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The Tenth Annual A. A. Sommer, Jr. Lecture
on Corporate, Securities, & Financial Law

Elisse B. Walter*
LECTURE

FORDHAM CORPORATE LAW CENTER

THE TENTH ANNUAL A. A. SOMMER, JR. LECTURE
ON CORPORATE, SECURITIES, & FINANCIAL LAW

WELCOME

Dean William Michael Treanor
Fordham University School of Law

INTRODUCTION

Ben A. Indek
Morgan, Lewis & Bockius

FEATURED LECTURER

Commissioner Elisse B. Walter
United States Securities and Exchange Commission

WELCOME

DEAN TREANOR: Hello, everyone. My name is Bill Treanor. I’m delighted to welcome you to tonight’s Sommer Lecture, where we’ll be hearing from Elisse Walter, Commissioner of the SEC.

In a few moments, Ben Indek, of the firm of Morgan, Lewis, which makes possible this event, will be doing the introduction. But I have the privilege of welcoming you and making a few introductory remarks.

The Sommer Lecture has a tradition of bringing to Fordham Law School and the business community the insights of prominent policy-

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9 Elisse B. Walter delivered this address at Fordham University School of Law on October 28, 2009. It has been edited to remove minor cadences of speech that appear awkward in writing. For more information about the Fordham Corporate Law Center please visit http://law.fordham.edu/corporate-law-center/corporatecenter.htm.
makers and regulators. At the 2007 Sommer Lecture, SEC Commissioner Paul Atkins remarked: "The Sommer Lecture has become a prominent feature in the ongoing dialogue among securities regulators, practitioners, and the regulated community." That’s fitting, given that the lecture honors the legacy of former SEC Commissioner and former securities law practitioner Al Sommer.

So we are just so, so, so delighted to be able to host this series that honors Al, who was really such a great man.

We are honored to have Commissioner Walter deliver the Tenth Annual Sommer Lecture. Past lectures have been by noted chief officers of our financial regulatory organizations, including not only the SEC, but the NASD, the New York Stock Exchange, and also the U.K.’s FSA.

Fordham Law has a great business law program, with outstanding faculty who are leaders in their specialty areas, highly acclaimed for their research and dedicated to their students and the craft of teaching. We’re joined here tonight by Professor Gus Katsoris, Professor Susan Block-Lieb, Professor Martin Gelter, Professor Richard Squire, Professor Rick Carnell, Professor Steve Thel, and, from the college, Professor Barbara Porco.

A round of applause for a talented faculty.

(Applause)

I would also like to recognize the Board of our Corporate Law Center, which makes possible this event. Their vision and support have allowed Fordham Law School to become a leader in the area of business law. Up here tonight are our Chair and members of the Board of Advisers: John Peloso, who is really the reason why we’re all here, who created the Corporate Center and really made this lecture a reality; Joe Connors; Bob Hollweg; Pamela Chepiga; Howard Tuckman, from the Business School; and Rick Ketchum.

In addition, we’re joined by many of our alumni who are adjunct professors and offer courses on the cutting edge of business law practice today. That’s one of the things that I think really separates Fordham from other schools that are committed to business law, the fact that we have so many top practitioners come in and teach our students about the most pressing issues that they themselves are confronting. It’s a great gift for us.

We also have a number of distinguished past Sommer Lecturers in the audience tonight: Margaret Cole, Director of Enforcement at the FSA in the U.K. — I would just like to show that, as dean in my eighth year, I’ve lost any sense of the passage of time. I was congratulating
Director Cole on her lecture from last year, and she reminded me that it was 2006. She’s right. I checked it.

We’re also joined by our 2004 lecturer, Rick Ketchum, the current CEO of FINRA and also a member of our Corporate Center Board of Advisers.

Members of the Sommer family who traveled here to join us tonight: Mr. Sommer’s wife Starr, their son Ed, who came here from Chicago, their daughter Susie, their son-in-law Jeff Futter.

Your presence really means so much to us. The fact that you are here every year is really — every year I look forward to your coming back.

From the SEC, we have Matthew Daigler, who is Special Counsel to the Commissioner. As she pointed out earlier, anything that is positive you should give him credit for.

The Law School is so grateful for the partnership of the Morgan, Lewis firm in presenting the Sommer Lecture Series. Ben Indek makes it possible year after year. We’ll be hearing from Ben in a moment. Ben, we are so grateful for your leadership and making this possible.

I also want to acknowledge Anne Flannery, who is a partner in the Washington, D.C., office, who helps us get such great speakers.

