

June 2, 2010

The Rules of Continuing Disclosure are Continuing to Change

After reshaping the municipal bond disclosure landscape with the creation of the Electronic Municipal Market Access system ("EMMA"), the Securities and Exchange Commission ("SEC") on Wednesday, May 26, announced significant changes to the continuing disclosure requirements of Rule 15c2-12 as well as the approval of two Municipal Securities Rulemaking Board ("MSRB") proposals.

The changes (1) prescribe a 10-day deadline for disclosure of specified events; (2) expand the list of events requiring disclosure; (3) mandate the disclosure of certain events regardless of whether they are "material"; (4) expand the scope of adverse tax events that require the filing of a material event notice; (5) virtually eliminate the variable rate demand obligation ("VRDO") exemption; (6) permit the MSRB to give special designation on EMMA to issuers that make certain "voluntary" undertakings; and (7) require underwriters to provide certain information about an issuer's continuing disclosure undertakings to EMMA.

Background

Rule 15c2-12 governs continuing disclosure by prohibiting an underwriter from underwriting most municipal securities unless the underwriter has reasonably determined that the issuer of such securities, or an obligated person, has agreed in writing to make the required post-issuance disclosures.

In an effort to improve the quality and timeliness of municipal securities disclosure and to close the gap between disclosure available to investors in municipal securities and that available to investors in corporate securities, the SEC adopted these amendments to Rule 15c2-12 (the "Rule"). Except as discussed below with respect to VRDOs, these changes are prospective and impact continuing disclosure agreements entered into in connection with primary offerings that occur on or after December 1, 2010.

AMENDMENTS TO SEC RULE 15c2-12

(1) New 10-Day Rule. The amended Rule will require that issuers and obligated persons file material event notices "in a timely manner not in excess of ten business days after the occurrence of the event." The Rule currently requires disclosure of such events "in a timely manner."

The SEC suggests that issuers and obligated persons consider including in their bond documents "contractual agreements to be advised of the occurrence of [disclosable] events by those persons or entities that may be expected to have direct knowledge of the occurrence." This suggestion may be of particular import in connection with conduit borrowings, where there is an obligated person other than the issuer.

(2) Additional Events Requiring Disclosure. The current list of events requiring disclosure will grow to include the following:

- (a) Tender offers (without regard to materiality)
- (b) Bankruptcy, insolvency, receivership or similar proceedings (without regard to materiality)
- (c) Mergers, consolidations, acquisitions, the sale of all or substantially all of the assets of the obligated person or their termination (if material)
- (d) Appointment of a successor or additional trustee or a change in the name of a trustee (if material)

(3) Removal of Materiality Determination. The SEC has taken the position that certain events are so important to investors that they should always be disclosed. To reflect this, the Rule requires the issuer or obligated party to always disclose each of the following events, regardless of whether the issuer believes it is material:

- (a) Failure to pay principal and interest
- (b) Unscheduled payments out of debt service reserves reflecting financial difficulties
- (c) Unscheduled draws on credit enhancements reflecting financial difficulties
- (d) Substitution of credit or liquidity providers or their failure to perform
- (e) Defeasances, including situations where the issuer has provided for future payment of all obligations under a bond
- (f) Rating changes
- (g) Tender offers
- (h) Bankruptcy, insolvency, receivership or similar events of the obligated person
- (i) Adverse tax opinions or other IRS determinations with respect to the tax status of the securities

(4) Disclosure of Tax Events. Issuers and obligated persons are currently required to disclose the receipt of adverse tax opinions or events affecting the tax-exempt status of the security, if material. The revised Rule removes the materiality determination and specifies that issuance by the 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 or affecting the tax status of the bonds or other events affecting the tax-exempt status of the security require disclosure.

(5) Elimination of VRDO Exemption. In response to the significant volume of auction rate securities that were converted to variable rate demand obligations due to problems in the auction rate securities market, treatment of such demand securities is changing. The new Rule will require that underwriters of a primary offering of VRDOs occurring after the compliance date reasonably determine that the issuer or obligated person has undertaken to provide continuing disclosure documents to the MSRB (with a "limited grandfather provision" for remarketings of currently outstanding demand securities).

APPROVED MSRB PROPOSALS

The SEC also approved two MSRB proposals. The first revises MSRB Rule G-32 to require underwriters to disclose to EMMA whether and when an issuer is obligated to provide the continuing disclosure information required by Rule 15c2-12 and who will be providing that information.

The second approved MSRB proposal offers a special designation on EMMA to those issuers and obligated persons that undertake to submit specified items to EMMA. An issuer or obligated person that makes such an undertaking would be rewarded by being "prominently disclosed on the EMMA web portal." In those cases where an issuer or obligated person does not make the undertaking, EMMA will not include any information regarding the availability or existence of the voluntary undertaking.

(1) Voluntary Annual Filing Undertaking. The approved proposal allows issuers or obligated persons to undertake to submit annual filings to EMMA within 120 calendar days after the end of the issuer's fiscal year. In addition, until January 1, 2014, issuers can select a "transitional option" to undertake to submit annual filings within 150 days. The present standard undertaking by Connecticut municipalities is eight months (approximately 240 days).

Issuers should consider the value of committing to the shorter time period, the challenges presented by a shorter filing requirement, and the steps necessary to address such challenges. This might include crafting RFP requirements aimed at identifying professionals willing to meet such shorter time frames and discussions with financial advisors and auditors regarding the value and feasibility of such an undertaking.

(2) Voluntary GAAP Undertaking. The approved proposal allows issuers or obligated persons to undertake to prepare their audited financial statements in accordance with GAAP, either as established by GASB or as established by FASB, as applicable.

These voluntary undertakings would be reflected in the issuer's continuing disclosure agreement or other agreement creating contractual obligations for the benefit of bondholders. This differs from the original proposal, in which the MSRB "contemplate[d] that the making of a voluntary undertaking through EMMA by an issuer or obligated person would reflect the bona fide intent of the issuer or obligated person to perform as undertaken" but not constitute a contractual obligation. Issuers and obligated persons would indicate the existence of the voluntary undertakings through a data input election on EMMA.

The MSRB will not police compliance with these undertakings. However, if an issuer later rescinds its undertaking or extends the time frame for submitting annual financial information beyond the permitted period, the issuer is expected to remove the designation of its voluntary undertaking from EMMA.

In addition to the two voluntary undertakings described above, the approved proposal allows issuers and obligated persons to post the URLs for their investor relations websites or other online repositories of financial or operating information on EMMA. Unlike earlier versions, the approved proposal no longer allows issuers to submit the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting.

These are significant and complicated changes to an already complex disclosure scheme. The members of Day Pitney's municipal finance team listed on the side of this alert are ready to help you meet the challenges of understanding and complying with your disclosure requirements and otherwise achieve your financing goals.