

“Recent Municipal Securities Law Developments–Rule 15c2-12 Amendments and Other Recent Developments Regarding Disclosure in Municipal Offerings”

(Webinar Presentation)

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- No charge
- Electronic submission of questions
- Slides available upon request (E-mail mvacha@dilworthlaw.com)



Purpose of Presentation

- Overview of recent amendments (“2010 Amendments”) to SEC Rule 15c2-12
- Discussion related to SEC Municipal Forums
- Overview of parts of Dodd-Frank legislation impacting municipal securities
- Other recent disclosure related news
- Focus on a number of common issues regardless of the precise characteristics of the issuer/conduit borrower



Purpose of Presentation (continued)

- Identify legal and related considerations relevant to these matters
- Informative for governmental entities/conduit borrowers, their management and advisors



Purpose of Presentation (continued)

- Intended to be at a fundamental and intermediate level
- To help spot issues
- To identify emerging developments to monitor in the future



Rule 15c2-12 2010 Amendments: Certain Basic Points Related to 2010 Amendments

- Pursuant to Release No. 34-62184A; File No. S7-15-09; RIN 3235-AJ66
- Action: Final rule and interpretation.
- Release date was May 26, 2010
- **Compliance Date: December 1, 2010**



Rule 15c2-12 2010 Amendments: Certain Basic Points Related to 2010 Amendments (continued)

- Consistent with previous SEC releases re Rule 15c2-12, does not directly regulate issuers, conduit borrowers or other obligated persons
- The 2010 Amendments revise certain requirements regarding the information that an issuer of municipal securities or an obligated person has undertaken to provide to the MSRB pursuant to a written agreement for the benefit of holders of the securities
- Reasonable determination must be made by parties acting as underwriters that this undertaking has been made



Summary—Putting 15c2-12 2010 Amendments in Larger Context (continued):

- Adopted in 1989—required participating underwriters (term of art) to obtain, review and distribute to potential customers copies of the issuer’s official statement
- 1994 amendments established continuing disclosure
- 2008 amendments to provide for MSRB as single centralized repository (post-NRMSIR regime)



Summary—5 Major Categories of Changes per Rule 15c2-12 2010 Amendments

- Variable Rate Demand Obligation (“VRDOs”) changes
- New specified events
- Changes to materiality determination
- Change in timing requirements for submitting material event notices
- Changes to adverse tax event category



Rule 15c2-12 Amendments—please note that certain key things, among others, not altered

- No changes concerning content for annual disclosure
- No accounting changes
- No rules about number of days after year end within which the annual filing must be made



Rule 15c2-12 2010 Amendments: VRDOs

- Amendments make VRDOs subject to continuing disclosure requirements as for fixed rate bonds
- Subject to certain limited grandfathering
- Other exemptions for VRDOs from Rule 15c2-12 remain (e.g. exemption from requirement to review deemed final OS)



Rule 15c2-12 2010 Amendments: VRDOs (rationale for changing exemption)

- Increased issuance, trading volume and outstanding dollar amounts of VRDOs
- Some investors, such as mutual funds, appear to hold VRDOs for long periods of time
- Input from large funds expressing desire for disclosure of underlying credit
- To assist individual investors as well as institutional investors



Rule 15c-12 2010 Amendments: VRDOs (“limited grandfather provision”)

- Requirements:
 - Securities are outstanding as of November 30, 2010
 - Remain in authorized denominations of \$100,000 or more
 - May, at the option of the holder, be tendered for redemption or purchase at par or more
 - Right to so tender at least as frequently as every nine months



Rule 15c2-12: Does the change in the VRDO exemption eliminate all exemptions related to the Rule?

