative difficulty that investors have in obtaining municipal disclosure information.

C. Dealers

Dealers are both users of disclosure information and intermediaries for communicating disclosure information between issuers and investors. Underwriters, of course, have an additional interest in disclosure based on their obligation to review key representations made by the issuer in new issue disclosure documents.¹⁵¹ From a business perspective, all dealers – not just underwriters – must be concerned with disclosure since it fundamentally affects the value of the products they buy and sell. There are also regulatory considerations that specifically require dealers to have access to and use disclosure information in order to meet MSRB customer protection obligations.

The primary MSRB customer protection rules governing dealer behavior are rules G-17 on fair practice and disclosure to customers, rule G-19 on the suitability of recommendations, and rules G-18 and G-30 relating to transaction prices. A dealer’s ability to meet the high standards set by these customer protection rules depends in large part on the quality and availability of disclosure information. This fact underlies a number of the MSRB’s efforts in the disclosure area.

III. Disclosure in the Municipal Securities Market

A. Primary Market

i. What rules apply?

While the SEC has substantial authority over corporate issuers of equity or debt, its authority with respect to municipal securities issuers is much more limited. Corporate issuers are subject to periodic registration and continuous public reporting requirements under the Securities Act and the Exchange Act and are required to make standardized periodic filings to the SEC's EDGAR system. Thus, there is substantial information about corporate equity and debt securities readily available to investors and often without cost.

Municipal securities issuers are subject to the antifraud provisions of the federal securities laws, but they have no specific registration or continuous reporting requirements mandated by the SEC. In fact, Section 15B(d) of the Exchange Act specifically prohibits the SEC from writing rules that directly or indirectly impose a presale filing requirement for issuers of municipal securities. The SEC has, however, through dealer regulation, set up a system of disclosure requirements for municipal issuers.

In the primary market, SEC Rule 15c2-12 requires underwriters participating in most offerings of municipal securities of \$1 million or more to obtain, review and distribute to investors copies of the issuer's disclosure documents. In addition, the Rule requires underwriters to contract with an issuer or its designated agent to receive copies of a final official statement within seven business days after any final agreement to purchase, offer or sell the municipal securities and in sufficient time to accompany any confirmation that requests payment from a customer.

The SEC has issued two interpretations of the application of the antifraud provisions of the federal securities laws to municipal market participants. The first dealt solely with municipal underwriter responsibilities.^{16]} The SEC stated that underwriters must have a reasonable basis for believing key representations in an official statement prepared by an issuer. To this end, the SEC expects, at a minimum, that underwriters will review the issuer's disclosure documents in a professional manner for possible inaccuracies and omissions. The second interpretation dealt with the disclosure obligations of market participants, both in connection with primary offerings and on a continuing basis with respect to the secondary market.^{17]} Among other things, the SEC noted a number of areas of concern in the primary market, including disclosure of potential conflicts of interest and material financial relationships among issuers, advisors and underwriters, as well as the importance of continuing disclosure of updated financial information at least on an annual basis by issuers.

In Section 15B of the Exchange Act, the MSRB is charged with writing rules 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 in municipal securities and, in general, to protect investors and the public interest.

MSRB rules apply only to dealers. In addition, in Section 15B(d) of the Exchange Act, the MSRB (like the SEC) is prohibited from writing rules that directly or indirectly impose a presale filing requirement on issuers of municipal securities. This section also 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. However, this section specifically allows the MSRB to adopt requirements relating to such disclosure documents or information as might be available from a source other than the issuer.

Although MSRB rules cannot require the production of an official statement, for more than two decades MSRB rule G-32 has obligated dealers selling new issue municipal securities to provide to customers in a timely manner any official statement prepared by the issuer.¹⁸¹ In addition, rule G-17 has been interpreted to require a dealer to disclose to its customer at the time of trade all material facts concerning the transaction, including transactions in new issue municipal securities.¹⁹¹ In the late 1980s, recognizing that disclosure information often is difficult to obtain in the municipal securities market, the MSRB recommended to the SEC that it use its rulemaking authority to establish a mandatory central repository of official statements.¹⁰¹ Later, the MSRB offered to establish such a repository if the SEC used its rulemaking authority to require issuers to prepare official statements.

As noted above, SEC Rule 15c2-12 requires an underwriter to contract with the issuer of most primary offerings of municipal securities¹¹¹ to receive the official statement within a specified timeframe. Although Rule 15c2-12 effectively requires an issuer seeking to have its new issue underwritten by a dealer to prepare an official statement, it does not require that the official statement be sent to a central repository. Instead, the Rule provides an incentive (rather than a mandate) to underwriters (not issuers) to send the official statement to one (but not necessarily all) of several nationally recognized municipal securities information repositories (NRMSIRs).¹²¹ Thus, there is no assurance under Rule 15c2-12 that all official statements would be sent to at least one NRMSIR or that any one NRMSIR would have a complete collection of all official statements that have in fact been submitted to a NRMSIR.

