

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 240 and 241

[Release No. 34-60332; File No. S7-15-09]

RIN 3235-AJ66

### Proposed Amendment to Municipal Securities Disclosure

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule and interpretation.

**SUMMARY:** The Securities and Exchange Commission (“Commission” or “SEC”) is publishing for comment proposed amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 (“Exchange Act”) relating to municipal securities disclosure. The proposal would amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the issuer’s municipal securities, to provide to the Municipal Securities Rulemaking Board (“MSRB”). Specifically, the proposed amendments would require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days after the event’s occurrence, would amend the list of events for which a notice is to be provided, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the amendments would revise an exemption from the rule for certain offerings of municipal securities with put features. The Commission also is providing interpretive guidance intended to assist municipal securities issuers, brokers, dealers and municipal securities dealers in meeting their obligations under the antifraud provisions.

**DATES:** Comments should be received on or before September 8, 2009.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. S7-15-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File No. S7-15-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission’s Public Reference Room, 100 F Street, NE., Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### **FOR FURTHER INFORMATION CONTACT:**

Martha Mahan Haines, Assistant Director and Chief, Office of Municipal Securities, at (202) 551-5681; Nancy J. Burke-Sanow, Assistant Director, Office of Market Supervision, at (202) 551-5620; Mary N. Simpkins, Senior Special Counsel, Office of Municipal Securities, at (202) 551-5683; Cyndi N. Rodriguez, Special Counsel, Office of Market Supervision, at (202) 551-5636; Rahman J. Harrison, Special Counsel, Office of Market Supervision, at (202) 551-5663; David J. Michehl, Special Counsel, Office of Market Supervision, at (202) 551-5627; and Steven Varholik, Special Counsel, Office of Market Supervision, at (202) 551-5615, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-6628.

**SUPPLEMENTARY INFORMATION:** The Commission is requesting public comment on a proposed amendment to Rule 15c2-12 under the Exchange Act.<sup>1</sup>

### **I. Background**

#### *A. History of Rule 15c2-12*

The Commission has long been concerned with improving the quality, timing, and dissemination of disclosure in the municipal securities market. In an

effort to improve the transparency of the municipal securities market, in 1989, the Commission adopted Rule 15c2-12<sup>2</sup> (“Rule” or “Rule 15c2-12”) and an accompanying interpretation modifying a previously published interpretation of the legal obligations of underwriters of municipal securities.<sup>3</sup> As adopted in 1989, Rule 15c2-12 required, and still requires, underwriters participating in primary offerings of municipal securities of \$1,000,000 or more to obtain, review, and distribute to potential customers copies of the issuer’s official statement. Specifically, Rule 15c2-12 required, and still requires, an underwriter acting in a primary offering of municipal securities: (1) To obtain and review an official statement “deemed final” by an issuer of the securities, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (2) in non-competitive bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (3) to send, upon request, a copy of the final official statement to potential customers for a specified period of time; and (4) to contract with the issuer to receive, within a specified time, sufficient copies of the final official statement to comply with the Rule’s delivery requirement, and the requirements of the rules of the MSRB.

While the availability of primary offering disclosure significantly improved following the adoption of Rule 15c2-12, there was a continuing concern about the adequacy of disclosure in the secondary market.<sup>4</sup> To enhance the quality, timing, and dissemination of disclosure in the

<sup>2</sup> *Id.*

<sup>3</sup> See Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 (July 10, 1989) (“1989 Adopting Release”).

<sup>4</sup> In 1993, the Commission’s Division of Market Regulation (n/k/a the Division of Trading and Markets) (“Division”) conducted a comprehensive review of many aspects of the municipal securities market, including secondary market disclosure (“1993 Staff Report”). Findings in the 1993 Staff Report highlighted the need for improved disclosure practices in both the primary and secondary municipal securities markets. The 1993 Staff Report found that investors need sufficient current information about issuers and significant obligors to better protect themselves from fraud and manipulation, to better evaluate offering prices, to decide which municipal securities to buy, and to decide when to sell. Moreover, the 1993 Staff Report found that the growing participation of individuals as both direct and indirect purchasers of municipal securities underscored the need for sound recommendations by brokers, dealers, and municipal securities dealers. See Commission, Division of Market Regulation, *Staff Report on the Municipal Securities Market* (September 1993) (available at <http://www.sec.gov/info/municipal.shtml>).