The support of the SEC Historical Society — here tonight is the Chair of the Board of Trustees, James Barratt. The SEC Historical Society, now in its tenth year, has a terrific virtual museum where anyone can access timelines and photos from the SEC’s past and download historical documents and speeches. One great example is the Oral History Project. Very appropriately, Al Sommer gave one of the first recorded oral interviews.

2009 is the seventy-fifth anniversary of the SEC. It has been a year marked with celebrations, conferences, and a reaffirmation of the commitment by the SEC to continue to take action to protect the nation’s investors and ensure the integrity of the securities markets. It’s very appropriate that we have tonight’s lecture in the seventy-fifth year of the SEC’s history.

Now I would like to thank the Corporate Law Center Dean’s Fellow Zachary Slates, a recent Fordham Law School graduate who has provided invaluable assistance with tonight’s lecture, and, finally, Ann Rakoff, Director of the Corporate Center, who has just done the most amazing job. Tonight, again, would not have happened but for her.

A big round of applause for everyone.

(Applause)
Just a few final words. Fordham Law School is a school that takes business law very, very, very seriously. One of the ways in which we show our commitment to business law is through our Corporate Law Center, which was created in 2001 and has really helped bring us even greater stature in the field. The Center was formed in 2001 to serve as a focal point for excellence and innovation in current and emerging issues in business law and business. The Center seeks to be at the forefront of identifying developing issues and proposing effective solutions. The Center invites nationally and internationally recognized experts to Fordham to offer their insights into and understanding of the complexities facing today’s global business world.

The Corporate Law Center has developed an extraordinary reputation through its public lectures, policy-related roundtables and symposia, speakers and panels who represent leading members of the bar, academia, regulatory agencies, and the judiciary. It really is consistently a forum for cutting-edge discussion.

The Center is quite fortunate to work with and have the support of members of the Fordham Journal of Corporate & Financial Law. We actually recently did a search, and our corporate law journal is one of the five most cited corporate law journals in the country. It has extraordinary influence. It was cited by the Supreme Court in 2005 in the Arthur Andersen case.

Additional information about the Corporate Law Center and the student-edited Fordham Journal of Corporate & Financial Law is available on the registration tables in the atrium. If you would like announcements of future programs, please stop at the registration table and leave us your name and contact information.

2009 has been a banner year for the Corporate Law Center. Our programs have attracted capacity audiences. Earlier in the month, we had William Dudley, President of the Federal Reserve Bank of New York. He gave a lecture, “A Bit Better, but Very Far from Best,” which got a lot of media coverage, including in the Times. On Wednesday, December 2, the Corporate Center will be co-sponsoring with the Law School’s Intellectual Property Law Institute a panel discussion on the pharmaceutical industry. We invite everyone to attend.

The Center values the interest and participation of all those attending our events. We hope to see you at future events.

Without further ado, let me present Ben Indek, who will introduce our speaker, Commissioner Walter. Ben?
INTRODUCTION

MR. INDEK: On behalf of Morgan, Lewis, let me welcome you to the Tenth Annual A.A. Sommer Lecture.

This year is particularly significant for us. Not only do we celebrate a decade of Sommer Lectures, but 2009 also marks the thirtieth anniversary of Morgan, Lewis’s securities law practice. That practice was started by Al Sommer, for whom Morgan, Lewis created this lecture series.

Al was a Morgan, Lewis partner from 1979 until 1994. He then became counsel to our firm. Al was a great public servant. To name just two roles he played in the public sector, Al was an SEC Commissioner from 1973 to 1976 and, later, Chairman of the Public Oversight Board of the American Institute of CPAs.

In private practice, he was a trusted counselor, a well-known author, and an expert commentator on a broad range of securities law topics. He had particular expertise in corporate finance and accounting issues.

When Al came to Morgan, Lewis 30 years ago, he brought with him his own trusted lawyer — in fact, his legal counsel at the Commission, Lloyd Feller. As always, Lloyd is with us here tonight, and we appreciate that.

Together, Lloyd and Al created and expanded our securities regulatory practice. Today we have more than 100 lawyers in six cities around the country devoted to providing advice regarding the securities laws to financial institutions and public companies. Our practice now mirrors the structure of the SEC. We practice in the enforcement and litigation, trading and markets, investment management, and corporate finance areas.

Al was an enthusiastic participant in the first two lectures we held at Fordham Law School. Sadly, he passed away in 2002. We’re delighted that his family continues its close relationships with our firm.