The MSRB adopted rule G-36 for the purpose of creating a central repository for information regarding municipal securities trading in the primary and secondary markets. Under the rule, underwriters for most primary offerings since January 1, 1990 have been required to submit copies of official statements and advance refunding documents (e.g., escrow deposit agreements) to the MSRB. These documents are indexed, imaged and stored by the MSRB's MSIL system and are made available to the marketplace by subscription in electronic format on a daily basis or on paper through its Public Access Facility located in Alexandria, Virginia. Since rule G-36 has been in effect, the MSIL system has processed and maintains in a central library over 135,000 official statement and advance refunding document submissions.

All existing NRMSIRs, as well as certain other market participants, subscribe to the MSIL system. The daily data files from the MSIL system provided to NRMSIRs allow them to maintain virtually complete sets of official statements and advance refunding documents for market participants. In particular, the MSIL system provides each NRMSIR with documents it may not have otherwise received, such as official statements sent only to one NRMSIR under Rule 15c2-12, or those for offerings exempt from Rule 15c2-12.¹³¹ The MSIL system also provides advance refunding documents for most offerings that

advance refund an outstanding issue.^[14]

The MSRB also has taken action to facilitate the use of electronic means to disseminate primary market disclosure documents. In November 1998, the MSRB published an interpretive notice that, among other things, permits dealers to deliver official statements to customers and to other dealers under rule G-32 by electronic means so long as certain standards previously enunciated by the SEC are met.^[15] More recently, the MSRB has published a notice seeking comment on a voluntary system of electronic submission of official statements and advance refunding documents to the MSIL system by underwriters under rule G-36.^[16] If ultimately approved, this system should make official statements submitted to the MSIL system in electronic form available to subscribers and at the Public Access Facility one or more business days earlier than if submitted in paper form.

ii. Current state of disclosure

Although the MSRB believes that Rule 15c2-12 and rule G-36 have greatly improved the availability of final official statements in the municipal securities market, the MSRB remains concerned about the quality and timeliness of disclosure in the primary market. In 1998, the MSRB hosted a Disclosure Forum at which many Forum participants urged improvement of primary market disclosure through development of and adherence to voluntary disclosure guidelines. A number of industry groups have formulated disclosure guidelines for official statements. The Government Finance Officers Association (GFOA) Guidelines have been in place for over 20 years. Other groups, such as the National Federation of Municipal Analysts (NFMA), are working to standardize market disclosure practices on a voluntary basis in various sectors of the market. The MSRB has sought to foster industry discussion on NFMA guidelines on land-secured and hospital financings through hosting a number of forums around the country.

The MSRB is not aware of any detailed study of the quality of official statements currently provided in the market. Some industry members have expressed concern that Rule 15c2-12's continuing disclosure requirements, defined by reference to the material in the official statement, may indirectly have an adverse impact upon the level of primary market disclosure. While many investors support the voluntary industry guidelines that have been developed, the level of issuer compliance with such guidelines is not clear.

In July 2000, the MSRB met with a number of institutional investors active in the municipal securities market to discuss their experience in receiving disclosure information in the primary market. Many of these investors emphasized the importance of ensuring the completeness of disclosures made in preliminary official statements. They also believe it is critical that preliminary official statements be provided to investors in sufficient time to allow an informed investment decision.

With respect to the timeliness of the final official statement, the MSRB remains concerned that some new issue customers are not receiving official statements by settlement as required under rule G-32. This is caused both by issuers failing to meet the timeframe for delivery of official statements established in

the contract with the underwriters entered into under Rule 15c2-12, as well as dealer failures to turn around official statements in a timely fashion.

In June 1999, the MSRB published its first comprehensive review of information collected for offerings sold in 1998.^[17] Based on information underwriters submitted pursuant to rule G-36, the MSRB found that, for approximately 19% of issues subject to Rule 15c2-12, the issuer failed to meet the seven business day timeframe for delivering official statements to underwriters. However, because rule G-36's final deadline for submission of official statements to the MSIL system is three business days later than Rule 15c2-12's contractual delivery deadline, late issuer deliveries had only a relatively small effect on the level of late underwriter submissions under rule G-36 with respect to issues subject to Rule 15c2-12.