<sup>1</sup> 17 CFR 240.15c2-12.

secondary municipal securities market, the Commission in 1994 adopted amendments to Rule 15c2-12 (“1994 Amendments”).<sup>5</sup> Among other things, the 1994 Amendments placed certain requirements on brokers, dealers, and municipal securities dealers (“Dealers” or, when used in connection with primary offerings, “Participating Underwriters”).

Specifically, Rule 15c2-12, as amended by the 1994 Amendments, prohibits Participating Underwriters from purchasing or selling municipal securities covered by the Rule in a primary offering, unless the Participating Underwriter has reasonably determined that an issuer of municipal securities or an obligated person<sup>6</sup> has undertaken in a written agreement or contract for the benefit of holders of such securities (“continuing disclosure agreement”) to provide specified annual information and event notices to certain information repositories.<sup>7</sup> The information to be provided consists of: (1) Certain annual financial and operating information and audited financial statements (“annual filings”);<sup>8</sup> (2) notices of the occurrence of any of eleven specific events (“event notices”);<sup>9</sup> and (3) notices of the failure

of an issuer or other obligated person to make a submission required by a continuing disclosure agreement (“failure to file notices”).<sup>10</sup> The 1994 Amendments also amended Rule 15c2-12 to require the Participating Underwriter to reasonably determine that an issuer of municipal securities or an obligated person has undertaken in the continuing disclosure agreement to provide: (1) Annual filings to each nationally recognized municipal securities information repository (“NRMSIR”); (2) event notices and failure to file notices either to each NRMSIR or to the MSRB; and (3) in the case of states that established state information depositories (“SIDs”), all continuing disclosure documents to the appropriate SID. Finally, the 1994 Amendments amended Rule 15c2-12 to revise the definition of “final official statement” to include a description of the issuer’s or obligated person’s continuing disclosure undertakings for the securities being offered, and of any instances in the previous five years in which the issuer or obligated person failed to comply, in all material respects, with undertakings in previous continuing disclosure agreements.

Furthermore, to promote more efficient, effective, and wider availability of municipal securities information to investors and market participants, on December 5, 2008, the Commission adopted amendments to Rule 15c2-12 (“2008 Amendments”) to provide for a single centralized repository, the MSRB, for the electronic collection and availability of information about outstanding municipal securities in the secondary market.<sup>11</sup> In the 2008 Amendments Adopting Release, the Commission stated that the establishment of a single

substitution, or sale of property securing repayment of the securities; and (11) rating changes. In addition, Rule 15c2-12(d)(2) provides an exemption from the application of paragraph (b)(5) of the Rule with respect to certain primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation. See 17 CFR 240.15c2-12(d)(2). As discussed in detail in Section II.C., below, the Commission is proposing to eliminate the materiality determination for certain of these events.

<sup>10</sup> 17 CFR 240.15c2-12(b)(5)(i)(D). Annual filings, event notices, and failure to file notices are referred to collectively herein as “continuing disclosure documents.”