When Elisse became SEC Commissioner last year, Starr sent me a handwritten note saying that she and Al got to know Elisse when he served on the NASD Board of Governors and she worked on the staff. Starr told me that she even hoped that someday Elisse could deliver this lecture. As you will all see in a moment, Starr’s wish has come true.

A couple of other notes. Dean Treanor mentioned both Margaret Cole and Rick Ketchum here, past speakers. Linda Thompson also sneaked in. She was a super pinch-hitter last year, in this baseball
season. We very much appreciate what you did for us last year, Linda. Thank you very much.

(Applause)

I would like to turn to tonight’s speaker. Perhaps even more than Al, Elisse Walter has dedicated her career to public service. The short version is this (the longer one is in your brochure): After a stint in private practice, in 1977 Elisse joined the SEC, where she served for seventeen years. She then served as General Counsel of the CFTC and in senior positions at NASD and FINRA. Elisse was appointed to her current position, SEC Commissioner, in July of 2008.

She has won many awards during her career, including several at the SEC.

Put simply, Elisse has played an enormous role in shaping the nation’s securities laws and regulations, and continues to do so today.

In preparing for tonight, I reviewed a number of Al’s speeches from his tenure on the Commission. I also looked at several that Elisse has given in her role as SEC Commissioner and gave some thought to the current and pressing issues confronting today’s SEC. I was struck by the fact that although more than thirty years separate their service on the Commission, Al and Elisse were, and are, confronted with some of the same issues.

For example, in 1974, Al spoke about corporate disclosure. Almost exactly thirty-five years later, Elisse delivered a lecture at the annual Corporate Counsel Institute where, among other topics, she tackled proxy enhancements and risk disclosures. The list goes on. In fact, I have it on pretty good authority that Elisse will hark back to some of Al’s 1976 speeches when she takes the stage in a few moments.

What really stood out were not necessarily the day-to-day issues faced by regulators and the regulated, then and now, but the fact that, despite decades having passed, some of the really large, I would say game-changing issues that confronted Al in the 1970s are back again to face Elisse now. Back then the securities industry was dealing with fixed commissions and the development of a central market system. Al gave a talk called “The SEC in the Midst of Revolution.” In today’s post-meltdown world, Elisse could use the same title and talk about the current issues embroiling the SEC now.

Here’s another. In 1975, Al delivered a lecture with the title “Can the SEC Help the Capital Crunch?” and another that same year, “The Delicate Balance of Regulation and Competition.” How about this one, from May 1975, when Al said — and I’m quoting here — “Many were
convinced that we were at or near the bottom of the country’s present economic miseries”? Al’s title for that speech was a simple but profound question: “Have We Learned Anything?” In his remarks, Al stated — and I’m quoting again — “We should reflect on what we have gone through, what brought us here, and what must be done in the future to make our system work better than it did in the past.”

Revolutionary transformation of the securities industry, capital crunch, regulatory change, lessons to be learned from the crisis — aren’t those the same big-picture issues that Elisse and her colleagues on the Commission face in 2009?

It seems trite to rely on the old adage that the more things change, the more they stay the same. But it really does ring true. I wish that Al could be here tonight to hear Elisse’s views on the challenges she and the SEC face. He could have given her some tips because he dealt with some of the same issues.

We are proud of Al Sommer’s affiliation with Morgan, Lewis and delighted to sponsor this annual lecture in his honor. I’m pleased to turn the podium over to our speaker tonight, SEC Commissioner Elisse Walter.

(Applause)

LECTURE

COMMISSIONER WALTER: Thank you, Ben, for that lovely introduction. And thank you also, Dean Treanor, for inviting me. I am delighted to be here at Fordham University, with the members of your Law School community, alumni, honored guests, and the many, many friends I see here tonight.

It’s particularly an honor to have been asked to give the Tenth Annual A.A. Sommer, Jr., Lecture on Corporate, Securities, and Financial Law. Particularly since I was unable to join you for the Ninth, this Tenth is very special to me. And I, too, would like to thank Linda Thompson for not only doing yeoman’s service, but for giving a speech that I’m sure will far outshine what I do tonight.

As you know, Al Sommer made extraordinary contributions to the federal securities laws. In his many different roles in public service, he set a sterling example for all public servants.

I had the distinct pleasure, as Ben noted, of working with Al when I was with NASD. To sum up that experience, I would simply say that the reality of Al lived up to his illustrious reputation, but with a warmth
and sense of humor that the reputation could not duplicate. I like to flatter myself by thinking that, in some small way, I can walk in his footsteps.

While working with Al, I also got the opportunity, as was also noted, to get to know Starr. She is an extraordinary woman—and I hope I continue to look nearly half as good as she looks tonight—and I am extremely pleased that she and her family are with us this evening.