^[18] For issues exempt from Rule 15c2-12 but still subject to rule G-36, the data showed that approximately half of all underwriter rule violations were caused by late issuer deliveries.^[19] Finally, the data suggested that, for a significant number of new issues, issuers were not making official statements available to the underwriters in sufficient time to permit dealers to meet their rule G-32 customer delivery obligations. The MSRB concluded its review of 1998 offerings by urging financing participants to establish a timetable that provides the parties with adequate time and opportunity to meet their respective obligations, including the obligation of dealers to deliver official statements to customers by settlement.

The following year (1999), the MSRB found modest improvements in the timing of official statement deliveries to underwriters by issuers of offerings subject to Rule 15c2-12 and in the timing of official statement submissions to the MSIL system by underwriters under rule G-36. However, the data for 1999 offerings suggested that the time available for dealers to meet their rule G-32 customer delivery obligations (*i.e.*, the period between the delivery of the official statement by the issuer to the underwriters and the bond closing date) had in fact become more compressed as compared to the 1998 data. The MSRB discussed these findings with the dealer community at its Compliance Seminar held in New York City in April 2000, emphasizing that official statements do not merely need to be at the closing table for the underwriting but, more importantly, need to be in the hands of investors on that day.

B. Secondary Market

i. What rules apply?

In the secondary market, Rule 15c2-12 provides that underwriters must ensure that issuers of most new issues of municipal securities have undertaken (i) to provide certain financial and operating information on an annual basis to each NRMSIR and to any state information depository (SID) that may exist in the issuer's state and (ii) to provide either to each NRMSIR and any appropriate SID or to the MSRB notice of certain specified events relating to such issue, if material. The MSRB understands that there are currently four NRMSIRs and three SIDs designated under Rule 15c2-12 through SEC no-action letters.

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The MSRB has consistently recognized the importance of continuing disclosure for the secondary market and has emphasized the need to improve access to issuer information as a means to strengthen the market and to promote better compliance with the MSRB's customer protection rules.^[21] In 1990, the

MSRB filed with the SEC a plan for collecting and disseminating voluntarily provided continuing disclosure notices. Ultimately, this system developed into the Continuing Disclosure Information Pilot (“CDI Pilot”) system.^[22]

The 1995 amendment to SEC Rule 15c2-12 on secondary market disclosure provided that the MSRB would serve as an alternative to the NRMSIRs for the filing by issuers and obligors of material event disclosures (but not the annual financial reports). Thus, the MSRB revised the CDI system and implemented a new system designed to accept material event notices.^[23]

ii. Current state of disclosure

Some market participants question whether Rule 15c2-12’s continuing disclosure requirements are adequate. In particular, they contend that annual financial information is not sufficient. Also, some suggest that, in the wake of the 1995 amendments, obligors have declined to provide responses to informal inquiries and have refused to provide information directly upon request, instead referring inquiries to the NRMSIRs.

Industry participants also have raised concerns about the ability to access secondary market information in a timely and cost effective way. To the extent that information is available only through the NRMSIRs, investors and analysts complain that they are forced to pay for disclosure and the necessary disclosure is difficult to find. Moreover, many participants believe that documents contained in different NRMSIRs are not the same and market participants cannot easily track whether issuers are complying with continuing disclosure requirements.

Recently, The Bond Market Association’s (TBMA) Municipal Credit Research Committee wrote a letter to the GFOA, the National Association of Bond Lawyers (NABL), and the National Association of Independent Financial Advisors (NAIFA) raising a concern about issuers who fail to comply with their continuing disclosure agreements. The TBMA letter notes that these failures have made it difficult for underwriters to bid on the securities of these issuers in the primary and secondary markets.^[24]

Given these concerns, there have been a number of voluntary industry efforts to help standardize and expand upon continuing disclosure. For example, the GFOA has published a recommended best practices paper regarding issuer investor relations program.^[25] Also, as noted previously in connection with primary market disclosure, the NFMA has published Best Practices in Disclosure papers in a number of market sectors, and more are planned. These papers recommend more standardized annual and quarterly financial information by issuers.^[26]

Recently, NABL released a paper for use by its members in counseling clients regarding voluntary secondary market disclosure.^[27] The MSRB agrees with NABL’s conclusion that providing information more frequently, providing information directly to investors, and responding to investor inquiries may very likely have financial advantages for issuers and improve investor relationships.

In connection with the format of continuing disclosure, the TBMA's Task Force on Electronic Information Delivery issued a comprehensive report and recommended that issuers make their disclosure documents available electronically to the public.^[28] This report and the above-noted efforts by GFOA, NFMA, and NABL are excellent contributions to the municipal securities industry's efforts to develop voluntary improvements to secondary market disclosure practices.