<sup>11</sup> See Securities Exchange Act Release No. 59062 (December 5, 2008), 73 FR 76104 (December 15, 2008) (“2008 Amendments Adopting Release”). See also Securities Exchange Act Release No. 58255 (July 30, 2008), 73 FR 46138 (August 7, 2008) (“2008 Proposing Release”). The 2008 Amendments became effective on July 1, 2009. The Commission proposes that the effective date of the proposed amendments discussed herein would be no earlier than three months after any final approval of the proposed amendments, should the Commission adopt these proposed rule amendments.

centralized repository will help provide ready and prompt access to continuing disclosure documents to investors and other municipal market participants and will help fulfill the regulatory and information needs of municipal market participants, including Dealers, Participating Underwriters, mutual funds and others.<sup>12</sup> Specifically, the 2008 Amendments require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in its continuing disclosure agreement to provide the continuing disclosure documents: (1) Solely to the MSRB; and (2) in an electronic format and accompanied by identifying information, as prescribed by the MSRB.<sup>13</sup>

#### B. Need for Further Amendments to Rule 15c2-12

As discussed below, experience with the operation of the Rule, changes in the municipal market since the adoption of the 1994 Amendments, and recent market events have suggested the need for the Commission to reconsider certain aspects of the Rule, including the exemption for primary offerings of municipal securities in authorized denominations of \$100,000 or more which, 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 (“demand securities”).<sup>14</sup> Furthermore, since the adoption of the 1994 Amendments, municipal securities industry participants have raised a number of areas in which the Rule’s provisions could be clarified or enhanced and have expressed a desire for additional information about these securities.<sup>15</sup>

<sup>12</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR at 76106.

<sup>13</sup> *Id.* See also Securities Exchange Act Release No. 59061 (December 5, 2008), 73 FR 75778 (December 12, 2008) (order approving the MSRB’s proposed rule change to establish as a component of its central municipal securities document repository, the Electronic Municipal Market Access (“EMMA”) system, the collection and availability of continuing disclosure documents over the Internet for free).

<sup>14</sup> 17 CFR 240.15c2-12(d)(1)(iii).

<sup>15</sup> See, e.g., Letter from Karrie McMillan, General Counsel, Investment Company Institute (“ICI”), to Florence E. Harmon, Secretary, Commission (July 25, 2008) (available at <http://www.sec.gov/comments/s7-13-08/s71308-44.pdf>); comments of participants in the 2001 SEC Municipal Market Roundtable—“Secondary Market Disclosure for the 21st Century,” (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>) (Leslie Richards-Yellen, Principal, The Vanguard Group: “\* \* \* what I’d like to see change the most

Continued

<sup>5</sup> See Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590 (November 17, 1994) (“1994 Amendments Adopting Release”). In light of the growing volume of municipal securities offerings, as well as the growing ownership of municipal securities by individual investors, in March 1994, the Commission published the *Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others*. See Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (March 17, 1994) (“1994 Interpretive Release”). The Commission intended that its statement of views with respect to disclosures under the federal securities laws in the municipal market would encourage and expedite the ongoing efforts by market participants to improve disclosure practices, particularly in the secondary market, and to assist market participants in meeting their obligations under the antifraud provisions. *Id.*

<sup>6</sup> The term “obligated persons” means persons, including the issuer of municipal securities, committed by contract or other arrangement to support payment of all or part of the obligations on the municipal securities to be sold in an offering. See 17 CFR 240.15c2-12(f)(10).

<sup>7</sup> See 17 CFR 240.15c2-12(b)(5)(i)(C). This provision now provides that the annual information and event notices are to be submitted to a single repository, the MSRB. See *infra* note 11 and accompanying text.

<sup>8</sup> 17 CFR 240.15c2-12(b)(5)(i)(A) and (B).

<sup>9</sup> 17 CFR 240.15c2-12(b)(5)(i)(C). Currently, the following events, if material, require notice: (1) Principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions or events affecting the tax-exempt status of the security; (7) modifications to rights of security holders; (8) bond calls; (9) defeasances; (10) release,

