Richmond Journal of Global Law & Business

Volume 2 | Issue 1 Article 2

2001

Building a Strong Subnational Debt Market

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FOREWORD

The *Richmond Journal of Global Law and Business* is proud to present its Fall 2001 issue. Founded in the Fall of 1998, the *Journal* functions as the student complement to the Center for Global Law and Business at the University of Richmond School of Law. The *Journal* features articles on international law and business topics by leading scholars and practitioners as well as notes and case comments written by *Journal* members.

On October 5, 2001, the *Richmond Journal of Global Law and Business* sponsored and hosted a symposium entitled "The Changing Labor Markets of the Western Hemisphere: Labor Issues Relating to the Free Trade Areas of the Americas (FTAA)." In the following issue of the *Journal*, we are pleased to present the papers resulting from that symposium. The *Journal* believes this topic to be of current significance in today's global economy and that the articles provide insight on this issue not found elsewhere.

The *Journal* would like to thank Professor Ann C. Hodges, Richard W. Fisher, Professor Maurizio Del Conte, Professor Don M. Mitchell, Professor Jonathan B. Wight, Terry Collingsworth, F. Amanda DeBusk, Dr. Thomas I. Palley, and Michael S. Plotkin for contributing to this issue. We appreciate the considerable time and energy these authors took to write such excellent articles as well as their patience with our editorial process. We also would like to thank Dean John R. Pagan and our faculty advisor, Professor Daniel T. Murphy. Their support has enabled the *Journal* to continue to grow and develop into the publication you see today. Finally, the *Journal* would like to extend its gratitude to its Staff and Editorial Board Members for their commitment to the success of this issue.

The Editorial Board

BUILDING A STRONG SUBNATIONAL DEBT MARKET A REGULATOR'S PERSPECTIVE

Paul S. Maco*

I. Introduction

Decentralization of responsibility for finance and growing infrastructure needs are two trends that are expected to stimulate a growth in government borrowing at the subnational level.[1] Statistics for the first half of 2000 show a significant increase in subnational debt volume, with global public finance, excluding Canada and the United States, more than doubling that of the first half of 1999.[2] Donor organizations such as the World Bank have focused their

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* Partner, Vinson & Elkins, LLP, Washington, D.C. This article was prepared by the author while he was Director of the Office of Municipal Securities, the U.S. Securities and Exchange Commission. The content of this article was utilized at the NIS/CEE Conference at the U.S. Securities and Exchange Commission headquarters in Washington, D.C. on July 17-21, 2000. The opinions expressed in this work are those of the author and do not necessarily represent the views of the U.S. Securities and Exchange Commission or other members of the Commission staff. The author is a faculty member of the Morin Center for Banking Law at Boston University School of Law, where he teaches Federal Securities Regulation. Portions of this text are derived from a previous work of the author, Regulation of Municipal Securities Transactions Under U.S. Federal Securities Law: Providing A Framework for Investor Protection, published as Chapter 9 of Little, Parry and Taylor, Bond Markets: Law and Regulation, Sweet & Maxwell, London, 1999 and upon a paper delivered by the author at Building Subnational Debt Markets in Developing and Transition Countries, a seminar of the World Bank Institute and Finance, Private Sector and Infrastructure Network of the World Bank, in Washington, D.C., April 4-6, 2000.

[1] *See Subnational Governments: A Rating Agency Perspective*, MOODY'S INVESTORS SERVICE, July 1998, at 4; *Local and Regional Government 2000*, STANDARD & POOR'S, Mar. 2000, at 21. The term "Subnational" refers to those entities subordinate to the national government, including states, regions, provinces, cities, towns, localities and authorities and the enterprises they own. "Municipal" is the term commonly used in the United States when speaking of such entities as issuers of debt, and will be used in this paper when referring to the United States. Thus, the term "municipalities" is used to include the variety of non-federal, government entities in the United States with the power to issue municipal securities, ranging from states, counties and cities to authorities, agencies and special districts. The terms "municipal bonds" and "municipal securities" are used throughout this text to include the variety of contractual structures ranging from simple debt to certificates of interests in pools of lease agreements used by state and local governments in the United States as funding mechanisms.

[2] Darrell Preston, *Global Public Finance Booms While U.S. Market Swoons*, THE BOND BUYER, July 11, 2000, at 7, *available at* 2000 WL 23695991. ("If current volume levels continue through the rest of this year, the market could be on a course to handle $30 billion of international non-sovereign debt, far outstripping the previous largest volume year of 1995, when volume totaled $22.23 billion.").

energies on encouraging the growth of subnational markets and for the last several years, the U.S. Securities and Exchange Commission (the "SEC") has included a component on municipal bond market regulation as part of its annual International Institute for Securities Market Development.

State and local governments in the United States have used the capital markets to finance their funding needs for over two hundred years. United States municipal bonds have financed everything from the Erie Canal to Cleveland's Rock and Roll Hall of Fame. Today, the U.S. municipal bond market is the largest domestic subnational debt market. Eighteenth century issues by Massachusetts and other colonies "provided the seed bed for the broader capital market that emerged in the last decade of the century."[3] Both success and scandal characterize these two centuries of U.S. public finance, from the early nineteenth century, when bonds financed the westward expansion of and fueled the industrial revolution in the then "emerging market" of the United States. Furthermore, defaults in railroad aid bonds gave rise to the institution of bond counsel, to "bond daddies," the multi-billion dollar default of the Washington Public Power Supply System and the recent collapse of the Orange County Investment Pools in the late twentieth century. In addition to the use of general credit by subnational issuers, the U.S. municipal market has fostered the development and growth of the revenue bond, which serves as the mainstay for modern public infrastructure development, as well as bond pools, derivatives and securitization.

A healthy municipal bond market is important to the U.S. economy. It finances the roads, water, and schools of U.S. communities, together with myriad other facilities. Modernization of the U.S. municipal bond market has been a priority for the SEC, which five years ago created a new office to coordinate the efforts, the Office of Municipal Securities.

This paper will discuss the overall goals regulating the subnational debt markets, the history of the U.S. municipal bond market, the growth of the U.S. municipal bond market, federal regulation of the issuance and trading of subnational securities and will conclude with several observations from the perspective of a market regulator.

II. Overall Goals of Regulation of Subnational Debt Markets

A. Background

Why regulate subnational debt markets? The answer to this question may have particular variations based upon the national experience and ambitions of a country and its people, but common principles form the core of the response. These principles are the same as those that motivate a decision to

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[3] EDWARD J. PERKINS, AMERICAN PUBLIC FINANCE AND FINANCIAL SERVICES 1700-1815, at 4 (1994).

regulate securities markets generally. Prevention of fraudulent activity in the sale of securities and unscrupulous practices by brokers are common and ancient themes. The late Professor Loss, a pre-eminent scholar of securities regulation, cites to a statute of Edward I, from 1285, authorizing the Court of Aldermen to license brokers in the city of London and efforts to regulate practices that follow upon scandals through the ages, such as the "Bubble Act" of 1720.[4] With respect to public debt, Stuart Banner observes that Exchange Alley in eighteenth century London was the focal point in transactions involving shares of the public debt as well as corporate stock (noting that the term "stock" referred to both) and that early efforts at regulation covered both.[5]

The October 1929 crash of the stock market in the United States stimulated a succession of Congressional inquiries into the activities of participants in the U.S. securities markets. The abuses chronicled in those hearings and in the media provided Congress and the Roosevelt administration with sufficient justification to enact national legislation regulating securities offerings, dealers and markets.[6] Congress framed the goals of these statutes in the opening paragraphs of this new legislation. The Securities Act of 1933 (the "Securities Act") was adopted to "provide full and fair disclosure of the character of securities sold . . . and to prevent fraud in the sale thereof." The Securities Exchange Act of 1934 (the "Exchange Act") was adopted to "provide for the regulation of securities exchanges and of over-the-counter markets . . . , to prevent inequitable and unfair practices on such exchanges and markets." As Congress observed, "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and practices . . . ."[7]

After the precipitous plunge of the '29 crash, the ensuing loss of confidence in securities markets, devaluation, and economic depression, Congress perceived that providing national oversight of the means for capital formation and investment was necessary for the economic and social stability of the country.[8] Providing full and fair disclosure to investors, fair and efficient markets, instilling investor confidence in those markets and assisting the process of capital formation are fundamental reasons to regulate securities and securities markets.

B. Securities Regulation of Subnational Debt Markets

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[4] LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 1-2 (1988).

[5] STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION 24 (1998).

[6] For a comprehensive history of the development of modern federal securities regulation in the U.S., particularly the enactment of the federal securities laws, *see generally* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET (Rev. ed. 1995).

[7] Securities Act of 1933, 15 U.S.C. § 77a, pmbl (1933); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78b (1934).

[8] JENNINGS, MARSH, COFFEE & SELIGMAN, SECURITIES REGULATION 2 (8th ed. 1998).

The approach taken towards securities regulation of subnational debt markets in the United States is described below, including the recent efforts to improve transparency, provide fair and accurate disclosure in the primary and secondary markets, and attempts to deter fraud. One note at the outset: municipal securities are statutorily exempt from the registration and reporting provisions of the federal securities laws. This statutory exemption is as much a product of the federal form of government under the U.S. Constitution and resulting political considerations at the time of adoption of the securities laws, as it is of particular characteristics of municipal securities issuers and investors.

