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Muni Disclosure Responsibility Would Shift to Issuers From Underwriters in Draft Bill

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WASHINGTON – Rep. Gwen Moore, D-Wis., has drafted a bill that would reorient the entire municipal securities disclosure regime by making state and local government issuers or borrowers, rather than their underwriters, responsible for the disclosure of bond-related information.

Currently, the Securities and Exchange Commission cannot regulate muni issuers and instead makes underwriters responsible for muni disclosures. The SEC's Rule 15c2-12 on muni disclosure says a firm cannot underwrite an issuer's bonds unless that issuer has contractually agreed to disclose financial and operating information at least annually as well as material events as they occur.

The draft bill, which is being circulated among muni market groups and could be introduced this week, would basically codify the recommendations the Securities and Exchange Commission made in its 2012 Report on the Municipal Securities Market.

The legislation would remove the muni exemption from registration for private activity bonds, so PAB transactions would either have to be registered with the SEC or fall under some other exemption such as the one for private placements. Bonds for nonprofit hospitals and universities would continue to be exempted from registration under their 501(c)(3) exemption.

The SEC has recommended that PAB or conduit deals that involve corporate borrowers be registered, since corporations must register corporate deals.

The bill also would authorize the SEC to establish baseline mandatory disclosure requirements, including content and timing, for primary offerings. But the requirements could vary for different classes of issuers or borrowers.

Issuers and borrowers with more than $10 million of outstanding municipal securities would have to adopt internal controls and systems, including written policies and procedures that, at a minimum, identify each official responsible for each aspect of disclosure as well as the process by which official statements are drafted and reviewed.

But the bill would authorize the SEC to adopt a rule allowing issuers and borrowers to comply with these control and systems provisions through a state-wide system of disclosure controls and education.

The legislation would also authorize the SEC to prescribe accounting methods for state and local bond documents and bond-related financial information. Alternatively, the SEC could require they use the reporting and accounting standards of a standards-setting body, such as the Government Accounting Standards Board (though the bill does not mention GASB).

The bill would provide a safe harbor for forward-looking statements made by issuers and borrowers.

The legislation would not repeal the Tower Amendment of the Securities Exchange Act of 1934, which prohibits the SEC and Municipal Securities Rulemaking Board from requiring issuers to file bond-related documents with them before the sale of municipal securities.

Moore's staff declined to comment. But sources say she has been interested in reorienting and toughening muni disclosure for some time, especially after the Municipalities Continuing Disclosure Cooperation initiative showed that a number of large issuers, such as Minnesota, Hawaii and Syracuse, as well as small issuers, falsely stated in offering documents that they were in compliance with their continuing disclosure requirements.

"It's just not a rational way for the market to operate where underwriters are responsible for issuers' disclosures," said one source who did not want to be identified.

At least one group is supportive of the legislation. National Federation of Municipal Analysts industry and media liaison William Oliver said NFMA supports any substantive effort to improve disclosure. He noted that the bill covers recommendations that the group made in an August letter to the SEC and said the effort is "an idea worth pursuing." NFMA's letter, which the group also sent to a number of other regulators, had recommended authorizing the SEC to require issuers to prepare primary and continuing disclosure during the term of the securities.

But issuers are up in arms about the draft.

"It's a very bad idea, very misguided," said Ben Watkins, Florida's bond finance director. "It will be vigorously opposed by state and local groups."

"It feels suspiciously like [SEC chair] Mary Jo White's Hail Mary" before she leaves the commission early next year, he added.

Watkins said the SEC should not be writing muni disclosure rules because it screwed up the initial muni disclosure regime that was set up, which included many Nationally Recognized Municipal Securities Information Repositories collecting disclosure documents all at once, and then it took 20 years to fix that system.

Emily Brock, director of the Government Finance Officers Association's federal liaison center, said the bill would "fundamentally change municipal disclosure" and raises "the issue of federalism."

GFOA's debt committee has asked Sean Gard, Moore's legislative director, to speak at its meeting here this week and explain why the legislation is needed and what problem it will fix.

Susan Gaffney, president of SG Associates and a predecessor of Brock at GFOA, said, "I think the issuers have been concerned that this kind of legislation would come forward after the SEC's 2012 report."

"A review of the legislation is troublesome," she said, adding, some sections are "vague and subject to SEC interpretation" while others are overly "prescriptive."

"GFOA has many best practices that hit on the issues raised by the legislation, showing that market practices are better than regulations" for improving disclosure, Gaffney said.

Chuck Samuels, a lawyer with Mintz Levin, said, "The bill would reverse many decades of regulatory approach and structure for municipal disclosure. I think we have to be very careful before we up-end the entire regime."

Samuels said the bill "comes at a time when we've had an election and one of the outcomes seems to be an interest in less regulation."

But one source who did not want to be named said the new Congress could be interested in the bill because it would mean less regulation for underwriters.

Frank Shafroth, director of the Center for State and Local Leadership at George Mason University, said, "Here we have a president-elect who's talking about all of this spending on infrastructure and we have people making it harder and harder and more expensive to do it," by proposing restrictions on municipal bonds.

"I think issuers are going to throw their full weight into opposing this legislation," said one lawyer who did not want to be identified. The dealer groups "may want this to happen, but they won't publicly support it," he added.

Bond Dealers of America declined to comment and the Securities Industry and Financial Markets Association could not be reached for comment.

The legislation includes twelve types of information an issuer would be required to include in an official statement but gives the SEC the discretion to require more disclosures.

The OS would need to identify and describe any issuer or other borrower with respect to the securities being offered as well as provide a description of any legal limitations on the incurrence of indebtedness by the issuer, borrower, or taxing authority of the issuer. It would also need to describe the issuer's or borrower's debt structure, including information with respect to amounts of authorized and outstanding debt, estimated short-term debt, security of debt, and debt service requirements, as well as the nature and extent of their other material contingent liabilities or commitments.

Other information would have to be disclosed about: defaults; whether securities are supported by taxes; the issuers' financial statements if they are material; the intended use of the proceeds of the offering; and any material conflicts of interest of the issuer or other obligated person and any other party involved in the offering.