Before I get too much further, I have to remind you that the following remarks represent my own views, and not necessarily those of the Commission, my fellow Commissioners, or members of the staff. Atypically, I would also like to let you know that in the interest of time and your continued friendship, my remarks tonight will be shorter than the version of the speech that will be posted on the SEC’s Website. Matt Daigler and I have spent the last four or five days cutting and cutting and cutting. But we’re not going to let it go to waste. It will be out there somewhere.

Tonight, I would like to talk about another topic that was important to Al—the municipal securities market. It is quite fitting that I address this topic here in New York because, as I am sure many of you are aware, the New York City financial crisis in 1975 was one of the major catalysts for change in municipal disclosure practices. And, for me, it’s a return to a subject near and dear to my heart: The last major project I worked on before leaving the Commission staff in 1994 was municipal disclosure.

The recent financial crisis has revealed many gaps and weaknesses in the existing regulatory framework and has led to calls for, among other things, a systemic regulator, regulation of hedge funds, and regulation of over-the-counter derivatives. This push for regulatory reform is certainly understandable. As Al rightly noted more than thirty years ago, “Most reform in society seems to come about as the consequence of crisis or a catastrophe or a dramatic event which points up the existence of a problem.” Perhaps less elegantly, but more recently and more colorfully, Rahm Emanuel said, “Never let a serious crisis go to waste.”

What is far less understandable to me, however, is the relative lack of attention being given to the municipal securities market. SEC Chairmen ranging from David Ruder and Arthur Levitt to Christopher Cox and Mary Schapiro have advocated taking a hard look at this area. But this topic has not received serious consideration in recent regulatory reform discussions. And yet this market is enormous and operates with
increasing participation by retail investors. Municipal securities are
securitized, and both large and small municipalities use complex
structured products and financial derivatives whose risks even
sophisticated investors sometimes have trouble understanding. As
Arthur Levitt put it this past summer: “Our nation’s leaders risk com-
mitting a major error if they don’t carefully consider the workings of the
municipal-bond market. The opacity of this market is unrivaled and thus
represents a significant threat to our economy.”

What I will say tonight is not necessarily new. These are not new
ideas. In fact, many of them have been floating around for years. You
can even find some of them in a speech Al gave back in 1976, when he
was an SEC Commissioner. But in my mind, these are ideas whose time
definitely has come, particularly while the window of opportunity for
effecting real regulatory change is still open.

Let me start with a little background.

As recently as the early 1970s, the municipal securities market was
still relatively small. There were about $25 billion to $49 billion of
bonds outstanding in 1975, and the market attracted very little attention.
The standard issue was usually a general obligation bond, with fairly
standard features. Interest rates were stable. Generally, the only pur-
chasers were wealthy investors, banks, and insurance companies.
Disclosure was minimal or sometimes even nonexistent.

In stark contrast, the current amount of municipal bonds
outstanding is estimated to be nearly $2.8 trillion, and more than $390
billion of new bonds and notes were issued last year. Since the Build
America Bonds program began in April of this year, states and localities
have issued more than $35 billion of what are affectionately known as
BAB bonds. Despite its reputation as a buy-and-hold market, trading
volume is also substantial, with almost $5.5 trillion of long and short-
term municipal securities traded in 2008 in nearly $11 million
transactions.

With nearly 50,000 issuers at the state and local level, it is an
extremely diverse market as well. The typical municipal bond investor
has changed, too. Individual investors hold approximately 36 percent of
outstanding municipal securities directly and up to another 36 percent
indirectly through mutual funds and closed-end funds. And, in spite of
their reputation for safety, municipal securities can and do default.
Since 1999, issuers have defaulted on over $24 billion in municipal
bonds out of a total of $3.4 trillion issued. In 2008 alone, 140 municipal
issuers defaulted on almost $8 billion in bonds.
In sum, the municipal securities market today bears no resemblance
to what former SEC Chairman Christopher Cox called "the relatively
small and sleepy municipal bond activity of days gone by."

Despite its size and obvious importance, however, the municipal
securities market, unfortunately, lacks many of the protections
customary in many other sectors of the U.S. capital markets. Investors
in municipal securities are, in certain respects, afforded second-class
treatment under current law or treated as second-class citizens.

Let me briefly outline the current disclosure requirements for
municipal issuers, with apologies to most of you and permission for a
short nap for the many for whom this background is unnecessary. I
promise to be short.

