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Municipal Securities Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Final Rule

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is adopting amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 ("Exchange Act") to deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of securities for which adequate information is not

Staff Report on the Municipal Securities Market ("Staff Report") regarding the growing participation of individual investors, who may not be sophisticated in financial matters, as well as the proliferation of complex derivative municipal securities, underscored the need for improved disclosure practices in both the primary and secondary municipal securities markets.[6] Information about the issuer and other obligated persons is as critical to the secondary market,[7] where little information about municipal issuers and obligated persons is regularly disseminated, as it is in primary offerings, where, as a general matter, good disclosure practices exist. As one industry group testified, today "secondary market information is difficult to come by even for professional municipal analysts, to say nothing of retail investors."[8]

Notwithstanding voluntary industry initiatives to improve disclosure, particularly primary market disclosure, the *Staff Report* recommended that the Commission use its interpretive authority to provide guidance regarding the disclosure obligations of municipal securities participants under the antifraud provisions of the federal securities laws, and that the Commission amend Rule 15c2-12 to prohibit municipal securities dealers from recommending outstanding municipal securities unless the issuer has committed to make available ongoing information regarding its financial condition. In order to assist issuers, brokers, dealers, and municipal securities dealers in meeting their obligations under the antifraud provisions, in March, 1994, the Commission published the *Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others* ("Interpretive Release"),[9] which outlined its views with respect to the disclosure obligations of market participants under the antifraud provisions of the federal securities laws in connection with both primary and secondary market disclosure.

Concurrent with the publication of the Interpretive Release, the Commission published Securities Exchange Act Release No. 33742 ("Proposing Release"),[10] which requested comment on amendments to Rule 15c2-12 ("Proposed Amendments") designed to enhance the quality, timing, and dissemination of disclosure in the municipal securities market by placing certain requirements on brokers, dealers, and municipal securities dealers. In proposing the amend-

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1994, the Commission approved changes to MSRB rule G-19 concerning suitability of recommendations, and rule G-8 concerning recordkeeping. Securities Exchange Act Release No. 33869 (April 7, 1994), 59 FR 17632. These changes are designed to ensure that dealers, before making recommendations to customers, take appropriate steps to determine that the transaction is suitable. Concurrently, the Commission approved MSRB rule G-37 relating to the linkage between political contributions and the municipal securities business. Securities Exchange Act Release No. 33868 (April 7, 1994), 59 FR 17621. The rule seeks to end "pay to play" abuses in the municipal securities market by prohibiting dealers from conducting certain types of business with an issuer within two years after any contribution by the dealer or certain affiliated persons of the issuer who could influence the awarding of municipal securities business. On June 20, 1994, the MSRB filed with the Commission a proposal to amend MSRB rule G-14 concerning reports of sales or purchases, and procedures for reporting inter-dealer transactions. Securities Exchange Act Release No. 34458 (July 28, 1994), 59 FR 39803. The proposed rule change is a first step to increase transparency in the municipal securities market by collecting and disseminating information on inter-dealer transactions. On December 19, 1993, the Commission issued a release proposing for public comment amendments to the rule regulating money market funds. Rule 2a-7 under the Investment Company Act of 1940. Investment Company Act Release No. 19959 (Dec. 28, 1993), 58 FR 68585.

[6]By 1993, individual investors, including those holding through mutual funds and money market funds, held approximately 76% of municipal debt outstanding, as compared with 44% in 1983. *The Bond Buyer*, "Holders of Municipal Debt," (July 1, 1994) at 5.

[7]The municipal securities market is not the only market for debt securities that suffers from information inefficiencies. For that reason, the Commission also is exploring means to increase the amount of information concerning issuers of corporate debt securities. *See* Securities Exchange Act Release No. 34139 (June 7, 1994), 59 FR 29453.

[8]Statement of Gerald McBride, Chairman, Municipal Securities Division, Public Securities Association, Before the House Committee on Energy and Commerce, Telecommunications and Finance Subcommittee (October 7, 1993) at 5.

[9]Securities Act Release No. 7049 (March 9, 1994), 59 FR 12748.

[10]Securities Exchange Act Release No. 33742 (March 9, 1994), 59 FR 12759. Also on March 9, the Commission published Securities Exchange Act Release No. 33743, which proposed the adoption of Rule 15c2-13. Proposed Rule 15c2-13 would have required broker, dealers, and municipal securities dealers to disclose mark-up information in riskless principal transactions in municipal securities; and to disclose when a particular municipal security is not rated by a nationally recognized statistical rating organization ("NRSRO"). Due to the recent development of proposals by the MSRB and market participants to make pricing information available to investors, the Commission has determined to defer the riskless principal mark-up proposal for six months. In addition, the portion of proposed Rule 15c2-13 that would require disclosure if a municipal security is not rated by an NRSRO has been deferred, and will be withdrawn if the MSRB acts to adopt similar amendments to its confirmation rule, Rule G-15. *See* Securities Exchange Act Release No. 34962 (November 10, 1994).

ers with significant flexibility to determine the appropriate nature of that disclosure. The amendments retain the requirement that a Participating Underwriter ascertain that an issuer or obligated person has undertaken to provide secondary market disclosure, including notices of material events, to information repositories, but rely on the parties to the transaction to establish who will provide secondary market disclosure, and what information is material to an understanding of the security being offered.

The amendments build upon and reinforce current market practices that have provided, as a general matter, good quality disclosure in official statements, and extend those practices to the secondary market. As is currently the practice, under the amendments, the participants in an underwriting would continue to determine which persons are material to an understanding of the Offering. Information concerning those persons would be included in the final official statement. Financial information and operating data that is material to an offering at the outset generally remains material throughout the life of the securities. Under the amendments, that information would be provided on an annual basis. Put simply, the amendments reflect the belief that purchasers in the secondary market need the same level of financial information and operating data in making investment decisions as purchasers in the underwritten offering.

The Proposed Amendments would have prohibited a broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipal security, unless it had reviewed the annual and event information provided pursuant to the undertaking. Commenters anticipated that such a prohibition would have a considerable negative impact on secondary market liquidity. Furthermore, brokers, dealers, and municipal securities dealers considered the proposed recommendation prohibition to be problematic from a compliance perspective. The Commission has modified this provision to require instead that brokers, dealers, and municipal securities dealers recommending municipal securities in the secondary market have procedures to obtain material event notices. Because under existing law brokers, dealers, and municipal securities dealers are required to use information disseminated into the marketplace in forming a reasonable basis for recommending securities to investors, the rule does not impose mechanical review requirements on a trade-by-trade basis.

The amendments contain an exemption to minimize the effect on small issuers. Offerings in which neither the issuer nor any obligor is obligated with respect to more than $10 million dollars in municipal securities outstanding following an offering will be exempt from the amendments, on the condition that there is a limited undertaking to provide upon request, or annually to a state information depository, at least the financial information or operating data they customarily prepare, and that is publicly available. In addition, the undertaking must meet the amendment's requirement regarding notices of material events.

II. Description of Amendments to Rule 15c2-12

A. Amendments with Respect to the Underwriting of Municipal Securities

Under the amendments to Rule 15c2-12, a broker, dealer, or municipal securities dealer ("Participating Underwriter")[19] will be prohibited, subject to certain exemptions, from purchasing or selling municipal securities in connection with a primary offering of municipal securities with an aggregate principal amount of $1,000,000 or more ("Offering"),[20] unless the Participating Underwriter has made certain determinations.[21] Specifically, the Participating Underwriter must reasonably determine that an issuer of municipal securities or an obligated person, either individually or in combination with other issuers of such municipal securities or other obligated persons,[22] has undertaken in a written agreement or contract for the benefit of holders of such securities, to provide, either directly or indirectly through an indenture trustee or a designated agent, certain annual financial information and event notices to various information repositories.[23]

The "reasonable determination" required by the amendments to Rule 15c2-12 must be made by the Participating Underwriter prior to its pur-

[19] *See* Rule 15c2-12(a).

