

## Securities and Exchange Commission Increases Disclosure Requirements for Municipal Securities

June 18, 2010

On May 26, 2010, the Securities and Exchange Commission (the “Commission” or “SEC”) adopted amendments to Rule 15c2-12 (“Rule 15c2-12” or the “Rule”) under the Securities Exchange Act of 1934, as amended. See SEC Release No. 34-62184A (the “Adopting Release”). In the Adopting Release, the SEC also provided additional interpretive guidance with respect to underwriters’ responsibilities to investors in municipal securities. Issuers of municipal securities and other obligated persons<sup>1</sup> will need to comply with the new rules beginning December 1, 2010 (the “Compliance Date”). The amendments will only affect continuing disclosure agreements that are entered into in connection with primary offerings<sup>2</sup> of municipal securities on or after the Compliance Date. This Client Alert highlights the key changes to Rule 15c2-12 recently adopted by the Commission.

Please click on this [link](#) to view the Adopting Release.

According to the Commission, the amendments are intended to improve continuing disclosure requirements for municipal securities in order to enable investors in such securities to make more informed and better decisions about their investments. Indeed, speaking of the Commission’s adoption of the amendments to the Rule, SEC Chairman Mary L. Schapiro stated that the new rules will enhance disclosure requirements for municipal securities by increasing the scope of securities covered by the Rule and the nature of events subject to continuing disclosure requirements and by establishing a specific time frame in which disclosure of certain events must be made.

---

<sup>1</sup>“Obligated person” means 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). Rule 15c2-12(f)(10).

<sup>2</sup>“Primary offering” means an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing of municipal securities: (i) that is accompanied by a change in the authorized denomination of such securities from \$100,000 or more to less than \$100,000, or (ii) that is accompanied by a change in the period during which such securities may be tendered to an issuer of such securities or its designated agent for redemption or purchase from a period of nine months or less to a period of more than nine months. Rule 15c2-12(f)(7).

## I. Disclosure Requirements under the Existing Rule

Rule 15c2-12 currently requires underwriters participating in primary offerings of municipal securities of \$1,000,000 or more to furnish investors, upon request, with copies of an official statement prepared in connection with the offering. Further, under the current Rule, an underwriter in a primary offering must reasonably determine before purchasing or selling municipal securities that issuers and other obligated persons have contractually undertaken, in writing, to provide continuing disclosure information with respect to the securities in question to the Municipal Securities Rulemaking Board (“MSRB”), subject to certain exemptions. The continuing disclosure information required to be filed with the MSRB includes annual financial statements, certain operating data with respect to an issuer or obligated person, notices of material events and notices of failure to comply with the aforesaid written undertaking.

## II. Amendments to the Rule

### a. *Variable Rate Demand Obligations Subject to Continuing Disclosure Requirements*

The current Rule affords limited exemption to certain types of municipal securities, including certain variable rate demand obligations (“VRDNs”) which are long-term securities that bear interest at short-term interest rates because they may be tendered for redemption or purchase.<sup>3</sup> As a result of this exemption, issuers and other obligated persons with respect to VRDNs are not required to furnish annual financial information or file notices of the listed events with the MSRB.

The amendments eliminate this exemption for VRDNs, requiring participating underwriters to reasonably determine that issuers of VRDNs, or other obligated persons, have agreed in a written contract to provide continuing disclosure documents and event notices to the MSRB. The rule changes would affect any primary offering of VRDNs, as well as a remarketing of such securities that constitutes a “primary offering” within the meaning of Rule 15c2-12. The SEC emphasized that the changes are justified given the substantial growth and other developments in the market for VRDNs since the inception of the Rule in 1989. The elimination of this exemption will now require issuers of VRDNs or other obligated persons in connection therewith to prepare annual financial information and operating data disclosure for their offerings.

---

<sup>3</sup>Specifically, the current Rule provides that a primary offering of municipal securities in authorized denomination of \$100,000 or more are exempted from the notice requirements of the Rule if such securities at the option of the holder thereof may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent. Rule 15c2-12(d)(iii).

The Commission stated that these amendments, however, will not apply to remarketings of VRDNs that are outstanding on the day preceding the Compliance Date as long as such securities (i) continue to remain in authorized denominations of \$100,000 or more and (ii) may, at the option of the holder thereof, be tendered to the issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by such issuer or its designated agent. Accordingly, issuers with VRDNs outstanding on or before November 30, 2010 and other obligated person with respect thereto will not be subject to the new continuing disclosure requirements.

*b. Additional Events Subject to Disclosure*

The amendments to the Rule expand the list of events relating to a municipal security that issuers or other obligated persons must have agreed to disclose pursuant to a written agreement. The amendments require four additional events to be reported, two of which would need to be disclosed only if material. The four additional events are (i) tender offers; (ii) bankruptcy, insolvency, receivership or similar proceeding regarding an issuer or an obligated person; (iii) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (iv) appointment of a successor or additional trustee, or the change of the name of a trustee, if material.

