

THE COUNCIL OF STATE GOVERNMENTS
RESOLUTION ON RATING AGENCY
REFORM AND PRESERVING THE TOWER AMENDMENT

Resolution Summary

Tower Amendment:

The Tower Amendment to the Securities Act of 1933 was enacted in 1975 as part of legislation creating the Municipal Securities Rulemaking Board (“MSRB”). The Tower Amendment prohibits direct or indirect federal regulations of municipal issuers. It recognized the unique place that state and local governments occupy in our federal system and was developed to balance these unique interests with the need for additional market regulation. The legislative history of the Amendment indicates that Congress sought to limit federal oversight of state and municipal issuers.

In a white paper (“Disclosure and Accounting Practices in the Municipal Securities Market”) submitted to senior leadership of the House Financial Services Committee and Senate Banking Committee on July 27, 2007, SEC Chairman Christopher Cox proposed increasing federal authority over state and local issuers of municipal debt.

The proposals would require Tower to be amended or repealed and include: making municipal disclosure more like corporate disclosure; creating a centralized Web-based free site, such as the SEC’s EDGAR, through which investors could access such disclosure information; clarifying the legal responsibilities of municipal transaction participants; requiring municipal issuers to use generally accepted accounting standards, which are issued by the Governmental Accounting Standards Board; and providing an independent source of funding for and SEC oversight of GASB.

The municipal marketplace is already regulated by a combination of state blue sky laws, federal tax laws, the anti-fraud enforcement power of the SEC, Rule 15c2-12 and MSRB regulations on broker/dealers participating in the buying and selling of municipal securities, the analysis of independent credit rating agencies, and the demanding requirements of the capital markets. Indeed, it is reasonable to conclude that the substantial growth of the market and the increased percentage of municipal debt holdings by individuals are, in part, because investors recognize the safety, liquidity, transparency and efficiency of the municipal bond market. They reasonably rely on existing regulations and oversight to make informed investment decisions.

Nevertheless, the National Association of State Treasurers (NAST), an affiliate of The Council of State Governments, has been active in enhancing the efficiency and transparency of the municipal marketplace. For example, NAST along with other market participants created the Central Post Office as a central repository of issuers’ secondary market disclosure information. NAST supports the MSRB’s proposed “access equals delivery” protocol for electronic delivery of primary offering materials. More recently, NAST endorsed in concept the creation of a web-based, central repository of primary and secondary market disclosure information under development by the MSRB.

Rating Agency Reform:

In the 110th Congress, the House Financial Services Committee approved legislation, the Municipal Bond Fairness Act (H.R. 6308), to improve consistency and comparability of credit ratings. The following summary on rating agency reform is provided by the Conference Report (110-835) for H.R. 6308.

There are about 55,000 issuers of tax-exempt municipal bonds including state and local governments as well as various non-profit organizations such as hospitals and universities. These issuers range from the large and well known such as the state of California to the small and obscure school districts in rural areas.

Municipal bonds can generally be categorized as either general obligation (GO) or revenue bonds. GO bonds are backed by the taxing power of the issuing government and generally viewed as the safest of municipal bonds along with those revenue bonds backed by the ratepayers of public water and sewer utilities. A 2007 study by Moody's Investor Services found that only one Moody's-rated investment-grade bond in this category defaulted between 1970 and 2006.

Despite the lack of defaults of municipal bonds, issuers of these securities have historically earned a lower rating than comparable corporate bonds when viewed in terms of likelihood of default. Moody's Investor Services, for example, has employed a distinctly separate method of evaluating municipal bonds for 70 years. In general, Moody's bases its municipal bond ratings on the fiscal strength of the municipality that issues the bonds. For corporate bonds and structured, or asset-backed bonds, on the other hand, Moody's bases its rating on risk of loss. The effect is that the rating on most single A-rated municipal bonds, for example, would merit AA or higher if they were rated as corporate bonds.

This resolution was originally adopted by the National Association of State Treasurers at the 2008 NAST Annual Conference.

Additional Resource Information

- National Association of State Treasurers
www.nast.org
- United States Securities and Exchange Commission
www.sec.gov

CSG Management Directives

Management Directive #1: CSG will support its affiliate, the National Association of State Treasurers, in its opposition to the revision or repeal of the Tower Amendment and to the enactment of legislation to subject state and local government issuers to federal disclosure laws.

Management Directive #2: CSG staff will post approved resolution on CSG's web site and make available through its regular communication venues at the state and local level to ensure its distribution to the state government and policy community.

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WHEREAS, state governments and other levels of government rely on the issuance of tax-exempt bonds to finance the construction of critically needed infrastructure; and

WHEREAS, bond ratings have a direct impact on the interest rates at which governments can issue their bonds, and therefore the debt service their taxpayers must support; and

WHEREAS, three rating agencies – Fitch, Moody’s and Standard & Poor’s – assign the great majority of ratings used in the municipal bond market and, therefore, their rating methodologies play an important role in determining the cost to taxpayers of investing in infrastructure; and

WHEREAS, because the three rating agencies have a profound impact on the municipal bond market, there is an important public purpose in ensuring that bonds are rated fairly and appropriately; and

WHEREAS, both Moody’s and Fitch acknowledge they have applied a stricter rating standard to the rating of municipal bonds compared to the rating of corporate bonds; and

WHEREAS, the primary obligation of an issuer of bonds is to pay the debt service on the bonds on time and in full; and

WHEREAS, the Council of State Governments adopted a resolution at the 2007 CSG Spring Meeting in Lexington, Kentucky, entitled “Resolution Opposing Amendment or Repeal of the Tower Amendment” which opposes the extension of federal disclosure laws to state and local government issuers; and

NOW THEREFORE BE IT RESOLVED, that The Council of State Governments acknowledges the recent dialogue rating agencies have conducted with state treasurers and other issuers in this regard and recommends that: (1) rating agencies should utilize a single rating scale for all debt instruments such that a rating applied to a municipal bond indicates the same credit risk as that same rating applied to corporate bonds, while also recognizing the need for relative ratings amongst municipal issuers; and (2) ratings should measure the ability of an issuer to meet its obligation to investors as promised in the bond documents, such obligation primarily being to pay debt service on time and in full.

BE IT FURTHER RESOLVED, that The Council of State Governments urges the Congress and the administration not to take any action that would preempt state and local finance authority

and state oversight of the debt issuance process through revision or repeal of the Tower Amendment or enactment of legislation to subject state and local government issuers to federal disclosure laws.

Adopted this ____Day of November, 2009 at the CSG Annual Conference in La Quinta, California

Governor Joe Manchin III, West Virginia
2009 CSG President

Sen. Bart Davis, Idaho
2009 CSG Chair