[20] The amendments also include an exemption for small and infrequent issuers. *See* Section II.D.1., *infra*.

[21] Rule 15c2-12(b)(5)(i).

[22] These concepts are discussed in Section II.A.1.b., *infra*.

[23] Information repositories are discussed in Section II.C., *infra*.

will act as a Participating Underwriter, until the final official statement is available, that the Participating Underwriter send, to any potential customer, no later than the next business day, a copy of the most recent POS, if any. The Commission expects that the Participating Underwriters' obligations with respect to dissemination of the POS will not change.

1. Determining the Required Scope of the Undertaking to Provide Secondary Market Disclosure

Under the amendments as adopted the financial information and operational data to be provided on an annual basis pursuant to the undertaking will mirror the financial information and operating data contained in the final official statement with respect to both the issuers and obligated persons that will be the subject of the ongoing disclosure, and the type of information provided. The amendments govern the core financial and operational data to be provided. It does not address the textual disclosure typically provided in annual reports, leaving the scope of that disclosure to market practice.[31] To clarify the intended quantitative focus of the rule, as adopted, the rule uses the term "financial information and operating data."

a. The Starting Point—Definition of Final Official Statement

(1) Information Concerning Persons Material to an Evaluation of the Offering

The Proposed Amendments would have revised the definition of final official statement to require that financial and operating information, including audited annual financial statements, regarding the issuer and any significant obligor be included in order to provide a fair presentation of the issuer's and significant obligor's financial condition, results of operations, and cash flow.

Commenters objected to various aspects of the proposed definition, including the general requirement that financial and operating information be presented in the final official statement.[32] Commenters also objected that the use of the term "the issuer," in specifying whose financial information should be included in the final official statement, failed to take into account a variety of situations in which the governmental issuer does not have any repayment obligations on the municipal securities (as with conduit issuers), as well as other situations (such as revenue bonds) in which the payments will be derived from entities, enterprises, funds and accounts that do not prepare separate financial statements. Some commenters took the position that in certain instances, inclusion of the financial statements of the general municipal issuer of which the enterprise is a part may be misleading.[33]

In view of these comments, the definition of final official statement has been revised to require that financial information and operating data be provided for those persons, entities, enterprises, funds, and accounts that are material to an evaluation of the offering.[34] Thus, the definition eliminates the reference to "the" issuer. In addition, the definition no longer requires that the official statement provide information about specific "significant obligors." It leaves to the parties (including the issuer and Participating Underwriters) the determination of whose financial information is material to the offering (including, without limitation, the credit supporting the securities being offered).

The definition does not set its own form and content requirements on the financial information and operating data to be included; in particular, the proposed requirement for audited financial statements has not been adopted. Instead, it provides the flexibility that many commenters asserted is necessary in determining the content and scope of the disclosed financial information and operating data, given the diver-

[31] *See* Association of Local Housing Finance Agencies, *Guidelines for Information Disclosure to the Secondary Market* (1992); Government Finance Officers Association, *Disclosure Guidelines for State and Local Government Securities* (Jan. 1991); Healthcare Financial Management Association, Principles and Practices Board, *Statement Number 18—Public Disclosure of Financial and Operating Information by Healthcare Providers* (May 1994); National Council of State Housing Agencies, *Quarterly Reporting Format for State Housing Finance Agency Single Family Housing Bonds* (1989) and *Multi-family Disclosure Format* (1991); National Federation of Municipal Analysts, *Disclosure Handbook for Municipal Securities 1992 Update* (Nov. 1992).

[32] *See, e.g.*, Letter of Indiana Bond Bank; Letter of Kutak Rock; Letter of NABL; Letter of Texas Public Finance Authority; Letter of Goldman Sachs & Co. ("Goldman Sachs").

[33] *See, e.g.*, Letter of Department of Community Trade and Economic Development, State of Washington; Letter of American Public Power Association ("APPA"); Letter of Municipal Treasurer's Association; Letter of Orrick Herrington.

[34] *See* Rule 15c2-12(f)(3).

documents will be considered to be publicly available if they have been submitted to each NRMSIR and to the appropriate state information depository or, if the information concerns a reporting company, filed with the Commission. If the document is a final official statement, it must be available from the MSRB.

If cross referencing is used, for purposes of determining the appropriate scope of the ongoing information undertaking, the final official statement will be deemed to include all information and documents that have been cross referenced.[47] The amendment does not place limitations on the type of issuer that may use cross referencing. This approach is consistent with the goal of making the repositories the principal source of information concerning municipal securities. Once received by a repository, the referenced information should be readily available regardless of the nature of the issuer.

As commenters noted, permitting cross referencing to other externally prepared and available information should result in official statements that are clear and concise, yet provide information material to the Offering.[48] Moreover, the use of cross referencing also should ease some expressed apprehension about the ability of some issuers to obtain information about parties not within their control, to the extent that information about these parties is made available to the repositories or, if a reporting company, filed with the Commission.[49]

(3) Description of Information Undertakings

The definition of final official statement also has been changed from the Proposed Amendments to include a requirement that the undertakings provided pursuant to the rule be described in the final official statement.[50] As the Commission recognized in the Interpretive Release[51] and a number of commenters echoed,[52] it is important for investors and the market to know the scope of any ongoing disclosure. By including a description of the undertaking in the final official statement, market participants will know the identity of the entities about which information will be provided, and the type of information to be provided. By reviewing the final official statement, investors in the secondary market will be able to ascertain the scope of that undertaking and whether it has been satisfied.

Critical to any evaluation of a covenant is the likelihood that the issuer or obligated person will abide by the undertaking. The definition of final official statement thus has been modified to require disclosure of all instances in the previous five years in which any person providing an undertaking failed to comply in all material respects with any previous informational undertakings called for by the amendments.[53] This information is important to the market, and should, therefore, be disclosed in the final official statement. The requirement should provide an additional incentive for issuers and obligated persons to comply with their undertakings to provide secondary market disclosure, and will ensure that Participating Underwriters and others are able to assess the reliability of disclosure representations.[54]

The amendments do not prohibit Participating Underwriters from underwriting an Offering of municipal securities if an issuer or obligated person has failed to comply with previous undertakings to provide secondary market disclosure. However, if a failure to comply with such previous undertakings has not been remedied as of the start of the Offering, or if the party has a history of persistent and material breaches, it is doubtful whether a Participating Underwriter could form a reasonable basis for relying on the accuracy of the issuer's or obligated person's ongoing disclosure representations.

b. Entities About Which Information Must be Provided to the Secondary Market

It is critical that current financial information

[47] Participating Underwriters and other market participants must keep in mind their obligations under the rule with respect to the DFOS and final official statement, and under the antifraud provisions of the federal securities laws. To the extent that cross references are used, the DFOS should be disseminated in sufficient time for review by Participating Underwriters, and the POS should be made available in time to enable prospective purchasers to make informed investment decisions based upon the referenced materials. *See* Interpretive Release at Section III.C.6.

[48] *See, e.g.*, Letter of New York Dormitory Authority; Letter of the Treasurer of the State of Connecticut.

[49] *See, e.g.*, Letter of Fieldman, Rolapp & Associates; Letter of State of Florida, Office of Auditor General; Letter of San Francisco International Airport; Letter of Texas Water Development Board; Letter of State of Washington, Office of the Treasurer.

[50] Rule 15c2-12(f)(3).

[51] *See* Interpretive Release at Section III.C.4.

[52] *See, e.g.*, Letter of Chemical Securities, Inc. ("Chemical Securities"); Letter of Ferris Baker Watts; Letter of National Federation of Municipal Analysts ("NFMA").

[53] *See* Rule 15c2-12(f)(3).