Since the adoption of the 1994 Amendments, the amount of outstanding municipal securities has more than doubled—to almost \$2.7 trillion.<sup>16</sup> Notably, despite this large increase in the amount of outstanding municipal securities, direct investment in municipal securities by individuals remained relatively steady from 1996 to 2008, ranging from approximately 35% to 39% of outstanding municipal securities.<sup>17</sup> At the end of 2008, individual investors held approximately 36% of outstanding municipal securities directly and up to another 36% indirectly through money market funds, mutual funds, and closed end funds.<sup>18</sup> There is also substantial trading volume in the municipal securities market. According to the MSRB, almost \$5.5 trillion of long and short term municipal securities were traded in 2008 in nearly 11 million transactions.<sup>19</sup> Further, the municipal securities market is extremely diverse, with approximately 50,000 state and local issuers of these securities. In addition, municipal bonds can and do default. In fact, at least 917 municipal bond issues went into monetary default during the 1990s with a defaulted principal amount of over \$9.8 billion.<sup>20</sup> Bonds for healthcare,

is the inclusion of securities that have been carved out of Rule 15c2–12. I would like securities such as money market securities to be within the ambit of Rule 15c2–12. In addition, I'd like to see the eleven material events be expanded. The first eleven were very helpful. The ICI drafted a letter and we've added another twelve for the industry to think about and cogitate on \* \* \* and Dianne McNabb, Managing Director, A.G. Edwards & Sons, Inc.: "I think that in summary, we could use more specificity as far as what needs to be disclosed, the timeliness of that disclosure, such as the financial statements, more events, I think that we would agree that there are more events \* \* \*"; and National Federation of Municipal Analysts, *Recommended Best Practices in Disclosure for Variable Rate and Short-Term Securities*, February, 2003 (recommendations for continuing disclosures of specified information) (available at [http://www.nfma.org/publications/short\\_term\\_030207.pdf](http://www.nfma.org/publications/short_term_030207.pdf)).

<sup>16</sup> According to statistics assembled by the Securities Industry and Financial Markets Association ("SIFMA"), the amount of outstanding municipal securities grew from approximately \$1.26 trillion in 1996 to \$2.69 trillion at the end of 2008. See *SIFMA Outstanding U.S. Bond Market Debt* (available at [http://www.sifma.org/research/pdf/Overall\\_Outstanding.pdf](http://www.sifma.org/research/pdf/Overall_Outstanding.pdf)).

<sup>17</sup> See SIFMA, *Holder's of U.S. Municipal Securities* (available at [http://www.sifma.org/research/pdf/Holder's\\_Municipal\\_Securities.pdf](http://www.sifma.org/research/pdf/Holder's_Municipal_Securities.pdf)) ("SIFMA Report").

<sup>18</sup> *Id.*

<sup>19</sup> See MSRB, *Real-Time Transaction Reporting, Statistical Patterns in the Municipal Market, Monthly Summaries 2008* (available at [http://www.msrb.org/msrb1/TRSweb/MarketStats/statistical\\_patterns\\_in\\_the\\_muni.htm](http://www.msrb.org/msrb1/TRSweb/MarketStats/statistical_patterns_in_the_muni.htm)).

<sup>20</sup> See Standard and Poor's, *A Complete Look at Monetary Defaults in the 1990s* (June, 2000) (available at <http://www.kennyweb.com/kwnext/mip/paydefault.pdf>) ("Standard and Poor's Report"). See also Moody's Investors Service, *The*

multifamily housing, and industrial development, together with land-backed debt, accounted for more than 80% of defaulted dollar amounts.<sup>21</sup> In 2007, a total of \$226 million in municipal bonds defaulted (including both monetary and covenant defaults).<sup>22</sup> In 2008, 140 issuers defaulted on \$7.6 billion in municipal bonds.<sup>23</sup>

At the time the Rule was adopted in 1989, municipal securities with put or demand features were relatively new. Approximately \$13 billion of variable rate demand obligations ("VRDOs")<sup>24</sup> were issued in 1989.<sup>25</sup> However, by 2008, new issuances of VRDOs had grown to approximately \$115 billion,<sup>26</sup> with trading in VRDOs representing approximately 38% of trading volume of all municipal securities.<sup>27</sup> Many issuers and other obligated persons are reported to have converted their municipal auction rate securities ("ARS")<sup>28</sup> to securities with other interest rate modes (as provided in related trust indentures),<sup>29</sup> such as VRDOs, or refunded or otherwise refinanced their ARS in order to reduce the unusually high interest rates on ARS caused by turmoil in the ARS market.<sup>30</sup> This