Congress exempted offerings of municipal securities from the
registration requirements and civil liability provisions of the Securities
Act and the system of periodic reporting under the Exchange Act. The
Commission is prohibited from imposing mandatory disclosure
obligations on municipal issuers or mandating that they use generally
accepted governmental accounting standards. We can, however, bring
effort actions against any person or entity, including municipal
issuers, who violate the antifraud provisions.

As part of the Securities Act Amendments of 1975, Congress
established a very limited regulatory scheme for municipal securities
intermediaries. This included mandatory registration of municipal secu-
rities brokers and dealers and the creation of the Municipal Securities
Rulemaking Board, or MSRB. Federal regulatory authority over issuers
of municipal securities, however, was specifically limited by the
provision commonly known as the Tower Amendment, which prohibits
the Commission and the MSRB from requiring any issuer of municipal
securities to make any filings with the Commission or the MSRB prior
to the sale of securities.

In 1989, in response to consistently slow dissemination of infor-
mation in connection with primary offerings of "munis," the Com-
mission adopted Rule 15c2-12, which requires underwriters in munis
offerings of $1 million or more to get, review, and distribute to investors
copies of the issuer's disclosure documents.

Under Chairman Levitt's leadership, in 1994 the Commission
adopted amendments to that rule to enhance the quality, timing, and
dissemination of disclosure in the secondary municipal securities
market. Among other things, these amendments prohibit an underwriter
from participating in a muni offering unless it has reasonably determined
that the issuer has undertaken to provide specified annual information and event notices to information repositories. In the same year, the Commission also issued interpretive guidance concerning the disclosure obligations of muni bond market participants under the antifraud provisions.

Since that time, the Commission has adopted further amendments to the rule to provide for a single centralized repository, the MSRB, for the electronic collection and availability of information about outstanding municipal securities in the secondary market. The system is known as EMMA, and EMMA should help provide ready and prompt access to continuing disclosure documents to investors and help fulfill the regulatory and information needs of muni market participants.

Finally — and the history is nearly over — this past summer, the Commission proposed additional amendments to the rule that would impose further requirements on broker-dealers and municipal securities dealers with respect to the disclosure of specified events by issuers or their obligated persons. In addition, the MSRB filed a rule proposal with the Commission that would permit issuers and their agents to make certain voluntary submissions to EMMA.

Now let’s take a look. We have a regulatory system that exempts municipal securities under the 1933 and 1934 Acts. Are these exemptions of continuing legitimacy? I don’t think so.

There are three reasons that are typically given for affording special treatment to municipal securities.

Regarding the first rationale, which is the perceived lack of abuses in the municipal markets, the Commission has brought dozens of enforcement cases in recent years that highlight the continuing disclosure weaknesses in that market and raise concerns about governmental accounting. These actions involved a wide range of disclosure violations.

Also, as I mentioned earlier, municipalities can and do default on their bonds. Perhaps the most notorious example is bonds of the Washington Public Power Supply System, or WPPSS, followed closely by Orange County, California, the largest municipal bankruptcy in American history. We are still waiting to see what happens to Jefferson County, Alabama, which is contemplating filing for bankruptcy protection to address its debt problems.

Finally, there have been numerous bid-rigging, price-fixing, pay-to-play, and other scandals in the market. There have also been a number of instances of abusive practices by financial advisers, who are largely
unregulated by the Commission.

So I don't think that rationale holds water any longer.

The second rationale for exempting municipal securities — namely, that it is a sophisticated institutional market — is clearly no longer valid today. The extensive retail participation in the municipal market I mentioned earlier is probably only going to increase as baby boomer senior investors like me increasingly include fixed-income and tax-free offerings in their retirement portfolios.

The third rationale is the most important. It is intergovernmental comity. That is more difficult to dismiss. I should begin by noting that this really isn't a federalism issue under the U.S. Constitution. Rather, intergovernmental comity is a matter of balancing the respect due to the local interests of municipalities and their citizens, on the one hand, and the federal interest in maintaining the integrity of the national market system for the benefit of investors, on the other.

This simple contrast between state and local interests and federal interests is a bit misleading, however, when you consider that municipalities are populated by taxpayers who also are frequently investors, perhaps even in the bonds issued by those same municipalities. Indeed, the concerns of a citizen qua taxpayer and the same citizen qua investor have something very important in common. Just as an investor wants to understand the true financial health of an entity whose debt it purchases, a taxpayer has an interest in understanding the true fiscal health of the state or local municipality in which he or she lives. So the call for greater federal regulation of the municipal securities market could have benefits for both taxpayers and investors alike.

Now that I have addressed briefly why the old arguments for exempting municipal securities from the federal securities laws are no longer compelling, let me provide some reasons in support of removing the exemptions.