[54] *See* Letter of PSA.

number of commenters indicated that the definition of significant obligor should include a requirement that a contractual relationship exist between the obligor and the repayment of the obligation before a continuing information obligation is imposed.[67] Second, commenters recommended modifying the definition to include different percentages of cash flow, ranging from a low of no threshold to a high of 50% of cash flow.[68] Third, some commenters suggested replacing the entire definition of significant obligor with the concept of materiality, in which the issuer and the other offering participants would determine, on a continuing basis, whose information would be provided.[69]

As suggested by a number of commenters, the amendments eliminate the reference to significant obligor.[70] Instead, the amendments include a definition of "obligated person," which means a person (including an issuer of separate securities) that is committed by contract or other arrangement structured to support payment of all or part of the obligations on the municipal securities.[71] By including a nexus to the financing through a commitment that is structured to support the payment obligations, the amendments address concerns raised by many commenters that the term "source of cash flow" in the definition of significant obligor was overbroad and could encompass persons with no relationship to the financing.[72] The requirement for a contractual or other arrangement will assist Participating Underwriters in identifying the persons for which information should be provided pursuant to an undertaking.

Some commenters recommended that the commitment with respect to payment of the obligation on the securities consist of a contractual obligation to and enforceable by bondholders.[73] Instead, the definition includes a broader notion of a contract or arrangement that is structured to "support payment," without specifying that it run to bondholders. The definition is intended to include contracts or arrangements where payments are made either to bondholders, to issuers to be used to pay obligations on municipal securities, or through conduit structures.[74] Similarly, the reference to "obligations on municipal securities" is intended to be broad enough to cover debt obligations, lease payments and any other repayment obligation on or resulting from the municipal securities.

As was the case with the proposed significant obligor concept, the term "obligated persons" includes, but is broader than, the concept of issuers of separate securities under Rule 131 pursuant to the Securities Act of 1933 ("Securities Act")[75] and Exchange Act Rule 3b-5.[76] Also, in response to comments raised that the terms "issuer" or "significant obligor" do not sufficiently

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[67] *See, e.g.*, Letter of ABA Business Law Section; Letter of APPA; Letter of City of Everett, Washington; Letter of Goldman Sachs; Letter of Hawkins Delafield & Wood; Letter of Merrill Lynch; Letter of Morgan Stanley; Letter of Mudge Rose; Letter of Orrick Herrington. Certain of these commenters noted that by including a contractual or similar relationship between the entity making payments and the financing, customers and taxpayers, having no connection to or responsibility in connection with the financing would not inadvertently be swept within the scope of the definition.

[68] *See, e.g.*, Letter of APPA; Letter of George K. Baum & Co.; Letter of City of Everett, Washington; Letter of IDS Financial Corporation; Letter of Standish, Ayer & Wood, Inc.

[69] *See, e.g.*, Letter of ABA Business Law Section; Letter of ALHFA; Letter of PSA.

[70] *See, e.g.*, Letter of FGIC; Joint Response; Letter of NABL; Letter of PSA.

[71] *See* Rule 15c2-12(f)(10).

[72] *See, e.g.*, Letter of Bose McKinney & Evans; Letter of Mudge Rose; Letter of New York Dormitory Authority; Letter of Orrick Herrington.

[73] *See, e.g.*, Letter of Bose McKinney & Evans; Letter of Goldman Sachs; Letter of Indiana Bond Bank; Letter of Hawkins Delafield & Wood.

[74] For example, if all or a portion of a project financed by bonds is used by a party that has committed, by contract or other arrangement (written or oral) to pay for such use, and such payments support payment of debt service on the bonds (as structured at the time of issuance), continuing information on the party would be appropriate. Accordingly, parties that support debt service through payments under a lease, loan, installment sale agreement, or other contract relating to use of a project are included in the definition, regardless of whether the financing is a conduit arrangement (such as a non-recourse loan to a manufacturer to finance acquisition of a new facility or to a hospital to acquire equipment) or system or project financing (such as a lease to a particular carrier of a terminal in an airport system or sale of the output of a facility pursuant to a take-or-pay (or take-and-pay) contract). Major customers purchasing power from a municipal light department that, in turn, is under a take-or-pay contract with a joint action public power agency would not be included in the definition, although the municipal light department would likely be included in the definition. Similarly, major taxpayers in a municipal general obligation issue would not be included in the definition; however, an undertaking covering a developed that is the sole landowner in a development district assessment financing in which the future collection of assessments to service the borrowing is dependent upon the developer as part of the structure of the financing may be appropriate.

[75] 17 CFR 239.131.

[76] 17 CFR 240.3b-5

"obligated person" encompasses these entities because they are committed, at least conditionally, to support payment of principal and interest obligations. Moreover, these persons normally are material to an understanding of the security, and, therefore, official statements should contain financial information concerning such persons either directly or by reference to publicly available materials. A number of commenters stated, however, that it would be inappropriate to put the onus on the issuer to provide information on such providers on an annual basis, particularly where that information is otherwise available to investors either upon request or in public reports that have been submitted to appropriate regulatory authorities.[84]

Commenters indicated a willingness by providers of bond insurance, letters of credit, and other liquidity facilities to deposit publicly available reports in a repository, or otherwise note where such reports may be easily obtained.[85] The issuer or other obligated person providing the undertaking may then refer to such reports in their annual financial information and indicate the location where any such current annual reports can be obtained. Based upon such representations, providers of bond insurance, letters of credit, and liquidity facilities have been excepted from the definition of obligated person to eliminate the need to separately obtain and disseminate annual information about such providers.

The Commission encourages industry participants to work together to adopt appropriate disclosure practices, both with respect to information concerning the provider contained in primary offering materials and on an ongoing basis in the annual financial information. The Commission will monitor developments in this area regarding the nature and quality of information made available about credit enhancers and liquidity providers, and the manner in which information is made available to determine whether further steps are necessary to assure access to this important body of information.

(2) Who Must Undertake

A related question to whose information must be given is who must provide the information undertaking; the person providing the undertaking may not necessarily be the person about which the information relates. The Proposed Amendments would have required that the continuing information undertaking be provided by the issuer. A significant number of commenters raised concerns about which of potentially several persons that could be considered an issuer of municipal securities[86] would be expected to provide the undertaking and who would make that determination.[87] This was a particular concern in light of the potential liability of the issuer providing the undertaking for the provision and the content of information regarding other issuers and significant obligors—persons not necessarily under their control. Commenters made a number of suggestions to address these perceived ambiguities, including requiring that each

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nomic Development Department; Letter of Realvest Capital Corporation; Letter of Thacher Proffitt & Wood. Some commenters also were concerned as to whether the definition would encompass providers of guaranteed investment contracts and other investments. *See, e.g.*, Letter of ABA Urban Law Section; Letter of Kutak Rock, on behalf of AMBAC Indemnity Corporation, Capital Markets Assurance Corporation, Capital Reinsurance Company, Enhance Reinsurance Company, Financial Guaranty Insurance Company, Financial Security Assurance, Inc., and Municipal Bond Investors Assurance Corporation ("Kutak Rock on behalf of Financial Guaranty Insurers"). A functional approach determines whether providers of investments should provide ongoing information. For example, if the proceeds of an Offering are invested in guaranteed investment contracts ("GICs"), and the income from the GICs is the predominant source of revenue to repay the obligations on the securities, information about the provider may be material to the Offering, including on an ongoing basis. If, however, other sources of revenue are committed to support payment of the obligations, the relative importance of the provider of the GIC to investors may be diminished.

[84] *See, e.g.*, Letter of ABA Urban Law Section; Letter of Smith, Gambrell & Russell; Letter of Texas Water Development Board. Some commenters noted difficulty in obtaining information from credit enhancers. *See* Letter of Association of Bay Area Governments; Letter of New York State Housing Finance Agency; Letter of State of Washington, Office of the Treasurer.

