

AGFS SPECIAL BULLETIN

Certain Recent SEC & MSRB Municipal Securities Law & Disclosure Developments

Governmental continuing disclosure practices have come to center stage.¹

In July 2009, significant changes occurred, and more are proposed by the Securities and Exchange Commission (SEC) and Municipal Securities Rulemaking Board (MSRB), that will affect not only local governments borrowing funds in the future, but also local governments with securities issues outstanding.

To begin, the MSRB's new and extensive Electronic Municipal Market Access (EMMA) municipal securities disclosure and market information platform at www.emma.msrb.org became fully operational as of July 1, 2009. From now on, pursuant to SEC action in December 2008, EMMA will be the sole nationally-recognized municipal securities information repository (NRMSIR). *This means that, from now on, all continuing disclosure documents must be filed with EMMA and in accordance with applicable EMMA standards.*

EMMA requires that all documents filed with it be in pdf format (word searchable after January 1, 2010). Because EMMA will require that documents for future offerings be accompanied by CUSIP numbers and other identifying information (for past offerings, some of the identifying information is voluntary, but recommended), it will be much easier to locate documents (and to determine whether local governments have made their required filings in a timely manner).

The following are selected EMMA highlights—

- Filings are free for local governments and their designated dissemination agents
- All filings must be made electronically
- All documents must be filed in pdf format with preservation of original document integrity (after Jan. 1, 2010, word searchable pdf format)
- Filed documents will become available quickly
- Filers will receive receipts for their filings
- Filed documents can be modified after filing

¹ Although this summary discusses specifically impacts on local governments, the summary is equally applicable to state governmental entities and to private obligors that enter into continuing disclosure undertakings in connection with municipal securities issues.

- Access to individual documents is free, a significant benefit for individual investors, traders, dealers recommending municipal securities to customers, underwriters and others seeking specific documents (fee subscription feeds are available for multiple filings)
- EMMA's search features based on CUSIP numbers and local government names enhance the ease of document and information access
- EMMA will facilitate local government-investor contacts regarding additional information by allowing local governments to post voluntarily their contact information and links to their internet pages containing financial statements and additional disclosure information
- There will be easy market and regulator identification of local governments that fail to make required filings in a timely manner

EMMA contains a wealth of important information regarding municipal securities, including the following—

- Primary market disclosure documents—official statements
- Beginning on July 1, 2009, continuing disclosure documents, if any, required to be filed by local governments pursuant to continuing disclosure undertakings
- Advance refunding documents
- Additional documents and information filed voluntarily by local governments
- Data regarding municipal securities issues
- Real time trading data
- Historical trading data
- Current interest rate and other data for variable rate demand obligations (VRDOs) and auction rate securities (ARS)
- Historical interest rate and other data for VRDOs and ARS
- Market statistics

An important benefit is the ability to view both real-time trading prices and also historical trading prices for outstanding securities (including for issuers, trading patterns and prices immediately after offerings in order to determine the effectiveness of

underwriter performance). The MSRB's market statistics also will assist local governments in viewing general market performance of their securities.

In connection with its December 2008 action, the SEC amended its Rule 15c2-12 to require local governments participating in offerings after July 1, 2009, but that have \$10 million or less in aggregate principal amount of municipal securities outstanding (unless otherwise exempt from the Rule), to file continuing disclosure documents with EMMA in the form of financial and operating information the local governments customarily prepare, as well as event notices. For outstanding issues, those local governments need only provide annual disclosure documents upon request.

Further, on July 15, 2009, the SEC took the following significant actions—

- Proposed further continuing disclosure amendments to Rule 15c2-12 to—
 - Eliminate the continuing disclosure exemption for VRDOs (including for outstanding issues once they are remarketed in a “primary offering” that changes the denomination to less than \$100,000 or the remarketing period to more than nine months)
 - Expand the occurrences requiring local government event reporting; as outlined by the Commission, these are—
 - Tender offers
 - Bankruptcy, insolvency, receivership or similar proceedings
 - The consummation of a merger, consolidation, or acquisition or the sale of all or substantially all assets, 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
 - Appointment of a successor or additional trustee, or the change of name of a trustee, if material
 - Eliminate local government materiality determinations from several occurrences requiring event reporting, so that all such events must be reported; as outlined by the Commission, these are—
 - Principal and interest payment delinquencies with respect to the securities
 - Unscheduled draws on debt service reserves reflecting financial difficulties

- Unscheduled draws on credit enhancements reflecting financial difficulties
 - Substitution of credit or liquidity providers, or their failure to perform
 - Defeasances
 - Rating changes
- Proposed an amendment to the Rule to provide specifically for the disclosure of adverse tax opinions, the issuance, by the Internal Revenue Service (IRS), 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-exempt status of securities, or other events affecting the tax-exempt status of the security
 - Proposed to require event filings to be made “[i]n a timely manner not in excess of ten business days after the occurrence of the event, instead of ‘in a timely manner’ as the Rule currently provides”
 - Proposed an interpretation re-emphasizing from a prior release facts and circumstances in which underwriters must make affirmative inquiry into local government compliance with past continuing disclosure undertakings and in which underwriters could not form a reasonable belief in continuing disclosure representations in future offerings by local governments that have failed persistently and materially to comply with past continuing disclosure undertakings, effectively foreclosing those local governments from public sales of securities in the market (private placements may still be available)—Local governments already are to report in their official statements noncompliance during the prior five years
 - Promised a stronger enforcement program with a focus on disclosure in the municipal securities market
 - Resolved to pursue greater regulatory authority with reference to the municipal securities market (for example, exploring potential legislation with key members of Congress)