- No. Doesn't change certain exemptions related to short-term securities.
- Also, the 15c2-12 analog of Reg. D/Rule 144 type private placement exemptions remains.
- To summarize, this exemption is for:
 - primary offering of municipal securities in authorized denominations of \$100,000 or more, if such securities:
 - Are sold to no more than thirty-five persons and the Participating Underwriter reasonably believes:
 - The investor has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and
 - The investor is not purchasing for more than one account or with a view to distributing the securities



Summary-Major Categories of Changes per Rule 15c2-12 amendments: New Event Notices

- Tender offers
- Bankruptcy/insolvency/similar events
- Mergers/acquisitions/similar events
- Trustee changes
- These four new types will be discussed in more detail below



Rule 15c2-12 Amendments: New Specified Events—Tender Offers

- Notice to be given to all bondholders even when the tender offer is made to a limited number of bondholders
- SEC noted that those holders who are not invited to participate could still consider and react (i.e. buy, sell or hold) to the information contained in the notice
- SEC noted that during a tender offer some investors may be left in doubt as to whether their securities are subject to the offer



Rule 15c2-12 Amendments: New Specified Events—Bankruptcy, Insolvency et. al.

- Notices about bankruptcy, insolvency, receivership or a similar event with respect to the issuer or an obligated person
- Although “similar event” is somewhat unclear would suggest that formal events that are short of a formal receivership be addressed either under this specified event or in a filing of other secondary market information to MSRB (through EMMA system)
- In Pennsylvania, a filing for Act 47 distressed municipality status would be appropriate for secondary market disclosure (whether or not it is formally within the scope of this event)
- In New York, the establishment of an interim finance authority or monitoring board to assist a fiscally distressed local government might be analyzed similarly to an Act 47 filing in PA (likely other analogs throughout the country)



Rule 15c2-12 2010 Amendments: New Specified Events—Mergers and Similar Transactions

- Covered events:
 - Merger
 - Consolidation;
 - Acquisition involving an obligated person; or
 - Sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business; or
 - 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



Rule 15c2-12 2010 Amendments: New Specified Events—Mergers and Similar Transactions (continued)

- Subject to a materiality condition
- SEC indicated that the “ordinary course” and “if material” qualifiers were appropriate because in some circumstances small acquisitions may occur occasionally but have little or no effect on value of municipal securities



Rule 15c2-12 Amendments: New Specified Events—Mergers and Similar Transactions (continued)

- Prime focus is on entities such as health care institutions, other non-profit entities and for-profit businesses that are conduit borrowers
- SEC commented that “these corporate type events are believed to be rare among governmental issuers”
- **However**, in Pennsylvania and New Jersey, for example, school district consolidation is not unheard of
- Speculative at this point, but may not be surprising if more local government consolidation in the future



Rule 15c2-12 Amendments: New Specified Events—Trustee Changes

- Covers appointment of a successor or additional trustee, or a change of name of a trustee, if material
- SEC suggests that some changes, such as certain name changes, may be so minor that they would not be material (speculation: possibly The Bank of New York/Mellon merger and name change would have been an example of this?)
- SEC stated that when a trustee transfers all or part of its trust operations to a different organization, it is important for the bondholder to be able to determine the identity of the new trustee



Rule 15c2-12 Amendments: New Specified Events—Trustee Changes (continued)

- Did not find in the SEC release references to “paying agent”, “sinking fund depository”, “bond registrar”, “tender agent”, etc. but taking a functional approach to what trustees are about, would suggest giving notice of changes in these other types of fiduciaries and agents



Summary-Major Categories of Rule 15c2-12 Changes—Per Se Materiality

- Unlike the past, now certain types of specified events are treated as per se material
- The following original specified events have the materiality condition removed:
 - Principal and interest payment delinquencies
 - Unscheduled draws on debt service reserves or credit enhancement reflecting financial difficulties
 - Substitution of credit or liquidity providers, or their failure to perform
 - Defeasances
 - Rating changes
 - Certain adverse tax events as discussed below



Summary-Major Categories of Rule 15c2-12 Changes—Per Se Materiality

- The following 2 specified events have been added without the materiality condition (i.e. per se material):
 - Tender offers
 - Bankruptcy, insolvency and similar events



Summary-Major Categories of Rule 15c2-12 Changes—materiality condition for certain specified events

- The following 4 original specified events retain the “if material” determination:
 - Non-payment related defaults
 - Modifications to rights of security holders
 - Bond calls
 - The release, substitution, or sale of property securing repayment of the securities