[85] *See, e.g.*, Memorandum of August 10, 1994 Meeting with Davis, Polk and Wardwell and Various Banks; Letter of Kutak Rock on Behalf of Financial Guaranty Insurers. One commenter recommended that bond insurers and banks providing letters of credit, who are not subject to periodic reporting requirements of the federal securities laws, send publicly available reports to the repositories. *See* Letter of ABA Urban Law Section.

[86] The term "issuer of municipal securities," as defined in Rule 15c2-12, includes issuers of separate securities as well.

[87] *See, e.g.*, Letter of ALHFA; Letter of Hawkins Delafield & Wood; Letter of Kutak Rock; Letter of National Auditors Association; Letter of the Treasurer of the State of North Carolina.

information.[92] Some commenters argued that the rule should include specified formats for information to be provided, including financial statements and certain industry reporting formats,[93] while other commenters contended that no form or content should be specified and that the parties should be permitted to make determinations based on materiality alone.[94] As discussed below, the flexibility afforded by the concept of annual financial information addresses these concerns by providing a minimum standard for ongoing disclosure, but allowing the parties to define that standard with respect to each Offering of municipal securities.

(2) Financial Information

The proposal to mandate audited financial statements produced considerable comment. As with the proposed definition of final official statement, commenters expressed concern with the availability of audited financial statements on an annual basis, as well as the relevance of financial statements for certain types of financings.

Some commenters indicated that some municipalities were not required by law to have independently audited financial statements, and any such requirement would impose a significant new expense.[95] A number of commenters also expressed doubt as to whether audited financial information could be delivered on an annual basis, because audits may not be completed for a number of years following the close of the fiscal year.[96] Commenters noted that in some cases, financial statements for certain types of entities were audited every year, and in other cases every 2–3 years.[97] Therefore, some of these commenters argued that the requirement for annual audited financial statements would have an adverse impact on an issuer's ability to access the public securities markets or increase its costs of financing.[98]

A number of commenters also raised concerns regarding the availability of full financial statements for certain issuers, whether or not audited.[99] As examples, commenters noted that some issuing entities do not have their own financial statements and may be included in the financial statements of a larger issuer or entity.[100] Commenters from two states indicated that governmental units of the states may be encompassed in the state's comprehensive annual financial report and that there may be only supplemental schedules that described the governmental units.[101]

Some commenters raised the point that financial statements of a general governmental unit may not necessarily be relevant in certain project and structured financings.[102] As an example, one commenter noted that in some asset backed financings, information about the governmental issuer may be relevant only with respect to its experience in managing programs of loan pools.[103]

Commenters proposed a number of alternatives to the requirement to provide annual audited financial statements. Among the alternatives was a suggestion that financial statements be required in the form customarily prepared by the issuer promptly upon becoming available and that audited financial statements be provided to the extent available.[104] Other suggestions included limiting the requirement to those entities

[92] *See, e.g.*, Letter of Dean Witter Reynolds, Inc. ("Dean Witter"); Letter of National League of Cities; Letter of NFMA; Joint Response; Letter of PSA; Letter of Tillinghast, Collins & Graham; Letter of the Treasurer of the State of Connecticut.

[93] *See, e.g.*, Letter of Dain Bosworth, Inc.; Letter of First Albany Corporation; Letter of MSRB; Letter of NFMA; Letter of Standish, Ayer & Wood, Inc.

[94] *See, e.g.*, Letter of CDFA; Letter of Chapman and Cutler; Letter of CIFA; Joint Response; Letter of H.M. Quackenbush; Letter of NABL.

[95] *See, e.g.*, Letter of Texas Water Development Board; Letter of State of Washington, Office of the Treasurer.

[96] *See, e.g.*, Letter of City of Barling; Letter of Dain Bosworth, Inc.; Letter of Friday, Eldridge & Clark.

[97] *See, e.g.*, Letter of AMP—Ohio; Letter of State of Indiana, State Board of Accounts; Letter of State of Montana, Department of Natural Resources and Conservation; Letter of Washington Finance Officers Association.

[98] *See, e.g.*, Letter of AMP—Ohio; Letter of Washington Finance Officers Association.

[99] *See, e.g.*, Letter of ABA Business Law Section; Letter of Florida Division of Bond Finance; Letter of Gust & Rosenfeld; Letter of Office of the State Auditor, Texas ("Texas Office of the State Auditor").

[100] *See, e.g.*, Letter of Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

[101] *See, e.g.*, Letter of the Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

[102] *See, e.g.*, Letter of ABA Urban Law Section; Letter of APPA; Letter of Goldman Sachs; Letter of Gust & Rosenfeld; Letter of The Hospital & Higher Education Facilities Authority of Philadelphia; Letter of Morgan Stanley; Letter of NABL; Letter of New York State Housing Finance Agency.

[103] *See* Letter of ABA Urban Law Section.

[104] *See, e.g.*, Letter of ABA Business Law Section; Letter of Association of Bay Area Governments; Letter of North East Independent School District; Letter of PSA; Letter of Washington Finance Officers Association.

guidelines, what operating data will be provided both initially and on an ongoing basis. For example, in a conduit health care financing, under current industry practice, an official statement typically provides information relating to the obligated party—the hospital—in an appendix. In addition to a discussion describing the hospital, its administration and management, economic base and service area, and capital plan, operating statistics such as bed utilization, admissions and type, patient days, and payor utilization often is provided. Under the amendments, in this type of transaction, parties at the outset of a transaction will determine which operating data will be included in the hospital appendix; such information, in turn, will be the type of "operating data" to be provided annually.

Some commenters expressed concern that the Proposed Amendments were not sufficiently flexible to permit parties to address changing conditions because the undertaking would have to describe the financial and pertinent operating information to be provided in the future.[113] Nonetheless, the requirement that the undertaking specify in reasonable detail the type of data that will be provided on an ongoing basis, including the identity of the persons (or category of persons) about which the information will relate has been retained. As is the case with financial information, the intent of the amendments is to give investors and market participants the ability to evaluate the security through comparisons of the quantitative operating data provided. Contrary to the suggestion of some commenters, the undertaking would be meaningless if issuers and obligated persons could unilaterally determine that certain types of information were no longer necessary or meaningful to investors.

Because the amendments require that the undertaking specify only the general type of information to be supplied, there should be sufficient flexibility to accommodate subsequent developments that may require adjustments in the financial information and operating data that should be provided annually. Of course, nothing in the undertaking will prevent a party from providing additional information, particularly where such disclosure may be necessary to avoid liability under the antifraud provisions of the federal securities laws. Similarly, the amendments make specific provision for adjusting the persons about which information is provided. As required in the case of pooled financings, parties may identify the persons covered by reference to objective selection criteria that will be applied on a consistent basis between the offering statements and with regard to annual financial information. Moreover, the party providing the undertaking need not continue to provide information concerning persons that are no longer obligated persons with respect to the municipal securities.

A new provision has been added to the amendments which permits the written agreement or contract to have a termination provision with respect to any obligated person that is no longer directly or indirectly liable for repayment of any of the obligations on the municipal securities.[114] Once an obligated person no longer has any liability for repayment of the municipal securities, whether through termination or expiration of its commitment to support payment, or as a result of a defeasance of the municipal securities with no remaining liability, then the obligation to provide annual financial information and notices of events may terminate.

2. Notice of Material Events

Commenters generally agreed that issuers and obligors should be subject to an undertaking to provide event information to the market.[115] Brokers, dealers and municipal securities dealers supported these provisions of the Proposed Amendments, because the use of a list provides guidance as to what events should be covered.[116] Other commenters, however, felt that the list should be deleted from the rule and that the concept of materiality should be relied upon to determine what events should be the subject of notices.[117] Some commenters believed that the list of eleven events should be expanded to include a provision that would cover any other event that might reasonably be expected to have

[113] *See, e.g.*, Letter of Chapman and Cutler; Joint Response; Letter of Kutak Rock.