*c. Elimination of the Materiality Condition for Certain Events*

Rule 15c2-12 currently requires, among other things, that issuers of municipal securities or other obligated persons file with the MSRB “in a timely manner” notices of certain material events relevant to the municipal securities that have been issued. Under the existing Rule, notices of the events listed in Rule 15c2-12 must be filed if such events are deemed to be “material”. Currently, the Rule lists eleven events that would need to be disclosed, if material.<sup>4</sup> The amendments clarify that six of such eleven

---

<sup>4</sup>The current Rule requires notices to be filed, in a timely manner, with the MSRB with respect to the following eleven events, if material:

- (1) Principal and interest payment delinquencies;
- (2) Non-payment related defaults;
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (5) Substitution of credit or liquidity providers, or their failure to perform;
- (6) Adverse tax opinion or events affecting the tax-exempt status of the security;
- (7) Modifications to rights of security holders;
- (8) Bond calls;
- (9) Defeasances;
- (10) Release, substitution, or sale of property securing repayment of the securities;
- (11) Rating changes.

Rule 15c2-12.

In addition, the existing Rule requires notices to be furnished in the event of a failure to provide required annual financial information within a specified time period.

events are of such great importance to investors that information about them should be automatically disclosed in all circumstances. Accordingly, the amendments repeal the materiality qualification with respect to such six events. These six events include: (i) principal and interest payment delinquencies with respect to the municipal securities being offered; (ii) unscheduled draws on debt service reserves reflecting financial difficulties; (iii) unscheduled draws on credit enhancements reflecting financial difficulties; (iv) substitution of credit or liquidity providers, or their failure to perform; (v) defeasances; and (vi) rating changes.

The materiality condition, however, will remain applicable to the following events: (i) non-payment related defaults; (ii) modifications to rights of security holders; (iii) bond calls; and (iv) the release, substitution or sale of property securing repayment of the securities.

*d. Disclosure of Certain Tax Events Affecting the Tax Status of Municipal Securities*

The current Rule requires issuers and other obligated persons to file a notice in the event of adverse tax opinions or events affecting the tax-exempt status of the security, if material. The amendments clarify that certain tax events (described below) are of such significance to investors that issuers or other obligated persons should submit notices regarding such events without regards to a materiality determination. The amendments require that participating underwriters reasonably determine that issuers or other obligated persons have undertaken in a written agreement to disclose, at all times, any adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security.

*e. Establishment of a Filing Deadline for Notices*

The existing Rule requires notices of the listed events be filed simply in a “timely manner”, without designating a specific filing deadline. The amendments provide clarity regarding the time frame for filing of event notices by requiring that event notices be filed in a timely manner not in excess of ten business days after the occurrence of the event, rather than simply “in a timely manner”.

### **III. Additional Interpretative Guidance on Obligations of Underwriters**

In previous years, the Commission has provided interpretative guidance relating to underwriters’ obligations under the antifraud provisions of the federal securities laws, particularly when making a determination as to whether there is a reasonable basis to recommend any municipal securities to investors in an offering. In the Adopting Release, the Commission reaffirmed its previous interpretations and provided additional guidance with

respect to underwriters' obligations and duties to investors in municipal securities. The Commission emphasized that an underwriter in a municipal offering should carefully evaluate whether an issuer of municipal securities or other obligated person would abide by its continuing disclosure undertaking that it has made. According to the Commission, underwriters should, at a minimum, review the issuer's or obligated person's disclosure documents in a professional manner for possible inaccuracies and omissions and should use independent judgment, considering all relevant facts, in forming their reasonable belief as to the accuracy or completeness of the issuer's or obligated person's continuing disclosure representations, rather than merely relying on such issuer's or obligated person's representations.<sup>5</sup> In making its independent judgment, an underwriter should, therefore, consider evidence suggesting that a particular issuer or an obligated person has in the previous five years repeatedly failed to provide annual filings or event notices. The Commission further stated that it is doubtful that an underwriter could meet the reasonable belief standard if it failed to affirmatively inquire as to a particular issuer's or obligated person's filing history with respect to continuing disclosure documents.

*For more information, please contact J. Anthony Terrell at +1 212 259 7070 or [jterrell@dl.com](mailto:jterrell@dl.com), Michael F. Fitzpatrick, Jr. at +1 212 259 6670 or [mfitzpatrick@dl.com](mailto:mfitzpatrick@dl.com), Peter A. Baumgaertner at +1 212 259 8057 or [pbaumgae@dl.com](mailto:pbaumgae@dl.com), S. Christina Kwon at +1 212 259 6372 or [ckwon@dl.com](mailto:ckwon@dl.com), or your Dewey & LeBoeuf relationship partner.*

---

<sup>5</sup>When evaluating the reasonableness of an underwriter's basis for assessing the accuracy and truthfulness of representations in final official statements, the Commission reiterated that the following non-exclusive list of factors should be considered:

- (1) the extent to which the underwriter relied upon municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts;
- (2) the role of the underwriter (manager, syndicate member, or selected dealer);
- (3) the type of bonds being offered (general obligation, revenue, or private activity);
- (4) the past familiarity of the underwriter with the issuer;
- (5) the length of time to maturity of the bonds; and
- (6) whether the bonds are competitively bid or are distributed in a negotiated offering.