*U.S. Municipal Bond Rating Scale: Mapping to the Global Rating Scale And Assigning Global Scale Ratings to Municipal Obligations* (March 2008) (available at [http://www.moody.com/cust/content/content.ashx?source=StaticContent/Free%20pages/Credit%20Policy%20Research/documents/current/102249\\_RM.pdf](http://www.moody.com/cust/content/content.ashx?source=StaticContent/Free%20pages/Credit%20Policy%20Research/documents/current/102249_RM.pdf)) (regarding municipal defaults of Moody's rated municipal securities).

<sup>21</sup> See Standard and Poor's Report, *supra* note 20.

<sup>22</sup> See Joe Mysak, *Subprime Finds New Victim as Muni Defaults Triple*, Bloomberg News, May 30, 2008.

<sup>23</sup> See Joe Mysak, *Municipal Defaults Don't Reflect Tough Times: Chart of Day*, Bloomberg News, May 28, 2009 (also noting that since 1999, issuers have defaulted on \$24.13 billion in municipal bonds).

<sup>24</sup> VRDOs principally are demand securities.

<sup>25</sup> See *Two Decades of Bond Finance: 1989–2008*, The Bond Buyer/Thomson Reuters 2009 Yearbook 4 (Matthew Kreps ed., Source Media, Inc.) (2009).

<sup>26</sup> *Id.*

<sup>27</sup> According to the MSRB, trading volume in VRDOs in 2008 was approximately \$2.1 trillion. Total trading volume in 2008 for all municipal securities was approximately \$5.5 trillion. See e-mail between Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, and Harold Johnson, Deputy General Counsel, MSRB, May 28, 2009 (confirming 2008 trading volume in VRDOs and trading volume for municipal securities).

<sup>28</sup> Auction rate securities are not demand securities.

<sup>29</sup> "Interest rate modes" is the term used to refer collectively to the various forms in which offerings that include variable rate demand obligations may typically be issued or converted. Such "multi-modal" bonds typically include a variety of optional forms (modes), such as fixed interest rate, variable interest rates of different lengths (e.g., daily, weekly or monthly interest rate resets), auction rate, and commercial paper.

<sup>30</sup> See, e.g., Press Release, Dormitory Authority State of New York, *DASNY Moving Clients Out of Auction Rate Securities* (March 26, 2008) (available

conversion or refinancing appears to have contributed to the increased volume of new issues of VRDOs in 2008<sup>31</sup> and was accompanied by an increased number of investors in VRDOs, with some investors holding these securities for long periods of time.<sup>32</sup> There has also been an increase in the trading volume of VRDOs. As the size and complexity of the VRDO market and the number of investors has grown, so have the risks associated with less complete disclosure. In addition, during the fall of 2008, the VRDO market experienced significant volatility.<sup>33</sup> Moreover, there have been concerns expressed by representatives of the primary purchasers of VRDOs—money market funds—that suggest that the exemption in Rule 15c2–12 for these securities may no longer be justified.<sup>34</sup> All of these developments highlight the need for the Commission to consider whether improvements should be made regarding the availability to investors of important information regarding demand securities.

