Regulations Gearing Up

By Susan Gaffney

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This Fall, many federal government agencies, including the Securities and Exchange Commission (SEC), the Municipal Securities Rulemaking Board (MSRB), and the Internal Revenue Service (IRS), have proposed or finalized regulations that also affect state and local governments. Highlights of these initiatives are listed below, and additional information may be found on the GFOA's Federal Government Relations Web site.

SEC SEEKS COMMENTS ON MUTUAL FUND REPORT

The SEC has requested comments on an October report, *The President's Working Group Report on Money Market Reform Options*. The report suggests money market mutual funds are susceptible to runs, which could contribute to systemic risks to the financial system. It weighs the pros and cons of possible rule changes the SEC could adopt, notably requiring the use of a floating net asset value (NAV) rather than the current stable NAV.

In June, the Government Finance Officers Association's membership approved a new public policy statement, *Maintaining the Stable Net Asset Value Feature of Money Market Funds*. In that statement, the GFOA opposed the idea of mandating that money market funds use a floating NAV, rather than a stable NAV, by eliminating the use of the amortized cost method of valuation. The GFOA has written to the SEC on this matter in the past and will again comment that the change would strip away a key safety trait of the funds for investors: a dollar in–dollar out investment tool. As state and local governments are large investors in stable NAV money market funds, and these funds are the largest purchaser of short-term municipal bonds, a move to a floating NAV would have a significantly negative impact on state and local governments.

The GFOA will work with other state and local government organizations on a response to the report of the President's Working Group on Financial Markets. While the SEC has not yet proposed specific changes to the rules governing money market funds, it is seeking public comment on the report by January 10, 2010.

IRS ISSUES UPDATED COST-OF-LIVING ADJUSTMENTS

The 2011 IRS dollar limits for qualified plans, other tax-favored retirement plans, and Social Security payments are determined using Consumer Price Index (CPI) data released October 15, 2010. Because the CPI increased just 0.1 percent from September 2009 to September 2010, the IRS dollar limits and the taxable Social Security wage base will not change in 2011, for the

Congress Yet to Act on Tax Bill

As of press time in early December 2010, Congress had yet to act on tax legislation that includes provisions important to state and local governments. It remains uncertain whether the following programs, which expire at the end of 2010 — most of which were included in the American Recovery and Reinvestment Act (ARRA) — will be included in the final package. The GFOA is closely monitoring these developments, and members should look to the GFOA Newsletter and Web site (at www.gfoa.org) for additional information.

Maintaining the Bank-Qualified Debt Limit at $30 Million

The ARRA increased the bank-qualified debt limit from $10 million (which was set in 1986) to $30 million. This provision allows banks to receive tax incentives for directly purchasing the bonds of smaller governments and lowers the debt issuance costs for those governments.

Build America Bonds Program

This taxable bond program allows governments to receive a subsidy payment from the federal government equal to 35 percent of the interest costs of the bonds, for the lifetime of the bonds. If this program is extended, all the proposals would decrease the amount of the subsidy for bonds issued in 2011 and thereafter.

Recovery Zone Bond Programs

The ARRA included another taxable bond program, Recovery Zone Economic Development Bonds, which are similar to Build America Bonds, but governments receive a subsidy payment of 45 percent of the interest cost for projects that promote economic development within a jurisdiction. In another program, Recovery Zone Facility Bonds, the federal government provides each state with an allocation that is then allocated to cities and counties within their state.

Federal Home Loan Bank Letters of Credit

The Housing and Economic Recovery Act of 2008 expanded the Federal Home Loan Bank's authority and allows their member banks to provide letters of credit to all tax-exempt bond issuers. Prior to this, Federal Home Loan Banks could offer letters of credit only to bonds for housing projects.

State and Local Sales Tax Deduction

Each year since 1994, Congress has reinstated a tax provision, eliminated in the 1986 Tax Act, allowing taxpayers to deduct state and local sales taxes from their annual federal tax returns. This provision is especially important for those residing in states that don't have an income tax.

Please monitor GFOA Newsletter and Web site for up-to-date information on these tax matters.

second consecutive year. The Social Security taxable wage base will remain at $106,800. The contribution limit for employees who participate in 401(k), 403(b), or 457(b) plans remains unchanged at $16,500. The catch-up contribution limit under those plans for those aged 50 and older remains $5,500. More information on pension plan limitations is available at http://www.irs.gov/newsroom/article/0,,id=229975,00.html. Information on the Social Security wage base is available at http://www.ssa.gov/pressoffice/factsheets/colafacts2011.pdf.

SEC FOCUSES ON MUNICIPAL SECURITIES

The SEC held its first field hearing on the "State of Municipal Securities" in San Francisco. The 2010-2011 series of hearings is an SEC effort being led by SEC Commissioner Elise Walter to learn more about all aspects of the municipal securities industry and issuer disclosure practices. When the hearings are over, the SEC will develop a staff report containing information learned and will make recommendations for regulatory changes and industry best practices, as well as legislative changes, if any. The GFOA has continued to express opposition to the idea that the SEC should have authority over state and local governments that issue debt, and the GFOA opposes any actions that would mandate specific disclosure practices on issuers.