The MSRB is also working to improve mechanisms for the dissemination of voluntary secondary market disclosure. In May 1999, the MSRB and the National Council of State Housing Agencies (NCSHA) announced the implementation of a test program for the electronic submission and dissemination of continuing disclosure information, including quarterly financial information. The MSRB joined with the NCSHA and certain housing finance agencies ("HFAs") to test a mechanism through which electronic disclosure can be provided to the market. The test program ("CDINet Web Test") currently allows certain HFAs to submit financial reports and material event notices in Microsoft Word and Excel formats, as well as in ASCII text format, to the MSRB's CDINet Web Test through the use of a Web browser with a connection to the Internet. The MSRB forwards the test information electronically to recipients that have agreed to participate as subscribers to CDINet Web Test.

It was the MSRB's hope that the CDINet Web Test would illustrate a potential mechanism to improve the efficiency of information flows for secondary market information, especially voluntarily prepared quarterly financial information. While the HFAs participating in the program have stated that the system is very easy for them to use and is an important first step towards getting acceptance of electronic transmissions of continuing disclosure information, there has been limited use of the CDINet Web Test by analysts and investors. Over the last year the MSRB has been considering ways to revise the CDINet Web Test to further promote electronic dissemination of disclosure information. The MSRB hopes that this will result in faster dissemination of such information in a format that is easier to use by market participants.

IV. MSRB Proposals to Improve Disclosure

The problems described in the section above suggest that, notwithstanding significant progress, disclosure still has not reached an optimum level in the municipal securities market. The MSRB believes that additional improvements in disclosure would strengthen the municipal securities market and benefit issuers, investors and dealers.

The specific kinds of improvements in disclosure that can be achieved are limited to a large extent by the existing legal and regulatory framework. As noted above, the MSRB is not empowered to mandate production of disclosure documents by issuers either directly or indirectly through dealer regulation. Similarly, it cannot mandate standards for the timing, format or content of issuer disclosure documents that are produced. SEC Rule 15c2-12 – the primary regulatory mechanism now in place to ensure timely production of disclosure documents – is itself an indirect attempt to secure disclosure, applying by its explicit terms only to dealers.

Given these considerations, the MSRB believes the most practical means to bring about improvements in disclosure are voluntary initiatives. It thus intends to work within the existing framework to facilitate voluntary market initiatives designed to make disclosure documents more timely and more useful. The MSRB will continue to review its rules and the information facilities it operates to determine how they may be changed or augmented to bring about more efficient and widespread dissemination of disclosure information. Also, the MSRB hopes to work with NRMSIRs on the creation of a central index of

disclosure documents. Finally, the MSRB plans to work with intermediaries involved in the dissemination of summary information to help ensure that those systems are providing the kind of complete and accurate information needed by dealers to comply with MSRB customer protection rules.

A. Facilitate agreement between issuers and investors on standards for content and format of disclosure

With respect to primary and secondary market disclosure practices, the MSRB continues to support the NFMA's efforts to develop sector-based recommended best practices. The MSRB's upcoming Disclosure Forum will explore the importance of timely and thorough disclosure in the market in light of these initiatives. The MSRB has invited panelists from a variety of marketplace perspectives to discuss the information needs of market participants and the benefits to issuers of providing better disclosure.

B. Encourage dissemination of documents

i. Primary market

The MSRB continues to believe that customer access to the official statement by settlement, as required under rule G-32, is a crucial customer protection concept. However, the MSRB also believes that, in many respects, the obligation to provide disclosure of all material facts concerning a transaction with a customer at the time of trade, as required under rule G-17, is even more crucial.

In this regard, the MSRB previously sought comment on whether, given the existing statutory limits, any alternative disclosure dissemination systems could provide for more efficient and timely delivery of disclosure materials to customers.^[29] For example, the MSRB noted that it could provide an alternative to the existing requirement under rule G-32 that dealers deliver final official statements to customers purchasing new issue municipal securities by settlement. Such alternative for dealer compliance with rule G-32 could include dealers: (1) delivering preliminary official statements to customers by the time they make their investment decisions and (2) providing information to customers prior to or simultaneously with receiving any confirmation requesting payment as to where they may acquire final official statements free of charge by settlement of their transactions.^[30]

Further, it may be possible for the MSRB to encourage more timely dissemination of preliminary official statements by providing interpretive guidance that would, subject to certain conditions, recognize timely delivery of the preliminary official statement, together with relevant pricing information, as fully satisfying the obligation under rule G-17 to disclose all material information regarding a transaction. The MSRB has not yet fully analyzed whether such an approach would be workable and recognizes that such interpretive guidance may necessarily hinge upon the substance of disclosure contained in the preliminary official statement, whether any material information in the preliminary official statement has changed and a determination of whether the time of trade or some other point in the transaction would be the appropriate measure of timeliness.