Market participants engaging in transactions in subnational debt are no less likely to engage in unscrupulous behavior because of the nature of their product than their brethren dealing in other securities. The "bond daddies" of the early 1970s clearly illustrate this point.[9] History also provides unfortunate examples of issuers unable or unwilling to repay their securities, from repudiations of railroad bonds in the 1800s to the $2 billion default of the Washington Public Power Supply System. Investors in subnational, or municipal, securities are likewise as interested in fair and efficient markets and full and accurate information upon which to base their investment decisions as are investors in other securities and markets. Subnational governments may reap the same benefits from fair and efficient markets as corporate enterprises, such as ready access to capital. The citizens enjoying the benefit of projects financed in subnational capital markets benefit as well, from the availability of capital financing for the project to the lower costs which capital efficient markets may achieve.

Securities regulation does not exist alone but should be viewed as part of an overall legal system, existing alongside and complemented by established systems of commercial law; bankruptcy and reorganization laws providing for the protection of creditors and the orderly reorganization or dissolution of enterprises as well as the rescheduling of financial obligations; laws establishing property rights and principles of conveyance, including the securing of collateral; and laws governing the validity and enforcement of contracts. As the International Organization of Securities Commissions ("IOSCO") observes, "effective securities regulation depends upon an appropriate legal framework."[10] Securities regulation is greatly assisted by standardized financial reporting, the language of finance, allowing for the accurate identification and communication of an issuer's financial condition.[11] As others have observed, "the availability of high quality, timely and credible financial information is a prerequisite to the development of liquid and deep financial and capital markets, which leads to a lowering of the costs of capital, the possibility of more optimal capital structures, and ultimately

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[9] In the early 1970s, dealers known as "bond daddies" were selling investors often-worthless municipal bonds out of offices in various cities in the American south. *See generally Bond Daddies: The Birth of the Memphis Blues*, INSTITUTIONAL INVESTOR 155, 156 (June 1997).

[10] *Objectives and Principles of Securities Regulation*, Annexure III, IOSCO (1998).

[11] See International Accounting Standards, Release Nos. 33-7801, 34-42430 (Feb. 16, 2000).

higher levels of investment."[12] The integrity of the judicial and administrative system is an essential backdrop for the effective operation of both securities regulation and commercial law. Without "the rule of law," such efforts are essentially hollow.

C. Securities Regulation in the Context of Subnational Debt Markets

To understand the purposes of securities regulation in the context of subnational debt markets, consideration must be given to what securities regulation is not and what it cannot accomplish. Securities law cannot prevent default on a bond, the loss of value of an equitable security, the collapse of a commercial or a public enterprise, or even the financial collapse of a sovereign or subnational government. These are matters covered by budget and fiscal policy, management practices and the risks of a competitive marketplace. An effective system of securities regulation can however, assist investors in understanding and appraising the risks of default, the fair valuation of a security and the financial viability of an enterprise or a government.

As stated, securities regulation will not eliminate fraud, although a statute coupling comprehensive disclosure requirements with strong antifraud provisions and a private right of action in a system possessing an impartial judiciary may serve as a formidable deterrent to fraud. A disclosure-based system of securities law may offer the additional advantage of informing investors of the peculiarities and shortcomings of the commercial legal system, including the ability to enforce legal and contractual rights.

Securities law is not the principal source of rules of corporate governance or investor rights. Those matters are covered by other areas of law and by contract, although, again, an effective system of disclosure will provide investors with information that may be of great assistance in the exercise of their rights. Securities law also does not address the management and regulation of affairs of subnational governments or financial institutions, the amount of debt incurred or purpose for which borrowed, nor the assessment, collection and administration of taxes, fees and charges that may secure and repay municipal securities. Securities law does not govern an investor's decision to lend, amount loaned, or criteria for lending to an issuer. In the first instance, limits on issuers are matters for constitutional and statutory regulation of the subnational entity activities; in the second, limits on the activities and operations of financial institutions are matters for the laws of financial institutions and corporate organizations and the internal by-laws and rules of governance of each entity.

Although many of the topics mentioned are appropriately treated under other areas of law, their status, terms and implications within a country's legal system may be of great significance to investors. A well-structured system of

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[12] Kim B. Staking & Alison Schulz, FINANCIAL DISCLOSURE: A FIRST STEP TO FINANCIAL MARKET DEVELOPMENT 16 (1999).

securities regulation will incorporate disclosure requirements mandating disclosure to investors of all material information that would affect an investor's decision to buy, sell or hold a security, including factors and risks associated with the nature of the issuer and the legal system within which it and the investor's rights exist. Providing a statutory private right of action to investors allowing recovery of damages and other remedies, independent of legal action by government regulators, will both ease the burden of administration of the regulatory scheme for the government regulator and increase investor confidence.

Securities regulation providing timely, accurate and complete information to investors, including disclosures of risk, through mandatory centralized disclosure, price transparency to investors, and regulation of broker-dealers and other market intermediaries, all supported by strong antifraud provisions and effective enforcement, should increase investor confidence in markets and issuers and provide a readily accessible, efficient source of capital for subnational borrowers. Many of these measures may be added to, or be already a part of, a securities regulatory code currently in existence, or developed simultaneously with provisions regulating other segments of national capital markets.

A system of securities regulation may cover the offer and sale of securities, as well as regulation of issuers, the professionals who bring issuers' securities to market and deal in the securities in subsequent trading, assist customers in the purchase and sale of securities, the markets in which transactions occur, including securities exchanges, trading systems and over the counter markets, and the process of execution and settlement of transactions. In a system in which the goals of regulation are investor protection and fair markets, securities, their issuers, the markets in which they trade and the traders are all appropriate subjects for regulation. Because matters of market and exchange regulation, execution, confirmation and settlement may be generic to all securities transactions, they will not be covered in this paper. Federal issuance and trading of subnational securities and of broker-dealers in those securities is discussed following an overview and short history of the market.

III. Overview and Short History of the U.S. Municipal Bond Market

A. Today's Municipal Bond Market

The U.S. market for municipal bonds, or subnational debt, today is valued at $1,539,200,000, making it the world's largest market for such debt. Over 52,000 issuers have over 1,500,000 issues of outstanding municipal bonds.[13] Individual investors are the largest holders, followed by mutual funds, money market funds, closed-end funds, bank trust accounts, banks, insurance companies and corporations. Pension funds are not a significant holder of U.S. municipal bonds,

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[13] *Holders of Municipal Debt 1985-2000*, THE BOND BUYER, June 20, 2000, at 7, available at 2000 WL 5812719.

primarily because the tax-exempt status accorded interest on municipal bonds makes the securities unattractive to entities which themselves are tax-exempt.

The U.S. municipal market is not centered in a physical place; municipal securities are traded through broker-dealers over-the-counter, not over an exchange. Daily trading volume averages $8.5 billion. Trading data, including price and volume for bonds traded four or more times during the reported trading day, together with price data for each transaction, are made available on a next-business day basis by the Municipal Securities Rulemaking Board (the "MSRB").[14] The market has ready access to this information at www.investinginbonds.com, a website of The Bond Market Association, an industry trade organization.

Within the last five years, as a result of initiatives of the Securities and Exchange Commission, the U.S. municipal securities market has been greatly modernized. Transparency, today's daily transaction reporting, did not exist five years ago, nor did centralized continuing disclosure by bond issuers. Primary market disclosure was in need of improvement, and allegations of corruption, hidden conflicts of interest and kickbacks tarnished the reputation of the market.[15] In the intervening years, price transparency and centralized secondary market disclosure have been introduced to the U.S. municipal market and concentrated enforcement action has improved the overall reputation of the market.[16]

Together with other markets in the United States, the municipal market is experiencing transformation stimulated by new communications technology. Today, new issues of municipal securities are sold over the Internet through both auction and negotiated sale.[17] Issuers have established web sites on which current financial information, as well as new issue official statements, are available.[18] Electronic trading systems have been established for secondary market trading of municipal securities.[19] At the same time, the market remains anchored in

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[14] The MSRB is created by statute. *See* Securities Exchange Act of 1934, 15 U.S.C. § 78*o*-4, *amended by* amendment in 1975.

[15] *See The Trouble With Munis*, BUSINESS WEEK, Sept. 6 1993, at 55; *Municipal Finance - Murky Depths*, THE ECONOMIST, Nov. 4, 1995, at 83; *The Big Sleaze in Muni Bonds*, FORTUNE, Aug. 7, 1995, at 113.

[16] For an extensive discussion of the Commissions program against "pay-to-play," the making of political contributions to influence the award of contracts to bring municipal securities to market, *see generally*, The Regulation of "Pay-to-Play" And The Influence of Political Contributions in the Municipal Securities Industry, 1999 COLUM. BUS. L. REV. 489, 491-583 (1999).

[17] *See* Dena Aubin, *Goldman Sachs Uses Its Web Site to Sell Bonds For Puerto Rico, Marking First for Muni Market*, WALL ST. J., Mar. 16, 2000, at C24.

[18] *See, e.g., State of Wisconsin Department of Administration* (last modified Feb. 1, 2001) http://www.doa.state.wi.us (using the term, "Official Statement" for the prospectus in the U.S. municipal market).

[19] *See* Michael Stanton, *MuniGroup.Com: The Sound of a Big Fish Splashing*, THE BOND BUYER, Mar. 13, 2000, (describing the joint venture among Goldman Sachs, PaineWebber and

traditional procedures as less than 50% of U.S. households have access to the internet and many of the 52,000 issuers of municipal securities remain primarily paper-based providers of information. Recent Commission initiatives modernizing the U.S. municipal market enable it to incorporate technological advances without additional regulatory measures.