[114] *See* Rule 15c2-12(b)(5)(iii).

[115] *See* paragraph (b)(5)(i)(B) of the Proposed Amendments. *See also*, Letter of A.G. Edwards; Letter of Chemical Securities; Letter of J.J. Kenny Co., Inc. ("J.J. Kenny Co."); Letter of MSRB.

[116] *See, e.g.*, Letter of Chemical Securities; Letter of Goldman Sachs; Letter of George K. Baum; Letter of PSA.

[117] *See, e.g.*, Letter of CDFA; Letter of Gust & Rosenfeld; Joint Response; Letter of Municipal Treasurers Association; Letter of Rauscher Pierce Refsnes, Inc.; Letter of Standish Ayer & Wood, Inc.

It is possible that an "event" affecting the tax-exempt status of the security may include the commencement of litigation and other legal proceedings, including an audit by the Internal Revenue Service, when an issuer determines, based on the status of the proceedings and their likely impact on holders of the municipal securities, among other things, that such events may be material to investors.

Commenters expressed concern that the party providing the undertaking may not have knowledge of the occurrence of events affecting other parties that might be called for by the provisions of the rule.[125] This concern should be addressed by the revised approach of enabling the parties to the transaction to determine who will provide the undertakings. For example, in the conduit context, the covenant could be provided by the person that is committed by contract or other arrangement to support payment of debt service, rather than the conduit issuer.

The timing for providing the notification has not been changed from the Proposed Amendments, which required that the notice be provided on a "timely" basis. The amendments do not establish a specific time frame as "timely," because of the wide variety of events and issuer circumstances. In general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice.

A new paragraph has been added to the amendments[126] that would require a Participating Underwriter to reasonably determine that the undertaking includes an agreement to notify the appropriate repository if the annual financial information is not provided in the stated time frame. Given the expressed concerns of some commenters regarding the difficulty that they would face in determining whether an issuer or other person was in compliance with any of its undertakings,[127] this provision will help inform market participants if annual financial information for such persons has not been made available in the agreed upon time frame.

3. Location of Undertaking in a Written Agreement or Contract

The Proposed Amendments called for the undertaking to be contained in a written agreement or contract for the benefit of holders of municipal securities. Commenters provided a variety of views as to where the undertakings should be memorialized, who should be parties to such undertakings, and the need for flexibility to modify undertakings in the future. Commenters suggested, for instance, that the undertakings could be included in the trust indenture, bond resolution, ordinance, or other legislation, a separate written agreement, or the underwriting agreement or bond purchase agreement.

As discussed in the Proposing Release, many offerings of municipal securities are issued pursuant to a trust indenture setting out the covenants of the issuer for the benefit of the holders of the municipal securities. If there is no trust indenture as part of an offering, as is the case with general obligation and certain other types of bonds, there may be a bond resolution, ordinance, or other legislation. Most commenters addressing this issue considered the trust indenture, bond resolution, ordinance, or other legislation to be appropriate for undertakings to provide secondary market disclosure, because they would create a direct obligation by issuers to bondholders.[128] Commenters also suggested the use of a separate written agreement between the issuer and the trustee as an appropriate method of memorializing undertakings.[129]

Several commenters suggested that the inclusion of the undertakings in an underwriting agreement or bond purchase agreement would be sufficient for purposes of Rule 15c2-12,[130] though another commenter suggested that a promise running to the benefit of the underwriter, whether in a bond purchase agreement

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[125] *See, e.g.*, Letter of First Southwest Company; Letter of New York Dormitory Authority; Letter of the Treasurer of the State of North Carolina; Letter of City of Pullman, Washington.

[126] *See* Rule 15c2-12(b)(5)(i)(D).

[127] *See, e.g.*, Letter of Gust & Rosenfeld.

[128] *See, e.g.*, Letter of Merrill Lynch. Certain commenters considered that undertakings in a trust indenture could prove inflexible, as well as difficult to modify if they became inappropriate in the future. Letter of ABA Business Law Section. Other commenters considered that the issue of flexibility could be addressed through careful drafting. Letter of Morgan Stanley; Letter of Rauscher, Pierce, Refsnes, Inc.

[129] *See* Letter of Chapman and Cutler (suggesting that an agreement could be made between an issuer and a trustee or between the issuer and a NRMSIR); Letter of Rauscher, Pierce, Refsnes, Inc. These commenters noted that such agreements provide flexibility for the future modification of the type, timing, or presentation of secondary market disclosure, as well as remedies in the event of a breach of the agreement.

[130] *See e.g.*, Letter of Mudge Rose.

them to consider the most current information before making a recommendation.

In view of the importance of secondary market liquidity in municipal issues, the Commission requested comment on whether the Proposed Amendments would have a substantial or long-lasting effect on market liquidity. This request for comment was based on concerns raised about whether municipal securities dealers would be willing to effect secondary market transactions in a broad range of municipal securities if review was required on a recommendation by recommendation basis.

Many commenters strongly criticized this provision of the Proposed Amendments. The majority of commenters responded that requiring the review of information prior to making a recommendation on the purchase or sale of a municipal security would create substantial compliance burdens for dealers.[136] Commenters also noted that the specific requirement to review information either would impel dealers to hire larger research and analysis staffs,[137] or, more likely, would cause dealers to restrict the issuers whose municipal securities they would trade to a smaller number of large and frequent issuers.[138] Commenters predicted that, as a result, liquidity for all but the largest and most frequent issuers would be reduced.[139]

Commenters proposed alternatives to the recommendation prohibition, including basing the type of review of a municipal security, and disclosure about such review, on whether the investor was an institutional or retail investor,[140] or on the type of municipal security recommended.[141] Other commenters suggested the continued reliance on the reasonable basis standard inherent in the MSRB's suitability rule, G-19, and the antifraud provisions, as discussed by the Commission in the 1988 and 1989 Releases proposing and adopting Rule 15c2-12, as well as the Interpretive Release.[142]

As adopted, this provision has been modified in a number of respects to respond to concerns expressed by commenters. In particular, the amendments replace the proposed review standard with a requirement that dealers have procedures in place that provide reasonable assurance that they will receive promptly any notices of material events regarding the securities that they recommend. The events are any of the eleven events disclosed as described in Rule 15c2-12(b)(5)(i)(C), or the notice of failure to provide annual financial information in accordance with an undertaking as described in Rule 15c2-12(b)(5)(i)(D) with respect to that security. Many dealers currently subscribe to electronic reporting systems that give notice of significant events made public by municipal issuers. To comply with the rule's requirement, these dealers should make certain that these systems receive, directly or indirectly, material event notices for issues the dealer recommends. In addition, dealers should develop procedures to ensure that notices of such events will be available to the staff responsible for making recommendations.

In the Commission's view, the recommendation provision, as modified, should substantially reduce the concerns of commenters with respect to compliance burdens and effects on liquidity. It also will help ensure that dealers will consider the material event notices that issuers produce, thus enabling them to have an adequate basis on which to recommend[143] municipal securities.

Moreover, even though the amendments do not require that dealers directly review an issuer's ongoing disclosure before making each recommendation, the Commission agrees with those commenters that said that additional informa-

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[136] *See* Letter of PSA (noting that paragraph (c) would require dealers to create records showing that they had reviewed municipal securities).

[137] *See, e.g.*, Letter of Chapman and Cutler (brokers with fewer analysts will be at a competitive disadvantage); Letter of Morgan Stanley (noting that in order to comply with paragraph (c) as proposed, reliance on third-party service providers for information analysis would be required).

[138] *See, e.g.*, Joint Response; Letter of PSA; Letter of Gabriel, Hueglin & Cashman.

[139] *See, e.g.*, Joint Response; Letter of PSA.