The MSRB is considering whether either of these proposals would improve the dissemination of primary market disclosure documents.

ii. Secondary market

As demonstrated by the CDINet Web Test, the MSRB believes that significant advances in secondary market disclosure could be achieved with increased use of electronic dissemination of disclosure documents. However, the current version of the CDINet Web Test functions purely as a pass-through

system. The MSRB receives electronic submissions from issuers, asks issuers to fill out a cover sheet that is attached to the submissions, and electronically forwards the submissions to subscribers.

The MSRB has determined to adopt several suggestions from users for changes to the CDI Net Web Test. Specifically, the MSRB plans to open the system up to accept interim financial information from issuers in areas where the NFMA has finalized Disclosure Best Practices (e.g., land-secured and hospital issuers). The MSRB also plans to enhance the system to include a more user-friendly database search feature to help find relevant documents. By expanding the CDINet Web Test in this way, the MSRB hopes that more issuers will be encouraged to provide voluntary periodic financial and operational disclosure electronically to the market and that investors will support this effort.¹³¹

C. Central Index of Disclosure Documents

Whether or not documents are provided by issuers electronically, the market benefits to be garnered by disclosure cannot be achieved unless the information can be discovered and accessed by those persons needing it. The MSRB believes that a comprehensive index of disclosure documents – showing the user specifically what documents are available and where they can be obtained – would be an important improvement in the market. Under the regulatory structure of SEC Rule 15c2-12, NRMSIRs serve a critical role in the dissemination of disclosure information for both primary and secondary market documents. With the cooperation of NRMSIRs, the MSRB believes that it would be possible for it to develop an index that would: (i) help each NRMSIR to maintain a complete collection of documents; (ii) make it easier for market participants to see what documents are available and to gain access to the documents; and (iii) retain the primary role of NRMSIRs as intermediaries for dissemination of municipal securities disclosure documents.

i. Role of NRMSIRs

Rule 15c2-12 contemplates that NRMSIRs will be among the primary resources utilized by dealers to obtain information about issuers and their securities. The critical role of NRMSIRs is underscored by the fact that dealers need disclosure information from NRMSIRs to comply with MSRB customer protection rules and for accurate pricing of transactions. Investors, investment advisors, and buy-side analysts, all of whom need disclosure documents to evaluate holdings and proposed transactions, also need NRMSIRs to obtain necessary information. Finally, the advent of electronic trading systems – and the possibility of investors effecting transactions in such systems without the assistance of dealer personnel – increases the importance of centralized information facilities. Such on-line investors cannot be presumed to know how to obtain documents directly from issuers and, in any event, not all issuers provide on-line disclosure documents. It would seem that a mechanism to direct such investors to NRMSIRs would offer the most reliable and efficient means for such investors to access documents.

ii. Need for Comprehensive Collections of Documents

There has been some discussion in the industry about NRMSIRs and their role in dissemination of disclosure documents since the 1995 secondary market amendments to Rule 15c2-12. The intent of Rule 15c2-12 is that each NRMSIR will have a comprehensive collection of the annual reports and material events notices mandated (albeit indirectly) by the Rule. However, commentators have suggested that this has not actually turned out to be the case. Dealers, in particular, have concerns that by accessing only one NRMSIR to check for documents, a document may be missed that would have affected pricing or suitability decisions or that would have required additional disclosure to a customer.

Several factors could explain why lists of disclosure documents at various NRMSIRs are different and why the collections do not contain all of the disclosure documents contemplated by Rule 15c2-12. For secondary market documents, the completeness of NRMSIR collections is dependent upon issuers or their representatives sending the documents to each NRMSIR.¹³²¹ Further, in the years since Rule 15c2-12 was amended, the identity and number of NRMSIRs have changed several times. Issuers may not always keep apprised of changes in the NRMSIR list, or personnel changes or other factors may lead to an unintentional oversight in issuers sending documents to each NRMSIR. In addition, Rule 15c2-12 contains exemptions for certain types of issues, which could explain why sometimes only one NRMSIR obtains a specific document voluntarily provided by an issuer.