B. A Brief History of U.S. Subnational Markets

The current structure of the U.S. municipal securities market has its roots in the history and government of the United States, in particular, the nineteenth century when the United States was itself an emerging market. Approval of issuance is not required at the national level; to the extent restrictions on issuance exist, they are matters of state law, as explained below.[20] The diversity in structures, the varieties in organization of municipalities, and the exemption, in most instances, from federal income taxation are features that are now characteristic of U.S. municipal securities and historically have attracted U.S. investors to the municipal bond market.[21]

1. Legal Framework

The U.S. Constitution establishes a parallel system of federal and state government, under which powers not delegated to the federal government are generally reserved to the states.[22] States retain characteristics of sovereign entities and operate under their own constitutions. In turn, state constitutions typically delegate, within certain restrictions, the power to create, modify, and abolish local governments to state legislatures and, in a few cases, provide for the establishment of home rule jurisdictions. Because local governments are creations of the state as Sovereign, local governments have only those powers that are either expressly granted to local governments or necessarily implied by the grant of powers.[23] Consequently, the organizational forms of municipalities, as well as their structure and power, vary from state to state and within each of the fifty states.[24] Today, the power to issue debt is granted to municipalities by state

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Bear Steams to trade municipal securities).

[20] *See* 26 U.S.C. § 171 (1994). Certain limitations do exist on the availability of the exemption from federal income taxation for certain types of bonds, such as "private activity" bonds.

[21] PUBLIC SECURITIES ASSOCIATION, FUNDAMENTALS OF MUNICIPAL BONDS 102 (1990).

[22] U.S. CONST. amend. X.

[23] *See* EUGENE MCQUILLEN, THE LAW OF MUNICIPAL CORPORATIONS § 10.09 (1995) (citing DILLON, LAW OF MUNICIPAL CORPORATIONS 448-49 (1911), what is commonly referred to as "Dillon's Rule:" "It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: First, those granted in express words; second, those necessarily or fairly implied in or incident to the powers expressly granted; third, those essential to the accomplishment of the declared objects and purposes of the corporation, not simply convenient, but indispensable."

[24] *See generally id.*, at Chs. 1-3 (discussing the nature and kinds of municipal corporations in

statute, charter or constitutional provision, and is subject to limitations, including amount and purpose.[25] Enforceable contractual structures that are outside the legal definition of "debt" for state law purposes, have developed in response to constitutional and statutory limitations, such as certificates of participation or "COPS" and the issuance of revenue bonds by independent public authorities. Such structures enable municipalities to borrow without violating these limits.[26]

2. Early, Issuance and Default

In 1751, Massachusetts became the first colony to borrow money by issuing interest-bearing transferable bonds (payable in six months) and was soon followed by Connecticut, New Hampshire, Rhode Island and North Carolina.[27] During the American Revolution, the Continental Congress joined the States in issuing debt. In post war New York, Boston and Philadelphia, as in Exchange Alley before, stock trading largely involved trading in shares of such debt.[28] The ability of state and local governments to issue municipal securities soon played a critical role in the expansion and growth of the United States. Infrastructure development, including canals, railroads, and turnpikes, as well as operational funds for the issuers were all financed by municipal bonds.

Following the organization of the United States, the increase in state debt was slow and moderate, with six states incurring an aggregate of under $14 million in debt between 1825 and 1830, much of which was borrowed in London and payable in Sterling.[29] New York City and state governments floated bond issues each year from 1812 to 1817.[30] The domestic market was growing: by 1825, New York State bonds issued to finance the Erie Canal were trading actively on the New York Stock & Exchange Board, the predecessor of today's New York Stock Exchange.[31] The growth increased as the industrial revolution, a sense of security, and the distribution of surplus revenues of the United States among the several states inspired the issuance of $108 million in state debt between 1835 and 1838. This debt financed ambitious programs for the construction of public works, including the building of canals, railroad aid, and

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the United States).

[25] *See id.*, at § 39.07.

[26] "[M]uch of the [California] market today consists of lease-backed securities and other instruments which have no specific statutory authorization. These types of securities are being increasingly used to finance new types of borrowing - such as for pension costs and health care premiums - based on new or evolving interpretations of the state's statutes and constitutional debt limits." California Debt and Investment Advisory Commission, Report of the Interagency Municipal Securities Task Force, 1998, at 13-14.

[27] *See* Banner, *supra* note 5, at 128-29.

[28] *See id.* at 129-31.

[29] WILLIAM L. RAYMOND, STATE AND MUNICIPAL BONDS 50, 51 (1923).

[30] ROBERT SOBEL, THE BIG BOARD: A HISTORY OF THE NEW YORK STOCK MARKET 25 (1965).

[31] *See* THE NEW YORK STOCK EXCHANGE: THE FIRST 200 YEARS 14, (James E. Buck, ed., 1992).

aiding state banks.[32] By 1838, the value of outstanding state debt securities exceeded $141 million.[33]

Early growth was soon followed by a period of default. Following the panic of 1837, European markets for state debt closed. Between 1840 and 1842, eight states defaulted on their bonds.[34] Mobile, Alabama incurred the first recorded local government default in 1839, a year in which only forty-four towns or cities had a population exceeding 8000 and the total of local indebtedness in the United States amounted to $20 million.[35] One lasting consequence of this first period of default was the amendment of many state constitutions to prohibit the gift or loan of state credit in aid of private enterprise, the holding of corporate stock by state and local governments, and the prohibition of loans or donations financed out of current funds.[36]

A second period of default followed the Civil War, when "a regular flood tide of defaults began."[37] Inability to pay following the depression of 1873 combined with post-Reconstruction unwillingness to pay generated numerous defaults in the South and West. While the Fourteenth Amendment to the Constitution of the United States declared "illegal and void" the debts "incurred in aid of insurrection or rebellion against the United States." In southern states investors were warned that post-war "carpet-bagger" bonds would not be paid, in this period railroad aid bonds constituted the greatest source of default. Outstanding municipal bonds totaled $850,000,000 in 1880 and bonds in default totaled between $100,000,000 and $150,000,000.[38] Adoption of a national securities code was not to occur for another fifty years; investors found what protection they could in the common law.[39] Bondholders search for payment took them to the Supreme Court of the United States, where "for a season, cases on municipal bonds bulked larger than any other category of the Court's business . . . [in this period] . . . the Court decided some two hundred cases on these railroad aid bonds."[40] During this era, "it was not unknown for the county officials to spend their entire tenure of office in jail for failure to obey a federal court order, or to spend most of their time evading federal marshals."[41]

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[32] *See id.* at 52.

[33] *See* Banner, *supra* note 5, (citing FRITZ REDLICH, THE MOLDING OF AMERICAN BANKING (1951)).

[34] *See id.* at 53; *see also* A.M. HILLHOUSE, LESSONS FROM PREVIOUS ERAS OF DEFAULT 17 (1993).

[35] *See id* .at 10.

[36] Mike Willatt, *Constitutional Restrictions On Use of Public Money and Public Credit,* May TEX. BAR J., 413, 416 (1975).

[37] Hillhouse, *supra* note 34.

[38] *Id.*

[39] Banner, *supra* note 5, at 201.

[40] 7 CHARLES FAIRMAN, THE OLIVER WENDELL HOLMES DEVISE HISTORY OF THE SUPREME COURT OF THE UNITED STATES, RECONSTRUCTION AND REUNION (1864-1868) 918 (1971).

[41] Hillhouse, *supra* note 35, at 13.

3. Birth of Bond Counsel

This "season" of default is the origin of bond counsel. The widespread defaults and issuer efforts to avoid payment on the basis of procedural and legal deficiencies led to the practice of submitting state and municipal issues to independent counsel. As one investment bank observed in an 1890 promotional brochure:

> Perfect equity between debtor and creditor demands . . . that the authority to issue shall be unquestionable, and bond-houses and other large fiduciary institutions of today meet this requirement by retaining attorneys of ability, who instead of taking for granted, as in former times, that everything had been 'properly done, happened and performed,' now insist on all steps being taken in strict conformity with law.[42]

Bond counsel's opinion began to stand between distant investors and the technicalities and obscure provisions of local law governing the issuer. The record of proceedings for the bond issue, including authenticated copies of enabling legislation, resolutions, notices and minutes of meetings of appropriate government bodies, would be sent to a New York or Chicago law firm specializing in municipal bonds. The firm would review the record and, if found satisfactory, issue an approving opinion. Only then would customers, often in a different state or country than the issuing locality, take delivery of the bonds. Many bond counsel still follow custom and begin their legal opinion, "We have examined a record of proceedings relating to the issuance . . . . ." Today's bond counsel opinion addresses the valid, binding and enforceable nature of the bonds, together with their tax-exempt status.[43] As a contemporary publication of an industry trade group, The Bond Market Association observes: "in order to be marketable, municipal bonds must be accompanied by a legal opinion."[44] The utility of bond counsel has grown with the complexity of transactions to cover a variety of issues in supplemental opinions accompanying the standard bond counsel opinion.

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[42] *Id.* (citing EBEN H. GAY, MUNICIPAL BONDS 39-40 (19XX)). *See also* PUBLIC SECURITIES ASSOCIATION, *supra* note 21, at 54.