First, the markets have changed. Municipal securities offerings are not a local affair any longer; they are national. Investors around the country buy bonds from states like New York and California. As the municipal market becomes more diffuse, the patchwork of state regulation makes less and less sense. Without uniformity of standards, it will be difficult for investors to fully appreciate and compare the relative risks associated with different investment products. This can lead to an inefficient allocation of capital resources.

Second, in the last two decades, the municipal market experienced
the same proliferation of innovation and financial engineering as the rest of the world’s capital markets. Municipalities frequently engage in complex derivative transactions, and their products are then securitized. While the largely unregulated nature of this market has been a problem for a long time, it only threatens to get worse as municipalities look for creative ways to manage budget shortfalls.

Third, markets have become increasingly interconnected. Consider that many mutual funds today hold municipal securities, and now there are even exchange-traded funds that hold municipal securities. But perhaps the best example of how the municipal securities market is interconnected with other markets is the liquidity crisis in auction rate securities caused by increasing subprime mortgage defaults and the resulting dramatic reduction in the value of many collateralized mortgage obligations.

The extent to which municipal securities should be regulated by the federal government comes down to a policy decision. While we have to make proper allowances for the unique characteristics of municipal issuers, I believe strongly that we do not have to tolerate muni investors being treated like second-class citizens. Investors deserve the same level of high-quality disclosure and protection in the municipal market as they currently get in the corporate market, and they should not have to be forced to rely on good-faith voluntary disclosure.

How should the municipal securities market be reformed?

Under the Commission’s current authority, our options seem to be limited. With the most recent proposals, we may have pushed Rule 15c2-12 about as far as we can, although I would be open to any ideas you have about how the Commission could do more with the rule. Absent legislation, however, I believe there are still some things that the Commission could and should do under its current authority.

First, I believe the Commission should further leverage its existing antifraud authority over municipal issuers to try to improve the quality and timeliness of disclosures. Various groups have published voluntary disclosure guidelines and industry best practices. But voluntary disclosure has its limitations, and I believe that the Commission needs to send a stronger signal to the municipal issuer community regarding their obligations to provide full and fair disclosure.

After fifteen years and dozens of enforcement actions, I believe it is time to update the 1994 Interpretive Guidance on the Antifraud Provisions. By making the obligations of municipal issuers more explicit, the Commission could help ensure that disclosure is as
complete, timely, and accessible as possible. For example, recent studies have indicated that many municipal issuers are woefully tardy in issuing their annual financial statements, and yet many of these municipalities continue to issue bonds in the market. But issuing securities based on out-of-date financials may violate the antifraud provisions of the federal securities laws if material changes have occurred in an issuer’s financial condition since its last financial statements were issued.

Second, I would like to see the Commission continue to work closely with the MSRB to further enhance the usefulness of EMMA. The MSRB has started this initiative well, and I think the Commission should support this effort strongly.

Finally, I believe that regulators and the industry should work more closely together to provide pre-trade transparency in this market. Why shouldn’t there be better information about potential buyers and sellers?

But as important as these regulatory and industry steps might be, municipal securities disclosure issues can only be addressed adequately through authority that federal securities regulators do not now possess. Therefore, to fully reform the regulation of the municipal securities market, I believe congressional action is necessary in a number of areas.

First, I believe that some changes need to be made to the MSRB. To begin with, it should have a majority public board.

Also, currently the MSRB does not enforce the rules it sets. Instead, FINRA, the Commission, and in some cases other appropriate regulatory agencies enforce the MSRB’s rules. Separating the regulatory function from the enforcement and examination functions can lead to coordination and communication problems. For this reason, I believe that Congress should seriously consider whether to combine the enforcement and regulatory authority over the municipal market into one self-regulatory organization.

Next, I believe that Congress should permit the Commission to apply to nongovernmental conduit borrowers the registration and disclosure standards that would apply if they issued their securities directly without using municipal issuers as conduits. This is something the Commission has long advocated, and I fully support the recommendation. The fact that the bonds are tax-exempt does not change the fact that these are private obligations in which investors look to a private entity for repayment.

I also believe that the Commission should have regulatory authority over all financial intermediaries involved in the municipal securities
The observed and reported misconduct of some municipal financial advisers is alarming. Here I am thinking of pay-to-play practices, undisclosed conflicts of interest, advice rendered by financial advisers without adequate training or qualifications, and failure to place the duty of loyalty to their clients ahead of their own interests.