As a result of the changes in the VRDO market, the Commission believes that investors and other municipal market participants today should be able to obtain ongoing continuing disclosure information regarding demand securities in order to make more knowledgeable investment decisions, to effectively manage and monitor their investments, and thereby be better able to protect themselves from

at <http://www.dasny.org/dasny/news/2008/080326moving.php>); Press Release, Office of Chief Financial Officer, District of Columbia, *Over \$100 Million Saved: \$10 Million This Fiscal Year by CFO Debt Management Strategy* (May 27, 2008) (available at <http://newsroom.dc.gov/show.aspx/agency/cfo/section/2/release/13845>); Henry J. Gomez, *Bond Failures Could Mean Millions In Lost Interest*, Cleveland Plain Dealer, March 4, 2008, at B3; Laura Brost, *Citizens to Cut its Borrowing Cost*, Orlando Sentinel, March 14, 2008, at C3; and Matt Krantz, *Credit Crisis Forces Museums to be Creative; Skittish Bond Investors Meant Their Interest Costs Were Getting Out of Hand*, USA TODAY, April 17, 2008, at 4B.

<sup>31</sup> According to Thomson Reuters, VRDO issuances in 2008 were much higher than in 2007—approximately \$115 billion in 2008 vs. \$50 billion in 2007. No ARS were reported to have been issued during the same period in 2008. See *Two Decades of Bond Finance: 1989–2008*, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., Source Media, Inc.) (2009).

<sup>32</sup> See *infra* note 45 and accompanying text.

<sup>33</sup> See Diya Gullapalli, *Crisis On Wall Street: Muni Money-Fund Yields Surge—Departing Investors Send 7-Day Returns Over 5%*, Wall Street Journal, September 27, 2008; Andrew Ackerman, *Short-Term Market Dries Up: Illiquidity Leads to Lack of Bank LOCs*, The Bond Buyer, October 7, 2008. ("The reluctance of financial firms to carry VRDOs is evident in the spike in the weekly [SIFMA] municipal swap index, which is based on VRDO yields and spiked from 1.79% on Sept. 10 to 7.96% during the last week of the month. It has since declined somewhat to 5.74%.")

<sup>34</sup> See *supra* note 15 and accompanying text.

misrepresentations and fraudulent activities. Accordingly, the Commission proposes to modify the exemption in the Rule, as discussed below, for demand securities<sup>35</sup> by requiring Participating Underwriters to reasonably determine that the issuer or obligated person of demand securities has undertaken in a written agreement to provide continuing disclosure documents to the MSRB.

In addition, the Commission proposes to require Participating Underwriters to reasonably determine that the issuer or obligated person has contractually agreed to provide notice of specified events within a certain time frame, amend the list of events that would trigger an issuer's or other obligated person's obligation under its continuing disclosure agreement to submit an event notice to the MSRB, and amend the Rule to modify those events that would be subject to a materiality determination before triggering a notice to the MSRB.<sup>36</sup> As discussed below, the Commission believes that these proposed changes would, among other things, help Participating Underwriters satisfy their obligations and help improve the availability of timely and important information to investors of municipal securities. In addition, in line with the objectives behind the Commission's prior revisions to Rule 15c2-12 and the 2008 Amendments, these proposed amendments are designed to help deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and recommendation of transactions in municipal securities for which adequate

<sup>35</sup> See 17 CFR 240.15c2-12(d)(1)(iii). Specifically, the Commission proposes to eliminate the exemption for primary offerings of demand securities contained in paragraph (d)(1)(iii) of the Rule and to add new paragraph (d)(5) to the Rule. Paragraph (d)(5) of the Rule, as proposed, would exempt primary offerings of demand securities from all of the provisions of the Rule except those relating to a Participating Underwriter's obligations pursuant to paragraph (b)(5) of the Rule and relating to recommendations by brokers, dealers, and municipal securities dealers pursuant to paragraph (c) of the Rule. As a result of these proposed changes, Participating Underwriters, in connection with a primary offering of demand securities, would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement with respect to the submission of continuing disclosure documents to the MSRB. In addition, brokers, dealers and municipal securities dealers recommending the purchase or sale of demand securities would need to have procedures in place that provide reasonable assurance that they would receive prompt notice of event notices and failure to file notices. See 17 CFR 240.15c2-12(c).