[43] NATIONAL ASSOCIATION OF BOND LAWYERS, THE FUNCTION AND PROFESSIONAL RESPONSIBILITIES OF BOND COUNSEL 1-36 (1995); John L. Kraft, *The Role of Bond Counsel in Public Agency Financing, in* 1 THE MUNICIPAL BOND HANDBOOK 228, 229-31 (Frank J. Fabozzi et al. eds., 1983).

[44] PUBLIC SECURITIES ASSOCIATION, *supra* note 22, at 28; CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION, *supra* note 27, at 3. (Concern about reliability of bond counsel's opinion was voiced in a recent report of the California Debt and Investment Advisory Commission: "the growing role of public finance in promoting economic development, coupled with the greater competition for business among bond firms, has led to very aggressive applications of the state's municipal bond laws.")

4. The Great Depression

Between 1929 and 1933, 4770 local governments defaulted on $2.85 billion of debt and by 1933 over 16% of the U.S. municipal market was in default.[45] As in the earlier depression of 1873, a large number of municipalities simply did not have the capacity to pay their obligations in full and many taxpayers considered the obligation to repay outstanding debt in dollars suddenly more valuable than at the time of borrowing as a payment for less than "their money's worth."[46] However, local government defaults in the Great Depression differed from those of earlier eras. Defaults were not concentrated in particular areas of the country. Unlike the earlier era, in 1933 Hillhouse notes only one case in which municipal officials had been jailed for the failure to obey the courts on repayment of debt, noting "to date there has been relatively little of the spirit of outright repudiation."[47] The practice of using bond counsel also reduced the percentage of issues declared void compared to the 1870s. "The legality of municipal bonds has been more carefully passed upon by attorneys for houses of issue since the unfortunate experience of that depression."[48] Almost all defaults were cleared up by the 1940s, "mainly because 95% of all debt at the time was general obligation, backed by the full faith and credit of the issuing municipality."[49]

While the Great Depression remains the unchallenged high water mark for turmoil in the U.S. municipal market, the six decades since have not been without event. Three municipal defaults, one in each of the last three decades, surpass in magnitude any municipal market event of the twentieth century other than the Great Depression. The declaration of a payment moratorium on outstanding New York City notes in November 1975, the default on $2.25 billion in bonds of the Washington Public Power Supply System ("WPPSS") in June 1983, and the Orange County, California bankruptcy in December 1994 represent municipal market milestones. In addition to the effect each event had upon bondholders and the marketplace, each event prompted an SEC report critical of disclosure practices. In addition, Commission rulemaking followed the WPPSS default, and Commission enforcement actions against numerous parties followed the Orange County bankruptcy.

IV. The Growth of the U.S. Municipal Bond Market

A. The Revenue Bond

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[45] MARLIN AND MYSAK, THE GUIDE TO MUNICIPAL BONDS 12 (1991).

[46] Hillhouse, *supra* note 35, at 19.

[47] *Id.* at 19-20.

[48] *Id.*

[49] MARLIN AND MYSAK, *supra* note 45, at 12.

No financing structure has been of greater importance to growth of the U.S. municipal market than the revenue bond. Of the $226.6 billion in long-term bonds issued in the United States in 1999, $156.4 billion were revenue bonds and $70.2 billion were general obligation bonds.[50] The turning point from general obligation to revenue bonds as the preferred tool of municipal finance occurred in 1976.[51] The concept of self-supporting municipal infrastructure financing existed a century before this turning point. Double-barreled revenue bonds, paid from fees collected from users of a facility but also secured by general obligation of the government issuer, had been used in the 1800s to finance water supply systems. The first "pure" revenue bond, with principal and interest derived exclusively from a project's earnings, was issued by Wheeling, West Virginia in 1885 to finance a water and gas plant.[52] Today, revenue bonds finance airports, toll roads, housing, health care, educational and environmental facilities as well as traditional municipal utilities.

Observers have called the 1921 Act of the New York and New Jersey legislatures, copied from the 300-year old Port of London Authority, creating the Port Authority of New York and New Jersey, "the most important development in the history of the revenue bond."[53] The Port Authority was the first major user of the public authority device in the United States.[54] Unlike earlier authorities in the United States, the Port Authority financed multiple projects. The creation of the Port Authority and the Triborough Bridge and Tunnel Authority also clearly established that the debt of special district governments with wide functional and territorial jurisdictions as well as political subdivisions was entitled to exemption from federal income taxation. By the 1950s, almost every state had enabling legislation for revenue bond financing.[55] Among other attributes, revenue bonds issued by authorities are considered by bond counsel to be outside many of the restrictive limits on debt earlier added to state constitutions. Debt financing for large infrastructure projects was now available without the hurdle of voter approval by means of the authority issued revenue bond. Numerous permutations of the basic structure of capturing project revenues under a trust agreement or indenture to provide for costs of operation, maintenance and repair as well as for payment of principal and interest have developed, adapting to the needs of specific situations. Some modern revenue bond structures use surplus revenues to support projects unrelated to the original facilities, such as bridge toll revenues providing additional security to subway and light rail transportation bonds. The flexibility of enabling legislation in many instances permits creativity in structuring

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[50] THE BOND BUYER/SECURITIES DATA COMPANY, 2000 YEARBOOK 5 (2000).

[51] MARLIN AND MYSAK, *supra* note 45, at 62.

[52] *Id.* at 18.

[53] *Id.* at 19.

[54] *See generally* ROBERT A. CARO, THE POWER BROKER: ROBERT MOSES AND THE FALL OF NEW YORK 345 (1974) (describing the development of the modern infrastructure of New York through the use of quasi-governmental authority financing pioneered by Robert Moses).

[55] ROBERT LAMB & STEPHEN RAPPAPORT, MUNICIPAL BONDS 15 (1980).

revenue bond issues. Revenue bonds are now the financing mainstay for modern infrastructure development in the United States.

There are three basic types of revenue bonds commonly used worldwide: standalone enterprise, supplement-supported enterprise, and government-guaranteed enterprise .[56] In the stand-alone enterprise revenue bond, payment of all costs of operation, maintenance and payments on bonds is derived exclusively from revenues of an enterprise. This is the classic revenue bond structure. The enterprise is an operation or facility, such as a toll bridge or water treatment plant. The cost of constructing and acquiring the enterprise is provided by the money raised through selling the bonds. Following completion of the project, fees are charged and collected for use of the service offered by the enterprise, such as bridge tolls or water or electric bills, and the collected fees are used to pay down principal and interest on the bonds.

Because the revenues provide debt service, the term of the debt may be as long as the expected life of the toll bridge or water plant. In some markets, this period may significantly exceed the maturities available in the market for the general obligation of the local government. The project may be owned by the local government or by an authority. If owned by the local government, revenues of the enterprise are segregated from other revenues of the government legally and in the financial statements of the local government. Use of authorities such as the Port Authority and Triborough Bridge and Tunnel Authority has become the preferred structure in the United States, although some local governments still issue revenue bonds.

If a stand-alone enterprise cannot collect sufficient revenues to cover costs of operation and maintenance and repay bonds, the classic revenue bond structure may be modified with the addition of a second revenue source. This second revenue source may be a subsidy or grant from the local, regional or national government or a surplus in revenues collected by the local government entirely independent of the enterprise.

If the stand-alone enterprise is unable to collect sufficient revenues to cover costs of operation and maintenance, and repayment of bonds and circumstances do not present an opportunity to add a supplemental revenue source, the local government may choose to guarantee bond payments out of its general funds, creating a double-barreled bond. In some circumstances where the local government has a very strong credit, the choice may be made to add such a guarantee even though the enterprise revenues are adequate to meet needs, because of savings in interest rates achieved by the resulting stronger credit.

B. Bond Banks and Pools

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[56] *See* STANDARD & POOR'S, PUBLIC FINANCE CRITERIA 2000, at 106 (2000) *available at* http://www.standardandpoors.com/ResourceCenter/RatingsCriteria/PublicFinance/index.html. (describing revenue bonds in detail).

As the number of authorities and use of revenue bonds grew in the first half of the twentieth century, so did variations in structure. The use of an authority to blend the revenue streams and credits of several issuers into one debt obligation through the revenue bond structure has proven particularly useful. Many subnational governments with modest needs are placed at a financial disadvantage by the fixed costs of selling securities in the public market on one hand and the higher interest rates charged by banks on the other. The costs of a public offering may exceed savings in interest rates over bank loans. For small, first time issuers, interest rate savings may be insufficient because the market is unfamiliar with the credit of the local government. Either or both conditions may make the public bond markets an unrealistic alternative to bank financing for small local governments. To address this problem, many States have created special government agencies, usually called bond banks or bond pools, to assist small units of local government to obtain capital more cheaply. The cost savings come from two sources: efficiencies of scale achieved through combination of the fixed costs of many smaller financings into the fixed costs of a single large financing, and lower interest rates achieved through blending of risks and issuer familiarity in the marketplace than would otherwise be available to individual small financings.

A bond bank issues its own debt securities and re-lends the proceeds to various units of local government with smaller needs. In exchange for a part of the proceeds of the bond bank's securities offering, each local government delivers its own debt instrument to the bond bank bearing interest at the same rate as the bond bank's securities. In some circumstances, the local governments pay a slightly higher interest rate to cover operating expenses of the bond bank or to fund reserves providing additional security for repayment of the bond bank's debt.

