



August 13, 2009

The Honorable Timothy F. Geithner  
Secretary  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Dear Secretary Geithner:

The MSRB has been following with interest the development of the Administration's proposal for the establishment of a comprehensive regulatory framework for over-the-counter (OTC) derivatives, most recently articulated in the proposed legislation sent to Congress on August 11, 2009. The proposed legislation makes clear that you are aware of the extensive use of derivatives by state and local governments, particularly interest rate swaps designed to hedge the risk of interest rate changes in variable rate demand obligations (VRDOs). There also is a market in credit default swaps (CDS) for which the reference obligations are municipal bonds or a portfolio of municipal bonds. We refer to those CDS as "muni CDS."

As you know, municipal derivatives are not currently defined as securities and, therefore, not within the jurisdiction of the Municipal Securities Rulemaking Board (MSRB)<sup>1</sup>. However, despite this fact, the MSRB has long emphasized to municipal market participants the importance of understanding derivatives and their risks, and of holding derivatives players to the same standards as those in the municipal bond market.

Because of the prevalence of municipal derivative activity, and the current lack of regulatory oversight of these contracts, in a February 6, 2009 letter to the chairmen and ranking members of the Senate Banking Committee and House Financial Services Committee (on which you were copied), the MSRB recommended that "derivative instruments based on municipal securities should be subject to the same comprehensive regulatory framework that may be

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<sup>1</sup> The Municipal Securities Rulemaking Board (MSRB) is a self-regulatory organization established by Congress in 1975 under Section 15B of the Securities Exchange Act of 1934 to develop rules for securities firms and banks that underwrite, trade, and sell municipal securities.

developed for swaps and other types of derivative financial products in other markets . . .”  
The MSRB noted that:

[t]he proposals under discussion for increased oversight of the derivatives market includ[ing] the development of a central clearinghouse for . . . CDS; the use of a central counterparty; filing disclosures by hedge fund managers, brokerages, and institutional investors; disclosure by CDS dealers of their trades and positions; and minimum capital reserves . . . appear reasonable, appropriate and worthy of further study. Should enhanced disclosures in derivative instruments be a part of any regulatory scheme, the MSRB is well poised with its [Electronic Municipal Market Access] (EMMA) system to provide disclosures of municipal derivative contracts and provide the necessary transparency for our market.

EMMA is the repository for trade data about municipal securities transactions, offering documents for new issues of municipal securities, advance refunding documents, and continuing disclosure about municipal securities. EMMA already accepts voluntary issuer disclosure concerning derivative transactions through its continuing disclosure system. While municipal derivatives disclosure is not mandated, many investors consider it material to their investment decisions and have recommended that issuers use EMMA as a means to disseminate such disclosure to all investors.

The MSRB continues to consider it essential that all municipal derivatives counterparties be well-informed about the risks of their derivatives contracts, which often are quite complex. We note that the proposed legislation would require the Commodity Futures Trading Commission and the Securities and Exchange Commission to adopt business conduct standards for derivatives dealers, which would require disclosure to counterparties of material terms and risks. This proposal is consistent with our principles of fair dealing, under which municipal securities underwriters should disclose the material facts (including affiliations or other potential conflicts of interest, fees earned, etc.), implications, and risks of complex derivatives transactions that are integral to municipal securities transactions. In addition, we reiterate our position stated earlier this year, wherein the MSRB Board called for bringing derivative advisors in our market under a comprehensive regulatory scheme including professional qualification requirements, pay-to-play restrictions, and fair dealing responsibilities.

We would welcome the opportunity to meet with you or your staff to discuss issues unique to the municipal derivatives market.

Very truly yours,



Ronald A. Stack  
Chair

Cc: Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission  
Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission  
Ben S. Bernanke, Chairman, Federal Reserve Board  
William C. Dudley, President and CEO, Federal Reserve Bank of New York



1900 Duke Street, Suite 600  
Alexandria, VA 22314-3412  
*p* 703 797 6600  
*f* 703 797 6700  
[www.msrb.org](http://www.msrb.org)