<sup>36</sup> As discussed below in Section II.F., the Commission is aware that undertakings by issuers and obligated persons that were entered into prior to the effective date of any final amendments would be different from those entered into on or after the effective date of any final amendments.

information is not available on an ongoing basis.

## II. Description of the Proposed Amendments to Rule 15c2-12

### A. Modification of the Exemption for Demand Securities

Rule 15c2-12(d) provides an exemption for a primary offering<sup>37</sup> of municipal securities in authorized denominations of \$100,000 or more, if such securities, 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.<sup>38</sup> Demand securities qualify for this exemption. The Commission now proposes to delete the current exemption for demand securities in paragraph (d)(1)(iii) and add language in new paragraph (d)(5) so that paragraphs (b)(5)<sup>39</sup> and (c)<sup>40</sup> of the Rule also would apply to a primary offering of demand securities.

The Commission believes that its experience with the operation of the Rule and market changes since the adoption of the 1994 Amendments have suggested a need to modify the exemption relating to demand securities as described. The effect of this proposed amendment would be to eliminate the current exemption of demand securities from the requirement that a Participating Underwriter reasonably determine that the issuer or obligated person has undertaken, in a continuing disclosure agreement, to provide continuing disclosure documents to the MSRB. As noted above, when this exemption was adopted VRDOs were relatively new and did not represent a large proportion of the market.<sup>41</sup> However, by 2008, the amount of

<sup>37</sup> See Rule 15c2-12(f)(7) for a definition of primary offering. 17 CFR 240.15c2-12(f)(7).

<sup>38</sup> 17 CFR 240.15c2-12(d)(1)(iii).

<sup>39</sup> As noted above, Rule 15c2-12(b)(5) requires a Participating Underwriter, before purchasing or selling municipal securities in connection with an offering of municipal securities, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of the holders of municipal securities, to provide annual filings, material event notices, and failure to file notices (*i.e.*, continuing disclosure documents) to the MSRB. See 17 CFR 240.15c2-12(b)(5). See also *supra* note 11.

<sup>40</sup> Rule 15c2-12(c) requires a broker, dealer, or municipal securities dealer that recommends the purchase or sale of a municipal security to have procedures in place that provide reasonable assurance that it will receive prompt notice of any material event and any failure to file annual financial information regarding the municipal security. See 17 CFR 240.15c2-12(c).

<sup>41</sup> See *supra* note 25 and accompanying text.

issuances of VRDOs was approximately \$115 billion<sup>42</sup> and trading volume of VRDOs exceeded 38 percent of all municipal securities.<sup>43</sup> The Commission observes that an unusually high volume of VRDOs were issued in 2008.<sup>44</sup> The increase in the amount of issuances and trading volume of VRDOs seem to indicate that more investors own such securities. Furthermore, despite their periodic ability to tender VRDOs to the respective issuer for repurchase, some investors in VRDOs appear to hold these securities for long periods of time<sup>45</sup> and would be better able to protect themselves against manipulation and fraud if they were able more easily to access information about important events, such as those listed in paragraphs (b)(5) and (c) of the Rule.

Accordingly, the increased amount of VRDO issuances, high VRDO trading volume, increased number of investors in VRDOs,<sup>46</sup> and some investors' tendency to hold these securities for long periods of time highlight the risks associated with less information being available and suggest a need to take

<sup>42</sup> See *supra* note 25 and accompanying text.

<sup>43</sup> See *supra* note 27 and accompanying text.

<sup>44</sup> See *supra* notes 30 and 31 and accompanying text.

<sup>45</sup> Telephone call between Heather Traeger, Associate Counsel, Securities Regulation, Capital Markets, ICI, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on July 14, 2009.