Bond banks may be used for many different public purposes. For example, the Indiana Bond Bank annually assists nearly all of the primary and secondary public schools in the state (i.e. province) to borrow for working capital each year because the timing of receipt of revenues and need to make expenditures is not coordinated. By keeping costs low, the Bond Bank ensures that more funds will be available to pay for educational costs instead of interest and financing costs. The Illinois Health Facilities Financing Authority operates a bond bank program to assist charity hospitals to borrow for new equipment purchases. The resulting reduced equipment costs ultimately provide lower costs to health care consumers than would bank financing or individual borrowing by each hospital. In many states, bond bank programs provide below-market rate financing (because of the federal income tax-exemption for interest on the bond banks debt) to sectors of particular policy or economic importance, such as small business assistance or blighted area development.

C. Securitization: The Old "New Thing"

Securitization sounds complex, and often is. However, the concept is simple. One or more instruments, contracts or obligations that generate payments are identified, such as a lease, a loan, or even a government grant. For any number of reasons, the instrument may be difficult to sell at a good price. Instead of selling the entire instrument to one party at what to the seller may be an undesirable price, legal interests are created in the instrument and its revenue stream. Each interest represents a portion of the whole instrument and together equal the whole. The interests are sold to many parties at a more agreeable price to the seller. Since the interests are identical and have many holders, they may be easily traded. The instrument has been turned into a security.

Securitized transactions have been present in the U. S. municipal bond markets for decades. Many revenue bond issues in the United States would be called "securitized," "structured," or "asset-backed" transactions in other markets. Single-family housing and student loan bonds are two examples. As Standard & Poor's observes, "tax-exempt housing is one of the original structured financing disciplines."[57] The identifying characteristic of a securitized transaction is the isolation of the revenue stream or revenue generating assets in a bankruptcy remote special purpose vehicle, separating the revenue stream or assets from the risks of operation of the local government or authority. Contemporary examples in the United States include tobacco settlement securitization transactions and the personal income tax and sales tax transactions of the New York City Transitional Finance Authority. Standard & Poor's has also noted the advantages securitization techniques offer subnational governments: "the careful application of existing revenue bond structuring techniques such as those found in . . . [the New York City Municipal Assistance Corporation] . . .and many other existing revenue bonds, combined with some of the new and creative features of the securitized market, can bring great opportunities to municipalities in their effort to achieve higher ratings and lower capital costs."[58]

The basic concept of a secured transaction can be found in some revenue bond structures, such as housing bonds, that have been familiar to the municipal market for decades. Modifications to this old concept, borrowed from other markets to create new structures, demonstrate the continuing vitality of the revenue bond model.

IV. Federal Regulation of the Issuance and Trading of Subnational With Securities

A. Framework.

1. Securities Act of 1933

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[57] *Id.* at 280.

[58] *Id.* at 280.

Codified regulation of securities and the securities markets at the national level did not begin in the United States until 1933 and the enactment of the Securities Act as the first of the federal securities laws. Some states had enacted "blue sky" statutes regulating the sale of securities within their borders a few decades before. Prior to the federal securities laws, aggrieved investors found whatever recourse the law offered in a combination of common law rights and various state statutes enacted to curb speculation. In the case of municipal bonds, as discussed earlier, numerous lawsuits found their way to the U.S. Supreme Court.[59]

In passing the federal securities laws, Congress exercised a lighter regulatory touch on municipal securities. Direct regulation of the process by which municipal issuers raise funds to finance government activities would have placed the federal government in the position of a gatekeeper to the financial markets for state and local governments.[60] Instead, Congress included exemptions for municipal securities in both the Securities Act and the Exchange Act for reasons including the local nature of the markets, a perceived absence of abusive practices, the predominantly institutional nature of investors, and federal-state comity.[61] The antifraud provisions served as the basis for regulation of the municipal market until market abuses prompted the addition of statutory provisions regulating municipal securities dealers in 1975.

The Securities Act mandates registration of the securities by an issuer, not registration of the issuer itself.[62] In general, any offer or sale of a security not registered with the Commission is unlawful, unless the offer or sale is pursuant to a transactional exemption contained in the Securities Act or the security itself is exempt within the meaning of the Securities Act.[63]

Municipal securities are exempted from the registration requirements of the Securities Act under § 3(a)(2), unless the securities are a type of third party conduit financing known as industrial development bonds that fail to meet the tax-exempt requirement contained in the exempting section.[64] Many municipal

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[59] *See* Banner, *supra* note 5, at 24 (discussing U.S. securities regulation in the eighteenth and nineteenth centuries).

[60] Municipal Securities Disclosure No. 26100, 53 Fed. Reg. 37778 (Sept. 22, 1988) (codified at 17 C.F.R. 240) (the "88 Release").

[61] 1993 Staff Report on the Municipal Securities CCH (1993).

[62] *See* Securities Acts Concepts and Their Effects on Capital Formation, 61 Fed. Reg. 40044 (July 25, 1996) (study recommended consideration of a shift in "focus of the regulatory process in the post-initial public offering context . . . from registering transactions to registering companies . . .").

[63] Securities Act of 1933 §5 (codified as amended at 15 U.S.C. §§ 77e (2001)) (Prior to the creation of the Securities and Exchange Commission under the Exchange Act, offerings of securities were registered with the Federal Trade Commission).

[64] Securities Act §3(a)(2), 15 U.S.C. §77c (2001) (The exemption covers: "[a]ny security issued or guaranteed by the United States or any Territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or Territory or by any public instrumentality of one or more States or Territories, . . . or any security which is an

securities today are not simple direct obligations of a municipality, but structured obligations such as certificates of participation. Care must be taken before concluding that a municipal security is exempt under the Securities Act. Although the "municipal" security is exempt, there may be a "separate security" within the structure of the security offered or sold, which may itself require identification of an exemption from registration, without which the offering will need to be sold in an exempt transaction or registered with the Commission.[65] Furthermore, all financing structures require analysis to determine their exempt status under the registration and reporting requirements of the Securities Act and the Exchange Act.

2. The Exchange Act

The Exchange Act requires exchanges and broker-dealers to register with the Commission; establishes a system of broker dealer regulation, with emphasis upon self-regulatory organizations ("SROs"), including the Municipal Securities Rulemaking Board ("MSRB") for municipal securities dealers; and also provides for registration and regulation of government securities brokers and dealers, a group over which the SEC, the Federal Reserve Board and the Secretary of the Treasury share regulatory authority. In addition, the Exchange Act provides for a system of periodic reporting and disclosure for publicly traded companies, as well as provisions regarding margin requirements and tender offers. The Exchange Act exempts issuers of municipal securities from its registration and reporting requirements.[66] Additionally, the Exchange Act contains a section known as the "Tower Amendment," added in 1975, which bars the MSRB from requiring issuer filings, both pre- and post-sale, and the Commission from requiring pre-sale filings.[67]

3. Antifraud Provision of the Securities Act and the Exchange Act

Both Acts, the Securities Act in §17(a) and the Exchange Act in §10(b), which is the well-known workhorse of U.S. securities litigation, contain general prohibitions of fraud.[68] These antifraud provisions prohibit fraudulent or deceptive practices in the offer and sale of all securities, including municipal securities,

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industrial development bond (as defined in section 103(c)(2) of the Internal Revenue Code of 1954) the interest on which is excludable from gross income under section 103(a)(1) of such Code, if by reason of the application of paragraph (4) or (6) of section 103(c) of such Code (determined as if paragraphs (4)(A), (5) and (7) were not included in such section 103(c)), paragraph (1) of such section 103(c) does not apply to such security"), Securities Act §2(a)(1), 15 U.S.C. § 77b (2001) (definition of "security").

[65] *See* Securities Act Rule 131. *See generally* ROBERT FIPPINGER, PRACTICING LAW INSTITUTE, THE SECURITIES LAW OF PUBLIC FINANCE Ch.2 (1997).

[66] Securities Exchanges § 3(a)(12), 12(A), 15 U.S.C. §78c, §78(i) (2001).

[67] Securities Exchanges § 15B(d), 15 U.S.C. §78o-4 (2001).

[68] These provisions are referred to as the "antifraud provisions" throughout this chapter.

regardless of registration status.[69] These provisions have paramount significance for municipal securities offerings, as such offerings are exempt from the line item disclosure requirements applicable to offerings registered with the Commission. In the municipal securities market, a desire not to violate the antifraud provisions shapes the content of a municipal issuer's disclosure. The Commission has made extensive use of the antifraud provisions in recent enforcement actions to improve disclosure practices and fight corruption in the municipal securities market.[70]

4. Securities Act Amendments of 1975

In the early 1970s, dealers known as "bond daddies" were selling investors often worthless municipal bonds out of offices in various cities in the American south.[71] The Commission responded through a series of enforcement actions.[72] Congress responded by amending the securities laws and creating a limited federal regulatory framework for the municipal market as part of the Securities Act Amendments of 1975.[73]

This new framework mandated registration of municipal securities brokers and dealers, created the MSRB, and gave the Commission broad rulemaking and enforcement authority over all municipal securities brokers and dealers.[74] The MSRB itself is a self-regulatory organization, or SRO, for municipal securities dealers with authority to promulgate rules governing the sale of municipal securities. Violation of the MSRB rules is expressly made a violation of federal law.[75] The 1975 Amendments created the tripod of regulation for the U.S. municipal securities market that exists today: Commission broker-dealer regulation, MSRB Regulation and the antifraud provisions. Recent Commission efforts to improve price transparency, provide a framework for continuing disclosure, curb conflicts of interest and corruption, and improve disclosure to investors all rest upon this tripod of authority.

a. Broker-Dealer Regulation-Rule 15c2-12.