It is difficult to know the extent to which NRMSIR collections may be incomplete. As noted previously, the TBMA Municipal Credit Research Committee believes that there has been an increase in the number of issuers who are failing to meet the continuing disclosure undertakings required by Rule 15c2-12.¹³³¹ The MSRB also is concerned that there may be significant discrepancies in the lists of documents available at any given time by the various NRMSIRs. This leaves dealers with an awkward and potentially expensive decision as to whether they need to subscribe to the services of multiple NRMSIRs just to be assured of having access to all required documents. However, without a central list of all documents that have been received by any NRMSIR, it is difficult to accurately assess the situation.

iii. Need for Central Index

The MSRB believes that the most practical way of improving the current situation is to work with NRMSIRs to create a central index of NRMSIR documents. Such an index would be web-based and free. It would provide a listing, updated each day, of all documents in each NRMSIR and at the MSRB and would provide a common identifier for each document. The listing of documents could also describe whether the documents are available electronically, and if so, in which form (*e.g.*, html, PDF, etc). The index would allow the user to see at a glance which documents are available, where they are available and in what form. The web-based index also would provide a web hyperlink for the user to directly contact any NRMSIR from which it wishes to obtain the document.

A central index could provide benefits to NRMSIRs as well as market participants. By participating in the central index program, NRMSIRs would be able to track their collections of documents against those of the MSRB and other NRMSIRs and assure that their collections are complete. Upon discovering that it is missing a document, a NRMSIR could take appropriate action, such as calling the issuer or trustee, to obtain the document. Since a central index user would literally be a mouse click away from the NRMSIR and its gateway for accepting document orders, the central index could provide additional orders for documents from persons who today may not be familiar with NRMSIR document services. The benefits to market participants would be even greater, since the index would allow them for the first time to be sure that they were seeing all documents required by Rule 15c2-12 that had been sent to any NRMSIR or to the MSRB. Users also should benefit in that NRMSIRs presumably will compete to meet user needs based on price, format of documents (*e.g.*, paper documents vs. imaged form) or other value-added services associated with document dissemination.

The idea of a central index of disclosure documents, of course, is not new. The MSRB's comment letter on the 1995 amendments to Rule 15c2-12 suggested that such an index be included within the structure of the Rule. The SEC declined to do this in favor of the current structure, which assumes that each

NRMSIR will receive each document from each issuer. Subsequently, the TBMA's Task Force on Electronic Information Delivery worked on a central index idea – called the Agora index. As noted in the September 2000 Final Report of the Task Force, the idea is not commercially feasible and is not at this time being pursued.^[34]

Although previous efforts to bring about a central index have not been successful, the MSRB believes that the improvements it would bring are substantial and would be worth the expenditure of MSRB resources. The MSRB is aware that previous efforts at constructing a central index may have failed in part because of concerns by NRMSIRs that the manager of the central index would be a profit-making entity and potentially would compete with NRMSIRs or in some manner competitively disadvantage the NRMSIRs. The MSRB may be better positioned to act as a neutral party among competing NRMSIRs in the creation of a central index. The MSRB's overall philosophy in the area of information systems has been to act only when critical information needs in the market are not being met and to do so without competitively disadvantaging private information vendors. The MSRB's information facilities – the MSIL system and Transaction Reporting System – demonstrate this philosophy. The MSRB believes these systems have operated to the benefit of the municipal securities market, without competitively disadvantaging any NRMSIR or information vendor. The MSRB also believes that a central index project can operate on this same basis.

The MSRB is currently discussing with NRMSIRs how best to conduct a feasibility assessment of a central indexing project. The details of such a system have yet to be worked out. The first step in this process, however, is for NRMSIRs and the MSRB to exchange document lists for a sample period. A study of these document lists should allow the scope of any discrepancies to be accurately assessed and should suggest a design approach for the index. At this time, it appears that it will be necessary for NRMSIRs and the MSRB to adopt a common document naming convention that will allow automated matching of document lists each day among NRMSIRs and the MSRB. The MSRB believes that a central index of disclosure information in the municipal securities market will greatly improve access to such information and it looks forward to working with the NRMSIRs on this important project.

D. Formatted Descriptive/Evaluative Information

Although issuer disclosure documents are the primary source material for disclosure information, summary descriptive and evaluative information produced by information vendors also plays a major role in the dissemination of information about municipal securities. Dealers generally obtain summary descriptive and evaluative information from information vendors in electronic format. Several vendors offer such services, which contain information culled by the vendors from official disclosure documents and other sources. The electronic formatting of the data by the vendors allows dealers and other market participants to use the information in a variety of automated systems. These range from those providing the electronic screens used by trading and sales staff to those generating confirmations and periodic account statements. In addition to the descriptive data culled from disclosure documents, these services also generally include other important evaluative data such as ratings from nationally recognized statistical rating organizations (NRSROs) or price evaluations done by the vendor.