In addition, as politically unpopular as this suggestion may be, I believe that the exemptions for municipal securities should be removed from the 1933 and 1934 Acts and that the Tower Amendment should be repealed.

Let me say immediately that I fully appreciate that deference should be shown to the special questions concerning disclosure and accounting that municipal issuers present. Municipal securities should not be treated exactly like corporate securities. Municipal disclosure serves a dual purpose. It both reports on the financial state of a municipal securities issuer and it tells citizens about how the municipality spends their hard-earned tax dollars. There is nothing quite like this in the corporate space. Moreover, there cannot be a one-size-fits-all approach to municipal disclosure, given the wide range of purposes and structures of the over 50,000 issuers in this market.

Nonetheless, appropriate legislative change would allow the Commission to take important steps to improve the quality and availability of municipal information to investors.

First, the Commission could require that municipal issuers make available to investors offering documents and periodic reports that contain information that is similar, although not exactly identical, to that required of issuers and offerings of corporate securities. Municipal issuers should not necessarily be required to receive pre-approval of offerings from the Commission. To me, what is most important is the integrity of the continuing disclosure obligations of issuers, not whether they receive pre-approval from the Commission before issuing a bond. Complete, timely, and accurate disclosure is essential for the proper functioning of the municipal securities markets — in particular, for efficient pricing.

Timeliness is a particular concern. With the appropriate authority, the Commission could mandate that municipal disclosures be issued in a time period that would make critical information available when investment decisions are made, not many months thereafter.

Of course, municipal issuers, like corporate issuers, should have an alternative to the registered public offering. With new authority, the Commission could engage in tailored rulemaking that would provide
appropriate exemptions, for example, for small issuances and private placements, just as currently exist for corporate securities offerings. One possibility worth considering is a tranched approach to issuer obligations. The largest issuers could be required to provide disclosures similar to public companies, while smaller issuers would be subject to a less rigorous disclosure regime.

Second, legislation could give the Commission the authority to mandate that municipal issuers use generally accepted governmental accounting standards. In some states, deviation from accounting standards set by the Governmental Accounting Standards Board, or GASB, is required by state law, and the situation seems to only be getting worse. Comparability of investment opportunities is critical, and today the only real way to compare municipal investments is by yield and ratings. That is not sufficient. Lack of uniform accounting standards makes financial statements hard to understand and difficult to compare, particularly for less sophisticated investors.

As part of this accounting reform, I believe that Congress should provide an independent funding mechanism for the GASB and permit Commission oversight of that body, as is now provided by the Sarbanes-Oxley Act for the Financial Accounting Standards Board, or FASB. Currently, GASB is funded by voluntary payments and contributions from states and local governments and the financial community, as well as sales of its publications. This funding mechanism simply is not adequate to ensure that the board is a truly independent standard setter.

Finally, I would like close with an observation on the recent discussion of mandating that credit rating agencies use a single scale for rating corporate and municipal bonds. I certainly support efforts to make the ratings of bonds more fair and accurate. In some ways, a single scale makes sense, given that corporate and municipal markets are increasingly interconnected. However, we do not want to lose the level of granularity that currently exists within the rating scale for municipal securities. At a minimum, though, if municipal issuers want to have their bonds rated on the same scale as corporate bonds, I believe they should be prepared to provide the same level of timely and accurate disclosure as corporate issuers. Investors deserve no less.

As I end my remarks, I think it would be fitting to quote Al one last time. He said, “Out of every crisis there emerges change, and in most, perhaps not all, cases, a change that serves the public good.” I hope that our experience with reform of the municipal securities market will be another instance of what Al called, “crisis fostering constructive
change."

I thank you very much for having me here this evening. I'd be happy to answer your questions.

(Applause)

MR. INDEK: We’ll take a couple of questions and then we’ll invite everybody to have a drink, including Elisse, outside.

QUESTION: Being an ex-Federal Reserve examiner, we were mandated to ensure the safety and soundness of the institutions down to the depositor. My dealings on the securities side are — if you are ensuring the interest of the investors, I don’t see presently how FINRA or SEC is ensuring the safety and soundness of the institutions that the people are investing in. Do you see them moving more in that direction, to have more oversight?

The second part of the question is, what about accountability of the examiners, the supervisor of enforcement when things are missed?

COMMISSIONER WALTER: Let me start with the first. The first really harks back to an age-old debate — or at least going back well beyond my years to when the securities laws were enacted in the 1930s — and that is what I think is a healthy tension between the banking laws and the securities laws. As you noted, the banking laws have as their focus the safety and soundness of the banking institutions and today, more broadly, the safety and soundness of the system. The securities laws, of course, don’t ignore either of those things, particularly with respect to entities we actually regulate — not corporate issuers, not municipal issuers, but broker-dealers, investment advisers. But the primary thrust of the federal securities laws is the protection of investors and the integrity of the markets.

