

## COMMENT LETTER

November 13, 2001

# Comment Letter on Disclosure in the Municipal Securities Markets, November 2001

November 12, 2001

Ms. Martha M. Haines  
Director  
Office of Municipal Securities  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: Disclosure Issues in the Secondary Market

Dear Ms. Haines:

The Investment Company Institute<sup>1</sup> is pleased to learn that your office is currently reviewing disclosure issues in the secondary market, and that this will be the subject of a panel discussion at the Commission's upcoming Municipal Market Roundtable. As we discussed when we met with you and your staff last spring, secondary market disclosure regarding municipal securities is woefully inadequate. We urge the Commission to take appropriate action to improve this disclosure. The purpose of this letter is to reiterate the Institute's views on this matter, and to provide a platform for further discussions.

There are more than 1,100 tax-exempt mutual funds, which in the aggregate hold almost 35% of outstanding municipal securities. As active participants in the municipal securities markets, our members are keenly interested in having timely access to relevant and reliable information relating to municipal securities offerings. This is particularly important to mutual funds because of their statutory obligation to price their portfolios daily. There are several issues related to secondary market disclosure that are of primary concern to our members, including issues related to: (1) Rule 15c2-12 under the Securities Exchange Act of 1934 (Exchange Act); (2) the Nationally Recognized Municipal Securities Information Repository (NRMSIR) system; and (3) issuer communications with security holders.

## I. Exchange Act Rule 15c2-12

As you are aware, our members have experienced significant frustration in obtaining important information on municipal securities. Specifically, our members have had, and

continue to have, difficulty in obtaining information in the secondary market that is timely and adequate.<sup>2</sup> We believe that this could be significantly improved if Rule 15c2-12 were modified in the following respects.

### **a. Short-Term Exemption**

The Institute recommends that the scope of the exemption for short-term instruments (i.e., those having a maturity of nine months or less) in Rule 15c2-12(d)(1)(ii) be amended so that it is only available to securities that have a final maturity of less than nine months, including all prior rollovers and refunds. Although the original purpose of the exemption was to remove from the reporting requirements under the rule those instruments that were limited in maturity, we note that many of the instruments that rely on this exemption are actually long-term instruments. These instruments include, for example, bonds with put options (typically, tender option bonds and variable rate demand obligations or VRDOs), and certain types of commercial paper (e.g., multi-modal commercial paper with long-term final maturities) that roll over at specified intervals (e.g., 90 days) and thus could be outstanding for a number of years. From the time of the original issuance of these securities until their true final maturity, many changes can, and often do, occur in the structure and credit quality of the instrument that are not being disclosed to the market in reliance on this exemption. In some instances, changes such as substitution of the credit facility, changes in ownership or control of the borrower, and material credit or tax events, have occurred. This information is critical to mutual funds, particularly money market funds, the traditional purchasers of VRDOs, to adequately monitor their portfolio securities. Consequently, money market funds are required to undertake significant efforts to obtain the necessary information or forego buying the instrument.

### **b. Material Events**

The notice of material events provision in Rule 15c2-12(b)(5)(i)(C) should be modified to more fully reflect the types of events that are material to today's investors. Since the rule was adopted, our members have identified events in addition to those specifically identified in the rule that can have a material adverse effect on their investments.

We understand that the Commission had intended for the list of material events set forth in the rule to constitute minimum disclosure requirements, and that investors would add to the list other events in the context of negotiating a particular transaction. That is simply not happening, primarily because investors lack the bargaining power and the opportunity to negotiate for additional items, particularly given the very short time frames for responding to bond offerings when they come to market. As a result, the material events listed in the rule have become the only ones disclosed in nearly every transaction. To better enhance the level of disclosure in this area, and make it more on par with that required of corporate issuers,<sup>3</sup> the Institute suggests modifying the rule to include the following events:

### **c. Frequency of Disclosure**

The Institute recommends that issuer financial information be provided more frequently than is currently required under the rule. Information about municipal securities issuers is currently only required to be provided annually, in contrast to corporate issuers, which are subject to quarterly reporting requirements. We note that the financial status of an issuer can change materially during the course of a year. Consequently, failure to make interim financial information available deprives investors of the opportunity to react in a timely manner to any such changes. Moreover, the rule does not provide any outside deadline for the disclosure of financial information, thus leaving the timing of the disclosure completely up to the issuer, which can occur anywhere from three months up to twelve months, or

even longer, following the end of a fiscal year. As a result, investors are provided financial information that is often stale upon receipt. The Institute therefore believes that the rule should be modified to provide for more frequent reporting of financial information, including, for example, quarterly reporting for certain sectors, and annual audit disclosure within 180 days of the end of an issuer's fiscal year.

## **II. The NRMSIR System**

Our members' experience with the NRMSIR system is that it is inefficient and ineffective, and does not meet the needs of municipal securities investors. In particular, our members are discouraged by the lack of centralization and organization of materials. They are also concerned that the same disclosure documents and material events notices are not always posted by all four NRMSIRs. Moreover, retrieving information from the NRMSIRs is often time-consuming and costly.

Clearly, appropriate steps are needed to improve the quality of information provided to and by the NRMSIRs. Such steps could include, for example, encouraging greater use of CUSIP numbers, providing ways to enable investors to access financial information within reasonable time limits after the end of the applicable reporting period and, most importantly, developing a workable, centralized system for accessing available public information about municipal securities, free of charge. Any such initiative would greatly facilitate the timely dissemination of important information, which would not only serve to enhance secondary market transparency but also provide greater market efficiency and liquidity, particularly in times of stress (e.g., when an issuer experiences financial difficulty).

## **III. Issuer Communications With Security Holders**

The Institute notes that implementing effective disclosure initiatives should include efforts to encourage issuers to communicate more freely with security holders. It has been noted by our members that, ironically, since the adoption of the rule, there has been a distinct shift away from the availability of timely information to investors, as issuers have come to view the rule as limiting what information they are required to provide, rather than looking at the rule as a base line minimum requirement. In fact, we understand from our members that sometimes issuers cite concerns about liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder to avoid providing information to investors. Apparently, these concerns have increased since the adoption of Regulation FD, even though Regulation FD does not apply to municipal securities issuers. To address these concerns, we note that in the past, you and your staff have participated in town meetings with issuers to dispel concerns about insider trading in the municipal securities market and to encourage a freer flow of information between issuers and the market. The Institute applauds such efforts and encourages the staff to continue to develop ways to foster better communication between issuers and security holders.

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The Institute appreciates the staff's consideration of our views on these important issues. We look forward to working with you in a continuing effort to improve disclosure in the municipal securities market. If you have any questions, or would like additional information, please feel free to contact me at (202) 326-5824, or Barry E. Simmons at (202) 326-5923.

Sincerely,

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#### **ENDNOTES**

[1](#) The Investment Company Institute is the national association of the American investment company industry. Its membership includes 9,108 open-end investment companies ("mutual funds"), 487 closed-end investment companies and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.396 trillion, accounting for approximately 95% of total industry assets, and over 88.6 million individual shareholders.

[2](#) Although not a focus of this letter, the Institute believes that the current state of disclosure in the primary market also could be improved. We note, for example, that there is room for improvement regarding the level of disclosure contained in preliminary official statements, and that the expanded use of technology could be better tailored for the municipal securities market to facilitate the communication of offering materials. We encourage the staff to consider these and other related issues as it pursues its disclosure initiatives.

[3](#) Corporate issuers, for example, are required to disclose on SEC Form 8-K the occurrence of certain events specified in the form. The filing of the form must occur within five or fifteen days after the event occurs, depending on the event.