Summary-Major Categories of Rule 15c2-12 Changes—materiality condition for certain specified events (continued)

- The following 2 new specified events require notice “if material”:
 - The merger specified event
 - The trustee change specified event

Major Categories of Changes per Rule 15c2-12—timing of material event notices

- Currently the Rule provides that event notices are to be provided “in a timely manner”
- The 2010 Amendments provide that event notices are to be submitted “in a timely manner not in excess of 10 business days after the occurrence of the event”
- SEC referenced the corporate context-- 8-K event notices would be filed in 4 business days



Major Categories of Changes per Rule 15c2-12—timing of material event notices (continued)

- Three reasons cited in favor of 10-business day provision:
 - Improve transparency in the market
 - Increase efficiency of markets in allocating capital at appropriate prices that reflect creditworthiness of issuers
 - Reduce likelihood that investors will be subject to fraud facilitated by inadequate disclosure



Major Categories of Changes per Rule 15c2-12—timing of material event notices (continued)

- The new 10 business day provision is valuable for interpreting existing undertakings that are not subject to the 2010 Amendments:
 - The SEC in a footnote specifically, “notes that the ten business day time frame will not apply to continuing disclosure agreements entered into with respect to primary offerings prior to the compliance date of these amendments or to remarketings of demand securities that qualify for the limited grandfather provision.”
 - **Nonetheless**, now given this bright-line rule, it seems difficult to conclude that in applying the old standard of “in a timely manner”, that submissions significantly later than 10 business days, could properly be considered to be done “in a timely manner”



Major Categories of Changes per Rule 15c2-12—Changes to adverse tax event

- Currently, the Rule pertains to “adverse tax opinions or events affecting the tax-exempt status of the security”
- The 2010 Amendments provide “[a]dverse 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.”
- The phrase “tax-exempt status” has been replaced with “tax status”



Major Categories of Changes per Rule 15c2-12—Changes to adverse tax event (continued)

- The SEC indicates that this change is to focus the disclosure on information relevant to investors, whether the municipal security is taxable or not
- This change is not surprising given the high issuance of Build America Bonds and other tax-favored bonds which are not tax-exempt bonds (e.g., various tax credit bonds such as qualified zone academy bonds)



Major Categories of Changes per Rule 15c2-12—Changes to adverse tax event (continued)

- SEC discussed audits
- Believes that an audit can be an “event affecting the tax-exempt status of the security”
- Expressed its view that “not all audits indicate a risk to the security’s tax status.”
- Noted that IRS staff sometimes conducts audits as part of “project initiatives” where it is not examining a specific problem or bond issue



Major Categories of Changes per Rule 15c2-12—Changes to adverse tax event (continued)

- SEC expressed the view that:
 - proposed determinations of taxability;
 - final determinations of taxability; and
 - notices of proposed issue

are of such importance to investors that they should always be disclosed pursuant to a continuing disclosure agreement



Rule 15c2-12 Amendments: Certain Practical “Q &A” Points (to summarize)

- *All “Q &A”s are for discussion purposes only and suggest certain initial points for consideration. Further analysis should be undertaken in any case based upon particular facts and circumstances with appropriate counsel.*
- Question #1: Do existing continuing disclosure agreements need to be amended due to the 2010 Amendments?
Analysis: Generally no. (May be permutations relating to limited grandfather clause for VRDOs).
- Question #2: For new primary offerings, for how long can the pre-amendment provisions be used?
Analysis: Generally, through most of the Fall. December 1, 2010 compliance date. Disclosure undertaking should be executed before December 1st. Should give further analysis to a transaction where the underwriting period may straddle December 1, 2010.
- Question #3: Are placements of municipal securities with banks affected by these amendments?
Analysis: If intended to be a private placement with the bank, existing private placement exemption in Rule 15c2-12 could still be utilized. It was not changed by the 2010 Amendments.