[140] Letter of Investment Company Institute ("ICI"). *See also* Letter of MRB; Letter of NABL. NABL suggested disclosure by dealers as to whether a party has committed to provide secondary market disclosure, and if not, the consequences of investing in the securities.

[141] *See, e.g.*, Letter of Edward D. Jones & Co. (suggesting application of the Proposed Amendments only to non-rated or special assessment bonds); Letter of NABL (suggesting exemptions from the amendments to Rule 15c2-12 for issuers that obtain and maintain an investment grade rating, and for general obligation bonds and revenue bonds issued to finance essential government purposes).

[142] *See, e.g.*, Letter of PSA; Letter of A.G. Edwards & Sons, Inc. (reviewing issuer's disclosure is not the only way to form the basis for a recommendation).

[143] As noted in the Proposing Release, most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer.

As a result of the amendments, NRMSIRs will play an expanded role in the collection and dissemination of secondary market information. In addition to the collection and dissemination of final official statements, they will collect and disseminate annual financial information, as well as notices of material events. The Commission is sensitive to the need of NRMSIRs for flexibility, especially with respect to the timing requirements for the dissemination of notices of material events. The Commission will monitor developments in the municipal securities market as participants adapt to the changes in Rule 15c2-12, and fully expects that the current and potential NRMSIRs are capable of adjusting to their expanded role. The Commission is of the view that NRMSIRs, as private information vendors, will have sufficient economic incentives to serve their expanded functions resulting from the amendments to Rule 15c2-12, even in the absence of the more specific review requirement of the recommendation prohibition of the Proposed Amendments.[151]

2. Definition of Nationally Recognized Municipal Securities Information Repository

The Commission requested comment on whether the term "NRMSIR" should be defined in Rule 15c2-12, and whether specific standards should be established for NRMSIRs. If standards were to be established in the rule, the Commission requested comment on whether proposed standards set forth in the release were adequate.[152] The majority of state-based information gatherers and disseminators, and other NRMSIRs that addressed the issue of defining the term "NRMSIR" supported maintaining the guidelines already established by the Commission in the 1989 Release.[153] After reviewing the comment letters, the Commission has determined that the guidance established in the 1989 Release for NRMSIRs should be modified only as necessary to reflect the amendments to Rule 15c2-12. In determining whether a particular entity is a NRMSIR the Commission will now consider, among other things, whether the repository:

(1) is national in scope;

(2) maintains[154] current, accurate[155] information about municipal offerings in the form of official statements, and annual financial information, notices of material events, and notices of a failure to provide annual financial information undertaken to be provided in accordance with Rule 15c2-12;

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is a central repository for voluntarily submitted official continuing disclosure documents relating to outstanding municipal securities issues. Securities Exchange Act Release No. 30556 (April 6, 1992) 57 FR 12534. Neither the MSIL OS/ARD system nor the CDI system is a NRMSIR; the Commission has previously indicated that it would consider the competitive implications of a MSRB request for NRMSIR status. *See* Securities Exchange Act Release No. 28081 (June 1, 1990), 55 FR 23333, 23337 n.26.

[151] *See, e.g.*, Letter of PSA (noting that the suggestion made by some market participants that municipal securities dealers will not utilize information they have long sought is implausible), Letter of Ferris Baker Watts (information will be used if it is available).

[152] The Commission suggested that NRMSIRs (a) maintain current, accurate information about municipal securities, including final official statements, the issuer's annual final information, and issuer's notices of material events; (b) have effective systems for the timely collection, indexing, storage and retrieval of these documents; and (c) be capable of national dissemination of final official statements, annual financial information, and notices of material events through electronic dissemination systems, in response to telephone inquiries, and hard copy delivery via facsimile, by mail and by messenger service. The Commission also stressed the importance of timely public availability upon receipt of information by a NRMSIR.

[153] *See, e.g.*, Letter of Bloomberg L.P.; Letter of Cypress Capital Corp. (a dealer chosen by the Louisiana Municipal Association to assist it in developing a repository to collect and disseminate information on Louisiana issuers of municipal securities). In discussing NRMSIRs in the 1989 Release, the Commission noted that in determining whether a particular entity is a NRMSIR, it would look, among other things, at whether the repository: (1) is national in scope; (2) maintains current, accurate information about municipal offerings in the form of official statements; (3) has effective retrieval and dissemination systems; (4) places no limit on the issuers from which it will accept official statements or related information; (5) provides access to the documents deposited with it to anyone willing and able to pay the applicable fees; and (6) charges reasonable fees. *See* 1989 Release at n. 65.

[154] In the past, the Division of Market Regulation has required that each NRMSIR maintain copies of all disclosure documents. In view of recent requests from information collectors and disseminators, the Division of Market Regulation will review, on a case by case basis, NRMSIR proposals to satisfy the requirement to maintain copies of disclosure documents through a contract with another entity (including the MSRB) that will maintain copies. *See* Letters from Laurence M. Landau, Vice President, Dow Jones Telerate, to Elizabeth MacGregor, Division of Market Regulation, SEC, (July 18, 1994) and to Gautam S. Gujral, Division of Market Regulation, SEC (August 4, 1994). *See also* Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial). This flexible approach, requested by industry participants, may allow NRMSIRs to reduce the cost at which they can collect and disseminate disclosure information to broker-dealers and investors.

[155] It should be noted that NRMSIRs are not being required to verify the accuracy of the information provided them. NRMSIRs are required to accurately convey the information provided to them.

disclosure in the municipal securities market.[165] State-based depositories will be in a special relationship with filers of disclosure information to provide for convenient and efficient dissemination. The Commission therefore encourages states to develop state-based depositories.

To encourage the development of state-based depositories, the Commission has amended Rule 15c2-12 to require that Participating Underwriters reasonably determine that the information undertaken to be provided, in addition to being submitted to the NRMSIRs, or, in some cases, to the MSRB, will be submitted to a state information depository ("SID"), if an appropriate SID has been established in that state. Further, as discussed below,[166] an exemption conditioned on making annual financial information available upon request or to a SID, and providing notices of material events to each NRMSIR or the MSRB, and to a SID, has been adopted. An appropriate SID would be a depository operated or designated[167] by the state that receives information from all issuers within the state, and makes this information available promptly to the public on a contemporaneous basis.[168] The Commission staff is prepared to provide guidance in particular instances regarding a SID's qualification for purposes of the rule.

4. Information Delivery Requirements

The Proposing Release asked to whom the required information should be delivered. It also requested comment on the feasibility of requiring NRMSIRs to inform the MSRB when they receive disclosure information from issuers, and whether such information also should be required to be placed with the MSRB, in addition to or in lieu of a NRMSIR. The NRMSIRs did not address the issue of requiring them to inform the MSRB whenever they received disclosure information from an issuer, although one commenter argued that designating the MSRB as a repository only would add an unnecessary layer to the dissemination process.[169] Other commenters suggested designating a single central repository.[170] Similarly, some commenters suggested imposing a requirement that disclosure information be delivered to all NRMSIRs,[171] while others suggested that NRMSIRs be required to share the information received with other NRMSIRs,[172] and a third group preferred the establishment of a central index.[173] State-based information gatherers and disemminators had diverging views on this issue.[174]

Based on these comments, the Commission has determined to require that annual financial information undertaken to be provided be deposited with each NRMSIR and the appropriate SID in the issuer's state. Any audited financial statements submitted in accordance with the undertakings also must be delivered to each NRMSIR and to the SID in the issuer's state, if such a depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID is a modification of the Proposed Amendments. This modification will ensure that all NRMSIRs receive disclosure information directly. It also permits the Commission to adopt the amendments without a delay for the creation of a central index or a system of information sharing among NRMSIRs.[175] The requirement to send information to all NRMSIRs rather than a single

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[165] *See, e.g.*, Letter of the Office of the State Comptroller, State of New York.