Ed Harrington, general manager of the San Francisco Public Utilities Commission and former GFOA president, testified on behalf of the GFOA about the internal controls in San Francisco, California. Harrington not only addressed the significant internal control policies that governments follow but also raised questions about the purpose of the hearings and spoke out against the SEC's premise that transparent and timely information is not available to investors or the public. Harrington's comments are available on the GFOA's Web site at www.gfoa.org.

At the second hearing, held in Washington, D.C. in December 2010, Timothy Firestine, chief administrative officer of Montgomery County, Maryland, and GFOA Executive Board member testified on a panel related to the Governmental Accounting Standards Board, accounting practices, and preparing financial documents.

Future hearings, yet to be formally announced, will likely take place in Chicago, Illinois; Florida; and Texas. More information about the SEC's focus on municipal securities is available at http://www.sec.gov/spotlight/municipalsecurities.shtml.

MUNICIPAL SECURITIES ADVISORS AND PROTECTING ISSUERS

The Dodd-Frank Act gave the MSRB the authority to regulate municipal financial advisors, including swap advisors, GIC providers, and public pension placement agents. The MSRB and the SEC have started their work with developing proposed regulations covering these professionals, including registration requirements. To advise states, localities, and authorities, all financial advisors will have to register with the MSRB by December 31, 2010. They will also be subject to professional requirements and regulations — to be developed — similar to those that are in place for the broker-dealer community. The Dodd-Frank Act also revised the MSRB's mission to protect not only investors of municipal securities, but also issuers. The GFOA's Debt Management Committee submitted a letter to the MSRB highlighting areas in which they could develop rules, encourage transparency, and enhance electronic municipal market access (EMMA) to help the issuer community.

> The SEC's proposed regulations would consider some municipal securities as asset-backed securities, making them subject to new disclosure and administrative rules.

MSRB RULE G-23: RULES FOR DEALERS AND FINANCIAL ADVISORS

The MSRB proposed changes to its Rule G-23 that would prohibit financial advisors from also serving as an underwriter on a bond transaction. The proposed rule change comes on the heals of the SEC chairman's statements that having a professional serve as both the financial advisor and underwriter is a conflict of interest. Currently, Rule G-23 allows a financial advisor to resign and become the underwriter in the transaction, so long as the advisor discloses the possible conflict of interest to the issuer.

The GFOA submitted formal comments supporting the changes to MSRB Rule G-23. The GFOA has previously submitted comments indicating that Rule G-23 should be changed to prevent a financial advisor from resigning and becoming underwriter in that transaction. This recommendation is also articulated in the GFOA's best practices on the *Method of Sale of Municipal Bonds*, *Selecting Financial Advisors*, and *Underwriters in a Negotiated Sale*.

THE SEC AND ASSET-BACKED SECURITIES

The GFOA, along with 13 other organizations representing issuers, underwriters, and financial advisors, submitted comments to the SEC in early November 2010 regarding the agency's proposed regulations over asset-backed securities. The Dodd-Frank Act, enacted this summer, places new disclosure, review, and risk retention responsibilities on asset-backed securities products. The SEC's proposed asset-backed securities regulations would consider some municipal securities as asset-backed securities, making them subject to new disclosure and administrative rules. The GFOA's comments strongly oppose the SEC's assumption, noting that municipal securities are far different than asset-backed securities products, and applying asset-backed securities rules to them would not work, at the very least, from a practical standpoint. More importantly, the comments conclude that there is no congressional intent to include municipal securities as asset-backed securities, since the Dodd-Frank Act specifically excludes municipal securities from its definition, and applying the asset-backed securities rules to munis would violate the Tower Amendment.

President Signs Legislation Removing Employer-Provided Cell Phones from Listed Property and Expands Roth Contributions to 457(b) Plans

In late September, President Obama signed legislation (P.L. 111-240) that removes employer-provided cell phones from the definition of listed property under the tax code, relieving state and local governments of the extensive, burdensome, and costly administrative and record-keeping requirements that have been necessary to identify and track calls made from these phones. The Government Finance Officers Association, along with other associations representing state and local governments, have been advocating for this change to the tax code for the past few years.

Also included in the law is a provision that would level the playing field for state and local government employees by allowing participants in governmental Section 457(b) plans to treat elective deferrals as Roth contributions. This option is already permitted in 401(k) and 403(b) plans. The bill would also allow 401(k), 403(b), and 457(b) plans to permit participants to roll their pre-tax account balances into a Roth account. The amount of the rollover would be included in taxable income except to the extent it is the return of after-tax contributions. If the rollover is made in 2010, the participant can elect to pay the tax in 2011 and 2012.

LOOKING TO 2011

In 2011, federal government agencies are likely to propose an avalanche of new regulations as the Dodd-Frank Act is implemented and tax rules for 2011 are finalized. The GFOA's Federal Liaison center will closely monitor the proposals that will ultimately affect state and local governments that issue debt and invest in many types of financial products. This is especially true of regulations over financial advisors, money market mutual funds, derivative contracts, and rating agency practices.

SUSAN GAFFNEY is the director of the GFOA's Federal Liaison Center in Washington, D.C.