So they are very different statutory schemes. They have been charged, perhaps wisely, to different bodies. That tension has been a healthy tension over many decades. So I don’t see the SEC shifting more to being a safety and soundness institution. I think that the SEC will continue to be what we like to call the investor’s advocate and to look at things through investors’ eyes.

That said, it, of course, doesn’t serve investors well to see their investments go down the tubes. But our first focus is not whether an issuer goes into bankruptcy — if that happens, that happens — but to try to preserve as much as possible for the investors in that entity.

Your second question related to the accountability of inspectors, examiners, enforcement folks, policymakers, and commissioners, when things go badly. I think we are accountable. I think we should be
accountable. I think there is enough blame in the current market crisis — or perhaps the evolving away from market crisis — to go around. I think we take our share of it. I do think that it is not appropriate to shift all blame to regulators when things go wrong. There is a tendency to do that at times. But I do think, particularly in this past financial crisis, the one we’re living through right now, that there were clearly mistakes that regulators, including the SEC, made. It is our job to try to rectify the consequences of that to the extent we can and to ensure that we don’t make the same mistake again — which will, of course, never be a guarantee that we won’t make a different mistake the next time. But we have to try.

QUESTION: Can you comment on the progress or potential timetable that the Commission will be taking with regard to the International Financial Reporting Standards?

COMMISSIONER WALTER: The question was on our potential timetable with respect to — I assume you’re talking about international accounting standards, IFRS.

As many of you probably know, the Commission late last year put out a roadmap with respect to potential adoption of IFRS for U.S. issuers. We plan to make another issuance on that subject before the end of this year.

As you may also know, since you seem to be familiar with the topic, there is an active convergence project going on between the FASB and the International Accounting Standards Board. That is one of the prerequisites, I believe, for the U.S. to move in that direction.

We are clearly, at the Commission, I believe, prepared to do that, if and when we determine that that is the best thing for U.S. investors. But it is moving forward and we are committed to moving forward with it.

QUESTION: Can you comment on the feasibility or desirability of increased regulatory authority of the SEC over the rating agencies, on whom the average investor relies?

COMMISSIONER WALTER: We’re trying to do two things in that area — or actually three things.

The first is to educate. One of the problems here is that people don’t understand what ratings do and what they don’t do.

Second is to take steps, along with others, to decrease reliance on ratings and to provide other accessible and understandable information to investors.

Third is to use the authority we have recently been granted to regulate rating agencies. As you probably know, that authority is
circumscribed. We are not entitled to interfere or to set rating agency methodology. I don’t particularly think that’s a flaw in the statutory structure, because I don’t believe that we have the expertise or will have the expertise to do that. But we are currently inspecting credit rating agencies. We have passed a number of rules to impose greater strictures on how they behave, and there are a number of rules that are also outstanding.

That, of course, is going on around the world. One of the most important aspects of this is, because we live in a global world with global markets, there has to also be some degree of consistency as you go across lines in this particular area.

QUESTION: What have you learned from Madoff?

COMMISSIONER WALTER: As I said, I think we learn from our mistakes, in terms of the mistakes we made with respect to Bernie Madoff. And there were many people who made mistakes, but the SEC was certainly among them. He would not be in that position again, because that lesson we clearly learned.

The question is whether we have learned more broadly to the next person who is going to be like that, who is going to take advantage of people in a somewhat different way.

I think what we should learn, all of us, is that healthy skepticism should be the norm. You look at many of the investors in Madoff who didn’t ask questions. You look at the regulators who didn’t ask enough questions.

I hope that we have learned on a number of different levels, in both very simple ways, as I suggested, and much more complicated ways, that we need to both close regulatory holes, do a better job examining people, and also take better care of our own money and be careful about whom we rely on in terms of making investments.

QUESTION: Are municipal pension liabilities currently shown on municipal balance sheets?

COMMISSIONER WALTER: There’s a question that I don’t really know the answer to. Some of them are and some of them are not, I believe. That’s a very important question, but rather a technical one, and although I confess to being a math major and I aspired to being an accountant, I am not one. But I can certainly find out the answer to that question for you if you want to give me a call next week. I will give you a very complicated answer to a simple question.

MR. INDEK: Thank you all. I invite everybody out for a drink. If everybody wants to get home for the first pitch tonight, you need to step
outside.

(Applause)