Dozens of items or “fields” of information may be provided by an information vendor with respect to a single issue of municipal securities. In addition to basic information obtained from the official statement such as interest rate, maturity date, call features, and a description of the credit, the formatted data generally include secondary market information such as the date and price of advance refundings and descriptions and dates of material event notices. Formatted descriptive and evaluative data are important

to dealers for a variety of business and regulatory reasons. Evaluative information such as ratings are used extensively by dealers to assist in judging the credit quality and price of issues. Descriptive data are frequently used by dealers to meet disclosure, suitability and pricing obligations to customers because they provide the quickest route for gaining relevant information in a fast-paced trading environment. As electronic trading systems become more common and customers trade directly through those systems, it is likely that customers increasingly will access formatted information from information vendors, either directly from the vendor or indirectly through a dealer's database which includes a vendor's information.

The MSRB is aware of concerns in the industry, primarily in the dealer community, that the formatted data from information vendors may not always be complete and accurate. For example, information services do not always agree even on the basic descriptive elements such as dated date, coupon or call features. Dealers are subject to potential liability if important disclosure information provided to customers is wrong and this understandably creates a concern and a desire to ensure that the data given to customers from the information vendors is as accurate as possible. Some dealers subscribe to multiple information services just so that data from each can be cross-checked to help flag potential inaccuracies.

One ongoing project within the MSRB's Transaction Reporting System may be of assistance to dealers in spotting potential problems with certain kinds of formatted data. Each day, the MSRB receives a report of each transaction, which report usually includes both dollar price and yield. To assist dealers in submitting accurate prices and yield, the MSRB cross-checks most of the submitted price/yield calculations to spot potential problems with the transaction data. When such a cross-check indicates a discrepancy in dollar price calculated from yield, it is usually the result of problems with descriptive data such as dated date, maturity date, call dates, call prices, prerefunding information, day count methodology for the issue, etc. This cross-checking process helps the MSRB and dealers spot potential problems with certain descriptive information contained in formatted data and should provide at least some degree of improvement over time as the discovered problems are reported to information vendors and their databases are corrected.

The MSRB understands that other industry efforts also may be under consideration to evaluate the problem of inconsistent formatted data and to consider a solution that would benefit the industry and also be acceptable to information vendors. The MSRB will monitor any such efforts and will offer its assistance if and when such programs are announced.

V. Conclusion

The MSRB hopes that its discussion of disclosure issues and proposals for improvement will energize an already committed and dedicated community of issuers, dealers and investors to come together and work toward improvements in disclosure in the municipal securities market.

December 21, 2000

^[1] This figure represents state and local governments and authorities recorded by the U.S. Census Bureau.

^[2] Source: Federal Reserve Board, Flow of Funds Accounts, Flows and Outstandings, Fourth Quarter 1999. Other major investor types include property and casualty insurance companies which held \$208.9 billion and commercial banks which held \$110.7 billion.

- ^[3] Municipal Securities Information Library and MSIL are registered trademarks of the MSRB.
- ^[4] Trustees, financial advisors, bond and underwriter's counsel, investment advisors and information vendors also help shape the disclosure process and the discussions about it. However, from the perspective of disclosure, each of these market professionals generally is aligned with the parties involved in issuing, investing, or dealing in municipal securities.
- ^[5] See Exchange Act Release No. 26100 (Sept. 22, 1988), 53 FR 37778; Exchange Act Rel. No. 26985 (June 28, 1989), 54 FR 28799.
- ^[6] See Exchange Act Release No. 26100 (Sept. 22, 1988), 53 FR 37778.
- ^[7] See Securities Act Release No. 7049 (Mar. 9, 1994), 59 FR 12759
- ^[8] Rule G-32 obligates dealers selling virtually all new issue municipal securities to deliver the official statement in final form, if one has been prepared, to customers by settlement.
- ^[9] See, e.g. Rule G-17 Interpretative Notice – Disclosure of Call Information to Customers of Municipal Securities, March 4, 1986, *MSRB Rule Book* (July 1, 2000) at p. 122.
- ^[10] See “Letter to SEC on Information in the Municipal Securities Market,” *MSRB Reports*, Vol. 8, No. 1 (January 1988) at 7.
- ^[11] Primary offerings exempted from Rule 15c2-12 consist of issues having an aggregate principal amount under \$1,000,000 (“Small Issue Offerings”), as well as three specific types of offerings if sold in authorized denominations of at least \$100,000: (i) issues maturing in nine months or less (“Short Term Offerings”); (ii) issues that allow the holders to tender the securities to the issuer for redemption or purchase at par or more at least as frequently as every nine months (“Puttable Offerings”); and (iii) issues sold to no more than 35 persons with knowledge and experience in financial and business matters, capable of evaluating the merits and risks of the investment and not purchasing for more than one account or with a view to distribution (“Limited Offerings”).
- ^[12] This incentive takes the form of reducing the period during which an underwriter must send the official statement to any potential customer requesting a copy by up to 65 days if a copy of the official statement is available from a NRMSIR. See Rule 15c2-12(b)(4).
- ^[13] Rule G-36 requires an underwriter of a Small Issue Offering, Short Term Offering or Puttable Offering for which the issuer has prepared an official statement to send the official statement to the MSRB, even though these offerings are exempted from the requirements of Rule 15c2-12. Only Limited Offerings are exempted from both Rule 15c2-12 and rule G-36.
- ^[14] Rule 15c2-12 does not provide for submission of advance refunding documents to NRMSIRs.
- ^[15] See Rule G-32 Interpretation - Electronic Delivery and Receipt of Information by Brokers, Dealers and Municipal Securities Dealers, November 20, 1998, *MSRB Rule Book* (July 1, 2000) at 157.
- ^[16] See “Electronic Submission of Official Statements, Advance Refunding Documents and Forms