Rule 15c2-12 Amendments: Certain Practical “Q &A” Points (to summarize)

- Question #4: For existing VRDOs, would a conversion from a short-term mode to a term mode implicate the 2010 Amendments?
Analysis: Expectation would be that such conversions would be new primary offerings and would entail compliance with new continuing disclosure requirements.
- Question #5: What about a conversion between daily and weekly modes?
Analysis: Appears to fit limited VRDO grandfathering provision assuming both modes were in the original bond documents.
- Question #6: What about a credit facility substitution?
Analysis: Even if denominations and tender provisions do not change, the change in credit providers (and typically a new remarketing circular) suggests that a new primary offering may have been made.



Certain other Securities Developments— Dodd-Frank Legislation:

- Brief note to highlight certain developments to monitor going forward:
 - Changes in MSRB composition
 - Creation of a municipal securities office within SEC
 - Certain government studies of the municipal markets are directed
 - Regulations for municipal advisors
 - Changes generally related to swaps, rating agencies, securitizations
- **Some of these developments may impact future changes and practices related to Rule 15c2-12 and municipal disclosure generally**



Certain other Securities Developments— Dodd-Frank Legislation (continued):

- MSRB changes--
 - Requires a majority of the Board to be independent of any municipal securities broker, dealer or advisor
 - One of whom is to be representative of municipal entities
 - One of whom is to be representative of institutional or retail investors
 - Initially, 15 Board members-8 independent, 7 associated with broker, dealer, municipal securities dealer or municipal advisor (if more added, to maintain slight majority for independent members)



Certain other Securities Developments— Dodd-Frank Legislation (continued):

- Creation within the SEC of an Office of Municipal Securities
- The office is to coordinate with the MSRB for rulemaking and enforcement action
- The head of the Office shall report to the Chairman of the SEC



Certain other Securities Developments— Dodd-Frank Legislation (continued):

- Certain government studies of the municipal markets are directed
- Within 18 months Comptroller General of U.S. is to submit a report, which among things, will provide:
 - recommendations for how to improve transparency, efficiency, fairness and liquidity of trading in municipal securities markets
 - analysis of mechanisms for trading, quality of trade executions, market transparency, trade reporting, price discovery, settlement clearing



Certain other Securities Developments— Dodd-Frank Legislation (continued):

- Another study (focus on disclosure by issuers)
- Comptroller General in study, among other things, is to:
 - Make certain comparisons between disclosures by municipal issuers and issuers of corporate securities
 - Make recommendations regarding the repeal or retention of the Tower Amendment (re certain prohibitions on requiring registration of municipal securities)
- Within 24 months Comptroller General of U.S. is to submit a report which, among other things, will provide:
 - Recommendations for how to improve disclosure by issuers of municipal securities



Certain other Securities Developments— Dodd-Frank Legislation (continued):

- Pursuant to Dodd-Frank, the SEC has adopted an “interim final temporary rule” requiring Municipal Advisors to register with the SEC (Form MA-T)
- October 1, 2010 deadline for registration
- SEC Chairman Mary L. Schapiro stated that the Commission acted “to create a temporary registration system to gather key data and provide transparency about municipal advisors”

Certain other Securities Developments— Dodd-Frank Legislation (municipal advisor registration) (continued):

- Subject to certain exemptions, municipal advisors include:
 - Financial advisors
 - Guaranteed investment contract brokers
 - Third-party marketers
 - Placement agents
 - Solicitors/finders
 - Certain swap advisors



Certain other Securities Developments— Dodd-Frank Legislation (municipal advisor registration) (continued):

- Municipal advisors are required to provide disciplinary history similar to what the SEC obtains from registered broker-dealers and investment advisors
- General comment: Expect the framework (and final rules) to borrow from these other registration approaches



Certain other Securities Developments— Dodd-Frank Legislation (municipal advisor registration) (continued):

- Form MA-T requires the municipal advisor to indicate the general types of municipal advisory services it provides (eight categories that can be checked):
 - 1) advice concerning the issuance of municipal securities
 - 2) advice concerning the investment of the proceeds of municipal securities



Certain other Securities Developments— Dodd-Frank Legislation (municipal advisor registration) (continued):

- 3) advice concerning guaranteed investment contracts
- 4) recommendation and/or brokerage of municipal escrow investments
- 5) advice concerning use of municipal derivatives