In recent months, the MSRB undertook the following additional significant regulatory actions—

- As described above, commenced full operation as of July 1, 2009, of the Board’s EMMA disclosure and market information platform as the sole NRMSIR
- Opened EMMA to voluntary local government filings of additional documents and information for those local governments interested in improved investor and market relations
- Proposed an incentive special recognition program on EMMA for local governments agreeing to prepare their financial statements in accordance with applicable generally accepted accounting principles or agreeing to file annual reports within 120 days following the ends of the local governments’ fiscal years (or within 150 days for a “transitional period” expiring Dec. 31, 2013)² (see additional detail below)
- Offered local governments the ability to identify on EMMA their contacts and websites, so that investors and others may seek additional information
- Proposed to require underwriters to identify for EMMA local governments (or others) entering into continuing disclosure undertakings in the offerings, their contact information, and the dates by which annual filings are to be made by them
- Issued an interpretation of MSRB Rule G-17 and other Board rules requiring dealers to put into place procedures to receive and review documents and information on EMMA in connection with recommendations to customers
- Commenced a detailed data service on EMMA regarding VRDOs and ARS

² According to the MSRB—

The fact that [a local government] has entered into [such] an annual filing undertaking would be prominently disclosed on the EMMA web portal as a distinctive characteristic of the securities to which such undertaking applies.

The MSRB noted that its

Original Proposal would [have] permit[ed] issuers to submit the Certificate of Achievement for Excellence in Financial Reporting awarded by the Government Finance Officers Association (‘GFOA’) in connection with the preparation of its Comprehensive Annual Financial Report (‘CAFR’). The Amendment would modify the Original Proposal to eliminate this item.

- Proposed further rule amendments to require dealers to provide further significant documentation and data to EMMA regarding VRDOs and ARS
- Required dealers to register with Depository Trust and Clearing Corporation (DTCC) and to participate in DTCC's NIIDS securities description system to increase efficiency and to promote uniformity of securities descriptions across multiple platforms

NOTE: It is more crucial than ever that local governments make *timely* filings of *all continuing disclosure documents* as agreed in existing and future continuing disclosure undertakings at the time of their offerings. EMMA will make it much easier to determine whether continuing disclosure reports have been filed. *AGFS strongly recommends careful record checking and document retention respecting past annual and event filings, and the timeliness of the filings, including filings through dissemination agents.* Regulators are focused on anecdotal reports, some purporting to be based upon research, asserting that large numbers of local governments are not complying with their continuing disclosure reporting obligations.

In future offerings, underwriters will be required to investigate (which will be much easier now on EMMA) local governments' past material continuing disclosure compliance, and will not be able to underwrite public offerings of municipal securities for local governments that are not sufficiently in compliance. There are exemptions from the continuing disclosure requirements for certain offerings—limited placements, short term securities issues, and in the past (but not going forward) VRDOs. There also has been a limited exemption for local governments with \$10 million or less in municipal securities outstanding, but in future offerings, those local governments will be required to agree to file with EMMA certain annual information that they customarily prepare and to make certain event filings with EMMA.

Due to the SEC's interpretation of underwriter responsibilities, local governments not in material continuing disclosure compliance may find it more difficult, if not impossible in more extreme cases, to access the public securities market. Limited placements may still be possible, but there is likely to be an interest cost associated with certain placements.

Further, the SEC and MSRB require dealers recommending municipal securities to customers, which applies to both the secondary market and primary offerings, to be informed regarding information in local government continuing disclosure filings.

Illustrating the importance regulators place on local government continuing disclosure, the Financial Industry Regulatory Authority (FINRA) advised investors in an advisory entitled "Municipal Bonds—Staying on the Safe Side of the Street in Rough Times," as follows: "Ask your broker if a bond's issuer is up to date with its reporting of its annual financial/operating data. Treat missing or past due financial information *as a potential red flag.*" [Emphasis added.]

In a “Muni Bond Checklist,” FINRA further advised investors to “confirm with your broker whether the issuer is current in its disclosure filings and be sure to review the information in the ongoing disclosures. Be wary of bonds whose issuers are not current in their disclosure filings.” [Emphasis added.]

FINRA also underscored for dealers the importance of reviewing compliance with MSRB rules on awareness of information on EMMA and other matters.

Due to the increased levels of regulatory and market attention to continuing disclosure compliance, local governments that do not file continuing disclosure reports regularly and on time may find that their securities become illiquid, which may harm the price in the market (including in future offerings).

One more Note: It is best for local governments to obtain financial statements from auditors in pdf format, rather than converting text or spreadsheet files. The conversion process may introduce format changes in tables, columns and graphics. The auditors should provide pdf files that they have pre-approved. The same caution applies to feasibility studies, appraisals and other expert studies and reports, which typically contain tables and columns. Remember, after January 1, 2010, the text portions of pdf files submitted to EMMA must be word searchable.

In addition, several legislative proposals are pending in Congress, including among them, the following—

- Modifying the composition of the MSRB to a majority of “public” members
- Regulating nondealer financial advisors and derivatives and investment brokers
- Requiring rating agencies to utilize common default risk criteria between the municipal and corporate securities markets
- Placing additional requirements upon rating agencies to enhance transparency and avoid conflicts of interest
- Regulating transactions in derivatives products