Prior to the 1975 Amendments, broker-dealer activities in municipal securities were substantially unregulated. Thirteen years after passage of the 1975 Amendments that provided the Commission with new rule-making authority,

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[69] *See generally* In re Wa. Pub. Power Supply Sys. Sec. Litig., 623 F. Supp 1466, 1478 (W.D. Wash. 1985); Sonnenfeld v. Denver, 100 F.3d 744, 746 (10th Cir. 1996).

[70] *See e.g.*, In re County of Orange, Securities Act Release. No. 7260, Exchange Act Release. No. 36760 (January 24, 1996); In re Lazard Freres & Co., Exchange Act Release. No. 36419 (October 25, 1995); In re Thorn Alvis, Initial Decision Release No. 88, AP File No. 3-8400, 1996 SEC LEXIS 1237 (May 2, 1996).

[71] *See* Bond Daddies, supra note 9.

[72] 1993 Staff Report on the Municipal Securities CCH at 6 (1993).

[73] Municipal Securities, Pub.L. No. 94-29, 89 Stat. 131 (1975) (the "1975 Amendments").

[74] *Id.*

[75] Securities Exchanges § 15B(c)(1), 15 U.S.C.§78o-4 (2001).

following its investigation of the Washington Public Power Supply System default, the Commission chose to use the new authority to adopt its first rule for municipal securities, Commission Rule 15c2-12.[76] Simultaneously, the Commission issued an interpretation of municipal underwriter responsibilities under the federal securities laws.[77] Rule 15c2-12 is a set of mechanical steps required to be taken by underwriters and does not alter the substance of the antifraud provisions. Rule 15c2-12 is the principal tool used by the Commission to create the municipal securities market's framework for disclosure.[78] The Rule requires underwriters participating in primary offerings of municipal securities of $1,000,000 or more to obtain, review, and distribute to investors copies of the issuer's official statement. Furthermore, it requires underwriters to receive assurances that the issuer will contract to provide annual financial information and operating data and notice of eleven material events to central information repositories. The Rule's requirements apply to underwriters; however, underwriters cannot meet them without the agreement of issuers to contract, as detailed in the Rule, to provide copies of final official statements to the underwriters and to provide annual disclosure and notice of certain specified events to the information repositories identified in the Rule. An issuer of municipal securities selling directly to investors, absent an underwriter, is not

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[76] "With the release of the Staff Report, the Commission has determined to close its investigation into transactions in WPPSS securities without initiating any enforcement actions. . .[t]he responsibilities of participants in offerings of municipal securities might be more effectively addressed by regulatory measures that would apply to all participants in the municipal securities markets. . . ." *WPPSS Report*, Transmittal letter of Chairman David Ruder to The Honorable John D. Dingell, Chairman, Subcommittee on Oversight and Investigations House Committee on Energy and Commerce, September 22, 1988.

[77] 88 Release, *supra* note 60, (modified following public comment, in 89 Release).

[78] 89 Release; Exchange Act Release. No. 34-34961; 59 Fed. Reg. 59590, (codified at 17 CFR Part 240) ("94 Release") (Under the Rule, in a primary offering of municipal securities, the underwriter will be required: (1) to obtain and review a copy of an official statement deemed final by an issuer of the securities, except for the omission of specified information; (2) in non-competitively bid offerings, to make available, upon request, the most recent preliminary official statement, if any; (3) to contract with an issuer of the securities, or its agents, to receive, within specified time periods, sufficient copies of the issuer's final official statement, both to comply with the Rule and any MSRB miles; and (4) to provide, for a specified period of time, copies of final official statements to any potential customer upon request. The Rule prohibits a broker, dealer or municipal securities dealer ("Participating Underwriter") from purchasing or selling municipal securities unless the Participating Underwriter has reasonably determined that an issuer of municipal securities or an obligated person has undertaken in a written agreement or contract for the benefit of holders of such securities to provide certain annual financial information and event notices to various information repositories and prohibits a broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipals security unless it has procedures in place that provide reasonable assurance that it will receive promptly any event notices with respect to that security).

subject to the Rule. When an underwriter becomes involved in the process, however, the Rule is triggered and the underwriter must meet its requirements.

i. Multiple Issuers and Information Repositories

In some financing structures there may be more than one issuer. Many issues of municipal securities are secured by revenue streams provided by multiple obligors. The question of which issuer or obligors would be required to provide ongoing information is addressed in the Rule by use of the term "obligated person," defined as "any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities)." The primary offering document serves as the template for disclosure. Ongoing information is required for each obligated person for whom financial information or operating data is presented in the final official statement.

The Commission chose private repositories, known as Nationally Recognized Municipal Securities Information Repositories ("NRMSIRS") to serve as the central collectors and disseminators of information under the Rule. To accommodate the concerns of smaller issuers described below, allowance was made for statewide collection of continuing issuer information at State Information Depositories, or "SIDs." Finally, to make use of a centralized information system created by the MSRB in the five years between the original rule creating NRMSIRs and the 1994 amendment, the Rule requires notices of material events be sent to the MSRB's Continuing Disclosure Information ("CDI") System. Both SIDs and NRMSIRs are designated through the staff "no-action" letter process.[79] The MSRB's CDI System is part of its Municipal Securities Information Library ("MSIL") System. The CDI System is a central repository for voluntarily submitted official continuing disclosure documents relating to outstanding municipal securities issues.[80]

ii. Rule 15c2-12

Brokers, dealers and municipal securities dealers are required by federal securities law to have a reasonable basis for recommending a security to a customer. In particular, the Rule makes it "unlawful for any broker, dealer, or municipal securities dealer to recommend the purchase or sale of a municipal security unless such broker, dealer, or municipal securities dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to" an event notice filed as described in the preceding

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[79] *See. e.g.*, letter of Brandon Becker, Director, Division of Market Regulation to Monty Humble, Esquire, Re: SID Status of Municipal Advisory Council of Texas, August 29, 1995.
[80] Exchange Act Rel. No. 30556 (April 6, 1992) 57 Fed. Reg. 12534 (April 10, 1992).

paragraph. The 94 Release observes that both the Commission's past interpretations of broker-dealer law and MSRB Rules emphasize the type of information produced by the Rule "must be taken into account by dealers to meet the investor protection standards imposed by its investor protection rules."[81]

The net effect of Rule 15c2-12 for most offerings over $1,000,000 is to provide copies of the official statement at the time of the offering to underwriters, who can then be required to facilitate its dissemination to central repositories, and to create a stream of annual financial and operating data, as well as material event notices, to central repositories. Dealers can look to this information as a means of forming the required reasonable basis for any recommendation they make to a customer regarding a municipal security. The Commission observed that "[t]he availability of secondary market disclosure to all municipal securities market participants will enable investors to better protect themselves from misrepresentation or other fraudulent activities by brokers, dealers, and municipal securities dealers." The lack of such information "impairs investors' ability to . . . make intelligent, informed investment decisions, and thus, to protect themselves from fraud."[82]

Between adoption of Rule 15c2-12 in 1989 and amendment in 1994, the MSRB used its own rulemaking authority to create a repository for primary offering disclosure documents, as described below. With the amendments to Rule 15c2-12 in place, primary offering documents for most municipal securities issued since 1990 are now publicly available. Annual financial information and operating data and event notices are publicly available for most municipal securities offerings since July 1995.

b. Municipal Securities Rulemaking Board

i. Organization

In the 1975 Amendments, Congress instructed the Commission to establish the MSRB as the self-regulatory organization charged with primary rulemaking authority for municipal securities dealers.[83] By statute, the MSRB's fifteen members are divided into five securities firms representatives, five bank dealer representatives, and five representatives of the general public, one of which must represent issuers and one investors.[84] Under the Exchange Act, the MSRB is given rulemaking authority, subject to Commission approval, to adopt rules to prevent fraudulent and manipulative acts and practices, promote just and equitable

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[81] 59 Fed. Reg. 59590 (1994).

[82] *Id.*

[83] 15 U.S.C. § 78o-4(b) (2001); MSRB Manual, CCH ' 101.