[166] *See* Section II.D.1. *infra*.

[167] There is no requirement that SIDs be instrumentalities of a state. A number of private organizations already function as state-based repositories, at times at no cost to the taxpayer. The Commission defers to each state's determination whether to have a private or public entity be its SID.

[168] As with NRMSIRs, for a SID to give preferential treatment to a NRMSIR by giving it market information before it is made available to other NRMSIRs would be wholly inconsistent with functioning as a SID.

[169] Letter of Bloomberg L.P.

[170] *See, e.g.*, Artemis Capital Group, Ltd. (proposing that the Commission designate the MSRB's MSIL system as the single central repository); Letter of Chapman and Cutler (there should be one central source of information).

[171] *See, e.g.*, Letter of J.J. Kenny Co.; Letter of National Association of Independent Public Financial Advisers.

[172] *See, e.g.*, Letter of MSRB; Letter of Richard A. Ciccarone.

[173] Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial); Letter of The Bond Buyer.

[174] The Ohio Municipal Advisory Council stated that it is feasible to require repositories to inform the MSRB as to which issuers have released information to it. Under Cypress Capital Corporation's proposal, the indexing party would receive descriptions of all materials received by the Louisiana Repository. *But see*, Letter of NASACT (requirement that a repository be required to notify a central index each time an item of information is received by the repository is unduly burdensome and unnecessary).

[175] Some commenters expressed an interest in creating a central index and an information sharing system. Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial); Letter of Dow Jones Telerate, Inc. The Commission is prepared to review such mechanisms for centralized collection and dissemination if requested to do so.

addition, Rule 15c2-12's limitation to primary offerings of municipal securities with an aggregate principal amount of $1,000,000 or more, and its existing exemptions, also apply to the amendments.[179]

1. Small Issuer Exemption

The Proposed Amendments would have exempted from the provisions of the undertaking and recommendation prohibitions of the rule municipal securities issued in Offerings by issuers that had (i) less than $10,000,000 in principal amount of securities outstanding, including the offered securities and (ii) issued less than $3,000,000 in aggregate amount of municipal securities in the most recent 48 months preceding the offering.

A number of commenters discussed the appropriateness of the proposed dollar exemption, with comments ranging from a call for increased thresholds to no thresholds at all.[180] Some commenters believed that the thresholds should be increased, because many small municipalities would exceed these thresholds if they delay their financings in order to issue a greater amount of bonds at one time. The commenters argued that these are small, infrequent issuers with limited trading in the secondary market and the cost of compliance would outweigh the benefits received from improved secondary market disclosure.[181]

Other commenters took exception to the proposed thresholds because they were too high. These commenters argued that the exemption as proposed would exclude from coverage of the rule the types of issuers who have historically had deficient disclosure practices and disproportionate numbers of defaults.[182] A number of commenters also argued that the $3 million/48 month component of the threshold was too complex.[183]

As adopted,[184] the exemption retains the aggregate $10,000,000 limitation, but eliminates the $3,000,000 threshold. Instead, in addition to falling under the $10,000,000 in outstanding securities threshold, the exemption is conditioned upon an issuer or obligated person providing a limited disclosure undertaking. Under this undertaking, financial information and operating data concerning each obligor for which financial information or operating data is presented in the final official statement, must be provided upon request to any person, or be provided at least annually to the appropriate SID. The undertaking would specify the type of financial information and operating data that will be made available annually, which must include financial information and operating data that is customarily prepared by the obligated person and is publicly available. The final official statement must describe where and how the financial information and operating data can be obtained.

Financial information and operating data of governmental issuers generally are subject to freedom of information laws, and thus would be publicly available for purposes of this condition of the exemption. Conduit borrowers generally provide annual financial information to trustees, credit enhancers, or the financing agency that issued the municipal securities, and thus would have no difficulty complying with this standard if that information is made publicly available. To the extent that an obligated person does not currently publicly disclose that information, they are free to specify the type of information they are undertaking to provide on an ongoing basis, but they must agree to provide some information. That information need not be the same type of information presented in the official statement. Nor would these exempt persons have to release their audited financial statements, unless they otherwise customarily prepare and make their audited financial statements publicly available. Moreover, the limited disclosure undertaking need only cover those obligors

[179] Former paragraph (c) of Rule 15c2-12 was proposed to be, and has been redesignated as paragraph (d)(1). This paragraph exempts primary offerings of municipal securities in authorized denominations of $100,000 or more, if such securities: (1) are sold to no more than 35 investors, each of whom the underwriter reasonably believes is capable of evaluating the investment and who is not purchasing with a view to distribution; (2) have a maturity of nine months or less or; (3) at the option of the holder may be tendered to an issuer at least as frequently as every nine months.

[180] *See, e.g.*, Letter of ALHFA; Letter of CDFA; Letter of NFMA; Letter of National Association of Independent Public Finance Advisors; Letter of Prudential Investment Corp.; Letter of PSA; Letter of Washington State Auditor.

[181] *See, e.g.*, Letter of NAST; Letter of SIA.

[182] *See, e.g.*, Letter of Chemical Securities; Letter of Eaton Vance Management; Letter of Edward D. Jones & Co.; Letter of Morgan Stanley; Letter of National Association of Independent Public Finance Advisors; Letter of Norwest Investment Services.

[183] *See, e.g.*, Letter of APPA; Letter of The Bank of New York; Joint Response.

[184] *See* Rule 15c2-12(d)(2).

gated persons, a governmental issuer could not avoid aggregation of its securities by restricting repayment to separate revenue streams.[192]

Commenters also discussed a related issue of what securities would be included in the calculation. Commenters contended that only publicly offered securities should be included in the calculation. Other commenters questioned how short term obligations such as bond anticipation notes, refunded bonds and installment/lease purchase agreements would be treated. Several commenters suggested that the threshold should be measured only against publicly offered, long-term bonds.[193]

The amendments have been clarified in this respect to exclude from the threshold calculation securities that were offered in transactions exempt from Rule 15c2-12 because they were otherwise exempt as private placements and short term financings. In addition, to the extent that an issuer or obligated person is no longer liable for repayment on bonds, as with certain defeased bonds, then such bonds would not be included in the calculation of the threshold for such issuer or obligated person.

A number of commenters indicated that an exemption should be available based on the number of holders of the municipal securities.[194] However, in accordance with concerns voiced by other commenters regarding the difficulty in ascertaining the number of holders due to the fact that most municipal securities are held in street name through a very limited number of depositories,[195] the amendments do not adopt any exemption based on the number of holders of the municipal securities.

A variety of other comments were raised relating to exemptions, and a number of alternative exemptions were proposed, including exemptions based on the type of issuer or the existence of an investment grade rating.[196] Commenters also believed that an exemption should be available for securities covered by bond insurance or other credit enhancement, such as bank letters of credit.[197] Except as described above, the exemptions have not been revised to adopt these suggestions. Commenters, including some bond insurance providers,[198] expressed the view that the existence of credit enhancement does not necessarily eliminate the need for information regarding the underlying credit.

A number of commenters also argued that new exemptions should be added that would mirror exemptions under the Securities Act.[199] Some commenters argued that exemptions should be included for non-profit entities that would have their own exemption from registration under the Securities Act.[200] The Commission is not including any exclusion in the amendments for any such issuers. Issuers accessing the tax-exempt public securities markets have obligations to promote the integrity and efficiency of those markets. As the Commission noted in the Interpretive Release, the high level of defaults in sectors such as healthcare, lifecare, retirement homes and multifamily housing, relative to other market sectors,[201] and the past problems with

[192] Significant indicia of whether an issuer in a revenue-type financing is in fact a part of a larger municipality would be whether the issuer's accounts are reflected in the municipality's financial statements and whether the municipality's officials or personnel manage the separate financing programs.