Certain other Securities Developments— Dodd-Frank Legislation (municipal advisor registration) (continued):

- 6) solicitation of business from a municipal entity or obligated person for an unaffiliated person or firm
- 7) preparation of feasibility studies, tax or revenue projections or similar products in connection with offerings or potential offerings
- 8) “Other” (a narrative description will be required)



Certain other Securities Developments—SEC Municipal Disclosure Forums (overview):

- SEC has launched a series of field hearings to examine the municipal securities markets
- First hearing was in San Francisco on September 21, 2010
- Chicago—November 2010
- Washington DC—December 2010
- Tallahassee—January 2011
- Austin—February 2011



Certain other Securities Developments—SEC Municipal Disclosure Forums (overview) (continued):

- The agenda from the San Francisco program provides a sense of important sub-topics and issues:
 - “Selected Disclosure Practices: Transparency and Presentation”
 - “Ratings—Impact and Practices”
 - “Disclosure of Certain Significant Liabilities”
 - “Internal Controls”
 - “Investor Experiences”



Certain other Securities Developments—SEC Municipal Disclosure Forums (San Francisco Forum) (continued):

- Commissioner Elisse D. Walter’s welcoming remarks suggest certain themes and objectives of the hearings:
 - At the conclusion of all the hearings, SEC staff will prepare a report including recommendations which may include “legislation, rulemaking and changes in industry practice”
 - Noted that “trading volume is substantial” despite the reputation of the muni market as “buy and hold”



Certain other Securities Developments—SEC Municipal Disclosure Forums (San Francisco Forum) (continued):

- Commissioner Elisse D. Walter’s remarks (continued):
 - “municipal securities can and do default”
 - The municipal securities market “lacks many of the protections customary in many other sectors of the U.S. capital markets”
 - Noted corporate: “...I believe that we can learn from the corporate world, but it is also essential that we recognize the differences in the municipal and corporate finance worlds...”
 - “In order to think about ways in which we can combat the ‘second class’ treatment of municipal securities investors, we need to listen to investors and understand their needs...”



Certain other Securities Developments—SEC Municipal Disclosure Forums (Submitted Comments):

- See www.sec.gov; Subject File No. 4-610 for the following described comments and others (more likely to come)
- One commentator suggested that the Commission “consider placing a greater regulatory focus on the specific municipal market sectors that lead to the greatest incidence of municipal securities defaults”
- “A related area needing significant attention is the quality of and disclosure related to feasibility studies, appraisals and other expert work products that are almost always involved in the riskiest municipal securities offerings.”
- Another commentator posed questions as to whether there would be sharing of liability for “flipping” of BABs (i.e. Build America Bonds) and as to whether firms might be prohibited from offering both municipal financial advisory services and negotiated underwriting services (even in unrelated matters)



Certain other Securities Developments— Dodd-Frank Impact in Related Areas:

- Dodd-Frank swap provisions are very extensive—impact both municipal and other markets
- Mostly beyond the scope of this program—note this as an area to monitor
- Regulations are forthcoming (SEC and CFTC roles)
- General comments: Municipal issuers and obligated persons are “end users” and less likely to face regulatory burdens than swap dealers
- Nevertheless, even if that’s the case, the new swap regime may impact the disclosure of a swap in a municipal offering—(e.g., disclosures about the swap dealer counterparty)



Certain other Securities Developments— Dodd-Frank Impact in Related Areas:

- Requirements on rating agencies (may impact standard rating agency disclosures in official statements)



Certain other Securities Developments— Dodd-Frank Impact in Related Areas:

- Funding provisions for support Governmental Accounting Standards Board
- Burdens appear that they will be widely allocated
- Annual accounting support fees shall not exceed recoverable annual budgeted expenses of GASB
- SEC is not given authority to affect the setting of generally accepted accounting principals by GASB

Possible Signs of Emerging SEC Trends?

- Recent enforcement action suggests focus on pensions and other future obligations
- Certain comments caution not to “bury” information
- sensitivity to investors beyond traditional sophisticated municipal institutional investors (e.g. foreign investors)
- September 1993 staff report on the Municipal Securities Market may be updated