[84] 15 U.S.C. § 78o-4(b) (2001). The divided composition of the MSRB reflects the overlapping regulatory schemes for banks and securities firms in the U.S., a topic not explored in this chapter. For a discussion of the influence of the overlapping schemes on municipal dealer regulation and creation of the MSRB, *see* Fippinger, *supra* note 65, at Ch.9.9, *et seq.*

principles of trade, and protect investors and the public interest.[85] The rules are enforced for securities firms by the National Association of Securities Dealers ("NASD"); for bank dealers by the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation; and for all brokers, dealers and municipal securities dealers by the Commission.[86]

As noted previously, Congress included language in the 1975 Amendments prohibiting the MSRB from requiring municipal issuers, directly or indirectly, through municipal securities broker-dealers or otherwise, to furnish the MSRB or prospective investors with any documents, including official statements. The MSRB specifically is permitted, however, to require that official statements or other documents that are available from sources other than the issuer, such as the underwriter, be provided to investors.[87]Following the adoption in 1989 of Rule 15c2-12 by the Commission, underwriters of most municipal offerings greater than $1,000,000 were required to receive an official statement within seven business days after any final agreement to purchase, offer, or sell an issuer's municipal securities. Now that underwriters were required by law to have official statements, the MSPB could, and did, require underwriters to file them with the MSRB. In 1990, the MSPB adopted rule G-36, requiring each broker, dealer or municipal securities dealer acting as an underwriter of municipals securities in a primary offering to file the official statement within one business day of receipt but no later than ten business days after any final agreement to purchase, offer or sell the municipal securities. In addition, if the underwritten issue advance refunds an outstanding issue of municipal securities, the rule requires delivery of the advance refunding documents as well.[88] The official statements sent to the MSRB under rule G-36 enter into the Official Statement and Advance Refunding Document-Paper Submission System ("OS/ARD") of MSIL. OS/ARD collects, and makes available on magnetic tape and paper official statements advance refunding documents.[89] Dealers must file the final official statement with OS/ARD; dealers choose to file it with a NRMSIR to reduce a customer production requirement from ninety to twenty-five days, although NRMSIRs by definition must maintain them as well. The second part of MSIL is the CDI System previously described. MSIL is not a NRMSIR.

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[85] 15 U.S.C. § 78o-4(b) (2001).

[86] MSRB Manual CCH & 103.

[87] Securities Exchanges, 15 U.S.C. §78o-4 (2001); *see also,* 53 Fed. Reg. 37778 (1988).

[88] Rule Approval Notice, 55 Fed. Reg. 23333 (June 7, 1990). An advance refunding transaction typically involves the defeasance of an outstanding issue of municipal securities subject to call protection (the "refunded" issue) through the substitution of a pool of escrowed U.S. Treasury securities providing payment of principal and interest to holders of the refunded issue until first call or maturity. The U.S. Treasury securities are purchased by a new issue of municipal securities carrying a lower interest rate (the "refunding" issue). The documents creating the escrow, are the "advance refunding documents."

[89] Proposed Rule Notice, 56 Fed. Reg 28194 (June 19, 1991); *see also,* Municipal Securities Disclosure, 17 CFR 240 (1994).

Readily available municipal issuer disclosure now begins at the MSIL System where the final official statement is found on the OS/ARD System and continues to NRMSIRs; or, for small issues, SIDs or the issuer itself for annual information and ends at the state SID or either the MSRB or any NRMSIRS for notices of material events.

ii. Municipal Market Transparency and the MSRB.

In the United States, municipal securities are traded over-the-counter in a "negotiated" market. There are no organized exchanges for municipal securities as there are for corporate securities.[90] Dealers publish a list indicating the municipal securities they are willing to sell, without quoting a firm price, and negotiate the price with dealers willing to buy the security. Until the MSRB mandated transaction reporting, current market transaction prices for municipal securities were difficult to access. Improving municipal market transparency was one of the objectives recommended in the 1993 Staff Report. A transparent market provides equal and immediate access to all quotations and reports of price and volume of all trades effected in the market to all market participants.[91]

Information on prices, sizes and reports of executed trades are now available through the MSRB's Transaction Reporting Program. Under the Program, the MSRB publishes a daily report including the high, low, average price and total par traded for municipal securities traded four or more times the previous trading day. Daily reports are available to subscribers, including The Bond Market Association, which makes the information available on the website identified in the Introduction. The surveillance database records, all municipal transactions, are available to the Commission, NASD and other enforcement agencies for market surveillance and enforcement purposes. The MSRB Transaction Reporting Program provides market participants and the public with information about the municipal securities pricing, and at the same time help agencies charged with enforcing MSRB rules identify transaction patterns in the inspection and surveillance process.

iii. MSRB Fair Practice Rules

MSRB fair practice rules address fair dealing, suitability and fair pricing and are designed to assure municipal securities brokers and dealers observe high professional standards in dealing with customers.[92] MSRB rules cover

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[90] Public Securities Association, *supra* note 21, at 29.

[91] 1993 Staff Report on the Municipal Securities CCH (1993). Without access to firm bid and ask quotations and last sale reports, market participants are disadvantaged in assessing the value in the secondary market of securities they own or might purchase. Access to prices paid by other market participants also enables investors to determine whether they have paid a fair price.

[92] MSRB rules G-17 (fair dealing), G-19 (suitability) and G-30 (fair pricing); MSRB Manual CCH §§ 3581, 3591, and 3646. *See generally*, 1993 Staff Report on the Municipal Securities CCH (1993).

confirmation information requirements and customer information disclosure, including delivery of official statements, in new issue offerings; establishment of uniform practices for transactions between brokers and dealers, rules governing syndicates for the sale of new issues; and providing record keeping and retention requirements.[93] MSRB rules are also designed to prohibit certain conflicts of interest, limit gifts and gratuities, require disclosure of consultants used to obtain municipal securities business, and prohibit brokers, dealers or municipal securities dealers from soliciting political contributions for certain elected officials who influence selection of brokers, dealers or municipal securities dealers or engaging in municipal securities business for two years following political contributions to such officials.[94]

The MSRB rules relating to political contributions and consultants are intended to curb a practice known as "pay-to-play," in which contracts for professional services associated with marketing new issues of municipal securities are awarded on the basis of campaign contributions to elected officials responsible for selection.[95] MSRB rules have joined the antifraud provisions to form the foundation for recent enforcement actions against municipal market participants discussed below.

c. Antifraud Authority and Enforcement

i. Authority

Under the antifraud provisions of the Securities and Exchange Acts, disclosures made by municipal issuers are subject to the prohibition against false or misleading statements of material facts, including the omission of material facts necessary to make the statements made, in light of the circumstances in which they are made, not misleading.[96] An objective standard determines materiality: "an omitted fact is material if there is a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[97]

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[93] MSRB rules G-15 and G-32, G-12 and G-11, and G-8 and G-9; MSRB Manual CCH §§ 3571 and 3656, 3556 and 3551, 3536 and 3541.

[94] MSRB rules G-23 (financial advisory activities), G-20 (gifts and gratuities), G-38 (consultants), and G-37 (political contributions and prohibitions on municipal securities business); MSRB Manual CCH §§ 3611, 3596, 3686, and 3681.

[95] *See Municipal Machinations*, THE ECONOMIST, Vol. 337, No. 7939, November 4, 1995, at 83.

[96] Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others ("1994 Interpretation"), Securities Act Rel. No. 7049, Exchange Act Rel. No. 33741, FR-42 (March 9, 1994).

[97] 1994 Interpretation; *see also,* TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

The broad reach of the provisions allows for application to numerous situations, including excessive undisclosed sales charges, or "mark-ups,"[98] and misleading disclosure in offering documents, continuing disclosure under Rule 15c2-12 contracts, or any statement "reasonably expected to reach investors and the trading markets."[99]

The federal securities laws, including the antifraud provisions, give the Commission the power of enforcement through a variety of means. The Commission may seek injunctive relief in federal court, disgorgement of ill-gotten gains and the imposition of money penalties.[100] Criminal referrals may be made to the U.S. Department of Justice. The Commission may also initiate administrative proceedings, issue cease and desist orders against any person who is violating, has violated or is about to violate any provision of the federal securities laws, assess money penalties, and discipline brokers, dealers and municipal securities dealers.[101] Federal courts also interpret the antifraud provisions as creating a limited cause of action for private plaintiffs under Rule 10b-5 for transactions involving municipal securities. However, the statutory remedies available to investors in registered securities under §§ 11 and 12 of the Securities Act are not available to private parties.

Municipal market participants were reminded of the scope of application of the antifraud provisions in the 1994 Interpretation, which pointed to existing deficiencies in disclosure practice. Among the topics identified as deficient and in need of improvement were disclosure of conflicts of interest, terms and risks of securities, financial information and timeliness of financial statements, as well as a caution on the use of disclaimers. Most of these topics were the subject of subsequent Commission enforcement actions.

ii. Enforcement

The Commission has brought over ninety enforcement actions arising from municipal securities transactions in the last six years based on the antifraud provisions and MSRB rules. These proceedings have found parties from almost every category of market participant to have violated the antifraud provisions of federal securities laws, including local government issuers of municipal securities, local government officials and employees, financial advisers, consultants, underwriters (including firms, individual bankers and heads of public finance departments), and lawyers.[102] Collectively, these actions encourage accurate disclosure by market participants, underscore the responsibilities of various

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[98] Grandon v. Merrill Lynch & Co., Inc, 147 F.3d 184, 194 (2d Cir. 1998).

[99] 1994 Interpretation; Statement of the Commission Regarding Disclosure of Year 2000 Issues and Consequences by Public Companies, Investment Advisers, Investment Companies and Municipal Securities Issuers, Securities Act Release No. 33-7558 (July 30, 1998).

[100] Exchange Act § 21; 15 U.S.C. § 78u.(d)(3)(A) (2001).

[101] Exchange Act §§ 21 B, 21C; 15 U.S.C. §§ 78u-2, *et seq.* (2001).