G-36(OS) and G-36(ARD) to the MSRB,” *MSRB Reports*, Vol. 20, No. 2 (November 2000) at 17.

^[17] See “Official Statement Deliveries Under Rules G-32 and G-36 and Exchange Act Rule 15c2-12,” *MSRB Reports*, Vol. 19, No. 3 (September 1999) at 29.

^[18] Rule G-36(b)(i) requires an underwriter in an offering subject to Rule 15c2-12 to send the official statement to the MSRB within one business day of receipt from the issuer but no later than 10 business days after the final agreement to purchase, offer or sell the issue.

^[19] At that time, rule G-36(c)(i) required an underwriter of a Small Issue Offering, Short Term Offering or Puttable Offering to send the official statement to the MSRB within one business day after the closing of the underwriting. Largely as a result of this finding, the MSRB amended the timeframe for the submission of official statements for such offerings to the later of (i) one business day after the closing of the underwriting or (ii) one business day after receipt of the official statement from the issuer. See “Amendment Approved Relating to Official Statement Submissions to MSRB under Rule G-36(c)(i),” *MSRB Reports*, Vol. 20, No. 2 (November 2000) at 37.

^[20] Information about NRMSIRs is available from the SEC on the Internet at www.sec.gov/consumer/nrmsir.htm.

^[21] See e.g., “From the Chairman,” *MSRB Reports*, Vol. 8, No. 5 (December 1988) at 2; “Board’s Comment Letter on SEC Releases Concerning Municipal Securities Disclosure,” *MSRB Reports*, Vol. 14, No. 4 (August 1994), at 37.

^[22] See “Continuing Disclosure Information Pilot System,” *MSRB Reports*, Vol. 12, No. 1 (April 1992) at 3.

^[23] See Exchange Act Release No. 38066 (December 19, 1996). See also “CDI System Approval,” *MSRB Reports*, Vol. 17, No. 2 (June 1997) at 25.

^[24] The TBMA letter is available on the Internet at www.bondmarkets.com/regulatory/failure_to_provide_continuing-disclosure.pdf.

^[25] See “Debt Management – Maintaining an Investor Relations Program,” available on the Internet at www.gfoa.org.

^[26] The NFMA’s Recommended Best Practices in Disclosure papers are available on the Internet at www.nfma.org.

^[27] “Providing Information in the Secondary Market Regarding Municipal Securities” (“NABL paper”) is available on the Internet at www.nabl.org.

^[28] A copy of the TBMA’s Final Report is available on the Internet at www.bondmarkets.com/market/disclosurefinalreport.pdf.

^[29] See “Official Statement Deliveries Under Rules G-32 and G-36 and Exchange Act Rule 15c2-12,” *MSRB Reports*, Vol. 19, No. 3 (September 1999) at 29.

^{130]} In meeting the requirement that the final official statement be available to customers free of charge by settlement, the MSRB would anticipate, but not require, that official statements be made available in electronic form. For example, dealers could rely on individual issuers making their official statements available in electronic form (*e.g.*, by posting on the issuer's Internet website), dealers could establish their own electronic libraries in connection with issues they underwrite or trade, or dealers could use one or more existing or new centralized repositories designed to make official statements quickly and easily accessible without charge to investors.

^{131]} The MSRB notes that by providing the voluntary quarterly financial information to the market through the MSRB's web site, issuers may be able to avoid many of the potentially thorny "republication" issues that accompany the posting of financial information on an issuer's own web site. *See e.g.*, NABL paper at pp. 6-7.

^{132]} There is relatively little concern expressed over missing official statements at NRMSIRs. This is probably due in large measure to the fact that NRMSIRs subscribe to the MSRB's MSIL system to ensure the completeness of their collections.

^{133]} *See* note 24 above.

^{134]} *See* note 28 above.

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