[193] *See, e.g.*, Letter of ABA Business Law Section; Letter of Day Berry & Howard; Joint Response; Letter of Kutak Rock; Letter of the Treasurer of the State of North Carolina.

[194] *See, e.g.*, Letter of ABA Business Law Section; Letter of Kutak Rock; Letter of Mudge Rose; Letter of National League of Cities.

[195] *See, e.g.*, Letter of Bank One Corporation; Letter of Reliance Trust Company.

[196] *See, e.g.*, Letter of ICI; Letter of McDonald & Company Securities; Letter of NABL; Letter of National League of Cities; Letter of NFMA; Letter of New York Dormitory Authority; Letter of Putnam Investment Management; Letter of State of Utah, Office of the State Treasurer; Letter of State of Washington, Office of the State Treasurer.

[197] *See, e.g.*, Letter of Delaware County Industrial Development Authority; Letter of Financial Security Assurance; Letter of McNair & Sanford; Letter of Smith, Gambrell & Russell.

[198] As some commenters indicated, the existence of credit enhancement or other programmatic enhancement features does not eliminate the need for information on underlying obligated persons, particularly where there is a long term guarantee, because of the potential impact of a default on the pricing of the securities. *See* Letter of Kutak Rock on behalf of Financial Guaranty Insurers; Letter of FGIC; Letter of Prudential Investment Corp. *See also* Securities and Exchange Commission, *Report by the Securities and Exchange Commission on the Financial Guaranty Market: The Use of the Exemption In Section 3(a)(2) of the Securities Act for Securities Guaranteed by Banks and the Use of Insurance Policies to Guarantee Debt Securities* (August 28, 1987).

[199] *See, e.g.*, Letter of ABA Business Law Section; Letter of Goldman Sachs; Letter of Morgan Stanley; Letter of Mudge Rose; Letter of Thacher Proffitt & Wood.

[200] *See, e.g.*, Letter of Morgan Stanley; Letter of Mudge Rose; Letter of New York Dormitory Authority.

[201] Interpretive Release at Section III.D. *See also* Letter of The Bond Buyer.

III. Effects on Competition and Regulatory Flexibility Act Considerations

Section 23(a)(2) of the Exchange Act[214] requires the Commission, in adopting rules under the Act, to consider the anticompetitive effects of those rules, if any, and to balance that impact against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission has considered the amendments to Rule 15c2-12 in light of the standard cited in Section 23(a)(2) and believes the adoption of the amendments will not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

In addition, the Commission has prepared a final regulatory flexibility analysis ("FRFA"), pursuant to the requirements of the Regulatory Flexibility Act[215] regarding the proposed amendments to Rule 15c2-12. The Commission requested comment on the extent to which current practice deviates from the requirements of the proposed amendments, and the extent to which additional costs may be imposed on small issuers, brokers, dealers, and municipal securities dealers if the amendments are adopted as proposed. The FRFA indicates that the amendments to the rule could impose some additional costs on small broker-dealers and municipal issuers. Nonetheless, the Commission is of the view that many of the substantive requirements of the amendments already are observed, absent access to the continuing information provided by the amendments, by issuers, brokers, dealers, and municipal securities dealers as a matter of business practice, or to fulfill their existing obligations under the antifraud provisions of the federal securities laws. To the extent that the Proposed Amendments would have imposed additional costs on small issuers, brokers, dealers, and municipal securities dealers, in response to commenters' concerns, the Commission has modified the amendments as described.

A copy of the FRFA may be obtained from Janet W. Russell-Hunter, Attorney, Office of Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 7-10, Washington, D.C. 20549, (202) 942-0073.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, securities.

Text of Amendments to Rule 15c2-12

In accordance with the foregoing, Title 17, Chapter II of Title 17 of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4 and 80b-11, unless otherwise noted.

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2. Section 240.15c2-12 is amended by adding a Preliminary Note preceding paragraph (a); revising paragraph (a); adding paragraph (b)(5); redesignating paragraph (c) through paragraph (f) as paragraph (d) through paragraph (g); adding paragraph (c); revising newly designated paragraph (d), paragraph (e), and paragraph (f)(3); adding paragraph (f)(9) and paragraph (f)(10); and adding four sentences to the end of newly designated paragraph (g) to read as follows:

§240.15c2-12 *Municipal securities disclosure.*

Preliminary Note: For a discussion of disclosure obligations relating to municipal securities, issuers, brokers, dealers, and municipal securities dealers should refer to Securities Act Release No. 7049, Securities Exchange Act Release No. 33741, FR-42 (March 9, 1994). For a discussion of the obligations of underwriters to have a reasonable basis for recommending municipal securities, brokers, dealers, and municipal securities dealers should refer to Securities Exchange Act Release No. 26100 (Sept. 22, 1988) and Securities Exchange Act Release No. 26985 (June 28, 1989).

(a) General. As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for any broker, dealer, or municipal securities dealer (a "Participating Underwriter" when used in connection with an Offering) to act as an underwriter in a primary offering of municipal securities with an aggregate principal amount of $1,000,000 or more (an "Offering") unless the Participating Underwriter complies with the re-

[214] 15 U.S.C. 78w(a)(2).
[215] 5 U.S.C. 604.

ful for any broker, dealer, or municipal securities dealer to recommend the purchase or sale of a municipal security unless such broker, dealer, or municipal securities dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to paragraph (b)(5)(i)(C), paragraph (b)(5)(i)(D), and paragraph (d)(2)(ii)(B) of this section with respect to that security.

(d) *Exemptions.* (1) This section shall not apply to a primary offering of municipal securities in authorized denominations of $100,000 or more, if such securities:

(i) Are sold to no more than thirty-five persons each of whom the Participating Underwriter reasonably believes:

(A) 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

(B) Is not purchasing for more than one account or with a view to distributing the securities; or

(ii) Have a maturity of nine months or less; or

(iii) 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.

(2) Paragraph (b)(5) of this section shall not apply to an Offering of municipal securities if, at such time as an issuer of such municipal securities delivers the securities to the Participating Underwriters:

(i) No obligated person will be an obligated person with respect to more than $10,000,000 in aggregate amount of outstanding municipal securities, including the offered securities and excluding municipal securities that were offered in a transaction exempt from this section pursuant to paragraph (d)(1) of this section;

(ii) An issuer of municipal securities or obligated person has undertaken, either individually or in combination with other issuers of municipal securities or obligated persons, in a written agreement or contract for the benefit of holders of such municipal securities, to provide:

(A) Upon request to any person or at least annually to the appropriate state information depository, if any, financial information or operating data regarding each obligated person for which financial information or operating data is presented in the final official statement, as specified in the undertaking, which financial information and operating data shall include, at a minimum, that financial information and operating data which is customarily prepared by such obligated person and is publicly available; and

(B) In a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any, notice of events specified in paragraph (b)(5)(i)(C) of this section with respect to the securities that are the subject of the Offering, if material; and

(iii) the final official statement identifies by name, address, and telephone number the persons from which the foregoing information, data, and notices can be obtained.

(3) The provisions of paragraph (b)(5) of this section, other than paragraph (b)(5)(i)(C) of this section, shall not apply to an Offering of municipal securities, if such municipal securities have a stated maturity of 18 months or less.

(4) The provisions of paragraph (c) of this section shall not apply to municipal securities:

(i) Sold in an Offering to which paragraph (b)(5) of this section did not apply, other than Offerings exempt under paragraph (d)(2)(ii) of this section; or

(ii) Sold in an Offering exempt from this section under paragraph (d)(1) of this section.

(e) *Exemptive Authority.* The Commission, upon written request, or upon its own motion, may exempt any broker, dealer, or municipal securities dealer, whether acting in the capacity of a Participating Underwriter or otherwise, that is a participant in a transaction or class of transactions from any requirement of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such an exemption is consistent with the public interest and the protection of investors.

(f) *Definitions.*

* * *

(3) The term *final official statement* means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the