[102] SEC Enforcement Actions (last visited March 21, 2001) http://www.sec.gov/divisions/enforce.shtml.

participants in a municipal securities offering, and, when combined with previous Commission reports and releases, provide guidance on disclosure practices.[103]

The Commission has settled several proceedings with municipal issuers for disclosure fraud, including Orange County, California. The violations include failure to disclose facts relating to development risk of a project, use of stale and misleading financial statements, misleading characterization of financial data as audited and the failure to disclose facts that may adversely affect the tax-exempt status of the municipal securities involved in the offerings.[104] In addition, the Commission has settled proceedings with financial advisers for having caused and willfully aided and abetted an issuer-clients violation of the antifraud provisions in the disclosure relating to the offer and sale of municipal bonds.[105]

a. Orange County

In December 1994, Orange County, California filed for bankruptcy following a paper loss that later exceeded $2.7 billion in a highly leveraged investment pool managed by the County Treasurer. In the spring and summer before the bankruptcy, the County issued municipal notes for the purpose of investing the proceeds in the investment pool. Repayment of other note issues was guaranteed by the investment pool and, in one instance the investment pool guaranteed the purchase of floating rate notes subject to a put on seven days notice if such notes could not be remarketed. Orange County and its Board of Supervisors, without admitting or denying the charges, consented to a Commission order finding violations of the antifraud provisions in connection with its disclosure in six offerings of municipal securities.[106] The County Treasurer and Assistant Treasurer were permanently enjoined by a federal court from future violations of the federal securities laws and convicted of state criminal charges arising from management of the investment pool.[107] The Commission also issued a report describing the conduct violating the federal securities laws of the individual members of the Board of Supervisors.[108] The

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[103]Special Studies Index: Report on Commission Proceedings (last visited March 22, 2001) http://www.sec.gov/news/studies/html.

[104]In the Matter of Maricopa County, Exchange Act Release No. 37748 (September 30, 1996); In the Matter of County of Nevada, City of Ione, Wasco Public Financing Authority, Virginia Horler, and William McKay, Securities Act Release No. 7535; AP File No. 3-9542 (May 5, 1998); In the Matter of Coahoma Co., Miss., et al., Exchange Act Release No. 40194 (July 13, 1998). In settled administrative proceedings, parties consent to entry of a Commission order without admitting or denying the charges against them.

[105] In the Matter of Peacock, Hislop, Staley & Given, Inc. and Larry S. Given, Exchange Act Release No. 37777 (October 2, 1996).

[106] In re County of Orange, *supra* note 70, at 2.

[107] Securities and Exchange Commission v. Citron and Raabe, Civ. No. 96-74 (C.D. Cal.) Lit. Rel. No. 14792 (filed January 24, 1996).

[108] Report of Investigation in the Matter of County of Orange, California as it Relates to the Conduct of the Members of The Board of Supervisors, Exchange Act Release No. 36761

Commission has settled proceedings relating to the underwriting of Orange County municipal securities.[109] The Commission's civil injunctive proceedings relating to underwriting of Orange County Securities by one individual banker were dismissed by the district court. The ruling of the district court is under appeal.[110] Last fall, the Commission instituted cease-and-desist proceedings against the City of Miami, Florida, Cesar Odio and Manohar Surana.[111] The Order instituting the proceedings alleges that the City, through Odio and Surana, violated the antifraud provisions in connection with the offer and sale to the public of municipal bonds issued by the City in June, August and December of 1995. The Order also alleges that the City, through Odio, violated the antifraud provisions when it disseminated its Comprehensive Annual Financial Report for fiscal year 1994 to the investing public in September 1995. A hearing before an administrative law judge was held in early March 2000 to determine whether the staff's allegations were true, and, if so, whether a cease-and-desist order should be entered against the Respondents.

b. Miami

Last fall, the Commission instituted cease-and-desist proceedings against the City of Miami, Florida, and persons Cesar Odio and Manohar Surana.[112] The Order instituting the proceedings alleges that the City, through Odio and Surana, violated the anti-fraud provisions in connection with the offer and sale to the public of municipal bonds issued by the City in June, August and December of 1995. The Order also alleges that the City, through Odio, violated the anti-fraud provisions when it disseminated its Comprehensive Annual Financial Report for fiscal year 1994 to the investing public in September 1995. A hearing before an administrative law judge was held in early March 2000 to determine whether the staff's allegations were true, and, if so, whether a cease-and-desist order should be entered against the Respondents.

V. Conclusion

(January 24, 1996).

[109] In the Matter of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Securities Act Release No. 7566, Exchange Act Release No. 40352, (August 24, 1998); In the Matter of Credit Suisse First Boston Corporation, Jerry L. Nowlin, and Douglas S. Montague, Securities Act Release No. 7498, Exchange Act Release No. 39595 (January 29, 1998). In settled administrative proceedings, parties consent to entry of a Commission order without admitting or denying the charges against them.

[110] Securities and Exchange Commission v. Dain Rauscher, Inc., Kenneth D. Ough, and Virginia O. Horler, Civ. No. SA CV 98-639 LHM (Anx) (C.D. Cal.) (August 3,1998).

[111] In re City of Miami, Cesar Odio, and Manohor Surana, Securities Act Release No. 7741, Exchange Act Release No. 41896 (September 22, 1999).

[112] In re City of Miami, Cesar Odio, and Manohor Surana, Securities Act Release No. 7741, Exchange Act Release No. 41896 (September 22, 1999).

A. Recent Developments in the Municipal Market

The Commission enforcement actions in the municipal market underscore the responsibilities of all market participants to municipal securities transactions. In addition to enforcement actions, programs to educate municipal market participants are underway, with particular emphasis on smaller, and less frequent municipal issuers. Other programs emphasize the need for prudent management of public funds. The Office of Municipal Securities hosted the Commission's first roundtable for the municipal market in October 1999. The 1999 Roundtable brought together issuers, underwriters, lawyers, financial advisors and investors to discuss and debate current market practices and explore additional improvements. The proceedings of the Roundtable (and future roundtables) may influence future Commission interpretive releases and staff guidance.[113]

The information available to investors in the U.S. municipal securities markets has significantly improved within the last five years. Investors now have next-day trade data available providing price information on secondary market transactions. A disclosure framework for municipal securities offerings is in place under which are primary offering documents, continuing disclosure (consisting of annual financial information and operating data), and material event notices. Many issuers voluntarily provide additional information, such as quarterly reports in the housing sector, beyond that called for in a Rule 15c2-12 contract. Investors are likely to receive better primary and continuing disclosure as a result of a continuing enforcement program emphasizing disclosure issues. Increased enforcement generally may serve to reduce conflicts of interest and corruption, and increase overall confidence in the municipal market.

Rapid developments in communications and information technology are bringing similarly rapid changes to securities markets. The Commission has provided guidance as to use of electronic media and fulfilling broker-dealer and other obligations under the federal securities laws. Industry groups are attempting to develop standard formats of communication within the disclosure framework.[114] The Commission has adopted new rules and rule amendments regarding the regulation of exchanges and alternative trading systems intended to strengthen the public markets for securities while encouraging innovative new markets.[115] Guidance on Internet disclosure practices has been provided in a

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[113] http://www.sec.gov. A transcript of the 1999 Roundtable is available on the Commission web site under special studies.

[114] Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Securities Act Release No. 7288, Exchange Act Release No. 37182 (May 9, 1996); Investment Company Rel. No. 21945; Investment Advisers Rel. No. 1562; 61 FR 95 24644 (May 15, 1996), The Bond Market Association Report of the Task Force on Electronic Information Delivery, February 20, 1998.

[115] Regulation of Exchanges and Alternative Trading Systems, Release No. 34-40760 (December 8, 1998).

Commission interpretive release that also seeks market response to a series of specific questions.[116] The framework for municipal market investor protection installed in the last few years is flexible and designed to incorporate a broad variety of market practices. Such flexibility may prove essential as market users shift to a greater use of electronic media while a significant market segment remains users of paper-based technology.

B. Final Observations

Investors in subnational debt markets are as entitled to protections against fraud and assurances of market integrity as participants in other securities markets. In structuring regulatory systems for securities transactions, careful consideration should be given to what effective securities regulation may and may not achieve, and the goals that are best pursued in other areas of regulation. For example, the practice of using bond counsel in U.S. municipal securities transactions may be useful as a means of addressing legal uncertainties presented to investors in legal systems in transition or under development, but may be more appropriately incorporated as part of the laws regulating permitted investments for certain institutions than as part of a country's securities laws.

The U.S. example of exempting municipal issues from standard registration and reporting provisions is explained more by its historical and constitutional origins than by its practical merits. It should be noted that, as U.S. municipal markets have developed over the past thirty years, the decisions made by Congress some sixty-five years ago have necessitated a combination of Congressional action (in the form of the 75 Amendments) and Commission rulemaking (use of its broker-dealer regulatory authority to create a disclosure framework) to provide workable regulation of the municipal securities market. Where such departures from a general approach to regulation are not mandated by considerations similar to those perceived by the Congress in the early 1930s, they may be unnecessary.

At the same time, subnational entities have obligations and priorities that differ greatly from corporate entities, such as the protection and provision of basic services to their citizens. In many ways they have a dual constituency: their citizens and the holders of their securities. Corporations have responsibilities only to their shareholder-owners. Disclosure and financial reporting requirements should be cognizant of these differences, while mandating a uniform standard of disclosure overall for the protection of investors and markets.

Similarly, the U.S. SRO structure is a product of history and U.S. regulatory structure, particularly the separation of banking and capital market regulation. A country not bound by similar considerations may wish to consider a more streamlined approach. The merits of self-regulation overall will likely continue to be debated, as noted by Professors Coffee and Seligman: "In the last analysis, self regulation will always continue to be a debatable issue in the current

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[116] Use of Electronic Media, Release Nos. 34-42728 (April 28, 2000).