<sup>46</sup> The recent increased investment interest and activity in VRDOs may be attributable, in part, to the recent turmoil in the market for ARS, which began in February 2008. See MSRB Notice 2008-09 (February 19, 2008) ("Recent downgrades of municipal bond insurers and other short-term liquidity concerns have created extreme volatility in the market for municipal Auction Rate Securities. There also have been an unprecedented number of 'failed auctions,' meaning that investors who chose to liquidate their positions through the auction process were not able to do so.") (available at <http://www.msrb.org/msrb1/whatsnew/2008-09.asp>). See also Anthony P. Inverso, 2008 *First-Half Municipal Market Review: The End of Securities and Bond Insurance As We Know It?* Building Futures, New Jersey Educational Facilities Authority (June 2008) (stating that as downgrades to bond insurer ratings grew, so did the rates on ARS. Further stating that by the end of the first half of 2008, nearly half of all auction rate securities will have been converted or redeemed, mainly in the form of more predictable fixed rate debt or variable rate secured by a bank letter of credit.) (available at <http://www.njefa.com/njefa/pdf/newsletter/NJEFA%20Building%20futures%20newsletter%20June%202008%20Vol.%207,%20No.%201.pdf>); and Adrian D'Silva, Haley Gregg, and David Marshall, *Explaining the Decline in the Auction Rate Securities Market*, Chicago Fed Letter, The Federal Reserve Bank of Chicago (November 2008) (stating that the rash of failed auctions in the ARS markets starting in February 2008 has prompted issuers to consider a variety of potential solutions, including: Finding buyers for ARSs in the secondary market; converting ARSs to variable-rate demand notes; and replacing ARSs with short term debt funding.) (available at [http://www.chicagofed.org/publications/fedletter/cflnovember2008\\_256.pdf](http://www.chicagofed.org/publications/fedletter/cflnovember2008_256.pdf)). See also *supra* note 30.

measures designed to help improve the availability of important information to investors in this considerable segment of the municipal market.

Representatives of money market funds have discussed their difficulty or, on some occasions, their inability to obtain the information that they believe is necessary to oversee their investments in demand securities.<sup>47</sup> Modification of the exemption for demand securities, as further discussed below, would help improve the availability of continuing disclosures about these securities, not only to institutional investors, such as mutual funds, that acquire demand securities for their portfolios, but also to individual investors who own, or who may be interested in owning, demand securities, and would help them make better informed investment decisions, and thereby better protect themselves.

Further, the Commission notes that the exemption for demand securities, which was included in the Rule when Rule 15c2-12 was adopted in 1989, was intended to respond to concerns expressed by commenters “that applying the provisions of the [Proposed] Rule to variable rate demand notes, or similar securities, might unnecessarily hinder the operation of this market, if underwriters were required to comply with the provisions of the Proposed Rule on each tender or reset date.”<sup>48</sup> The exemption in the original Rule was intended to ensure that the remarketings would not be affected by application of paragraphs (a) and (b)(1)–(4) of the Rule, which require Participating Underwriters to review an official statement that the issuer “deems final” before it may bid for, purchase, offer or sell an offering; to deliver a preliminary official statement or final official statement to any potential customer, upon request; and to contract with the issuer to receive an adequate number of the final official statement to

<sup>47</sup> See, e.g., comments of Leslie Richards-Yellen, Principal, The Vanguard Group, transcript of the 2001 Municipal Market Roundtable—“Secondary Market Disclosure for the 21st Century” (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>) (“\* \* \* what I hope more than anything is that variable rate demand obligations become within the Rule 15c2-12 disclosure regime \* \* \* put yourself in the position of a fund, we have on one hand Rule 15c2-12, which is very helpful and it sets the floor of what kind of information must be delivered for a secondary market, \* \* \*. But on the other hand, mutual funds are bound by Rule 2a-7 and that says for short-term obligations what we must find for every security, and Rule 2a-7 has legal requirements that we must fulfill in order to buy the securities, and \* \* \* to make these findings we have to make our own determination, we can't rely on rating agencies, we do this all in house.”) See also *supra* note 15.

<sup>48</sup> See 1989 Adopting Release, *supra* note 3, 54 FR at 28808, n. 68.

accompany confirmation statements and otherwise fulfill its regulatory responsibilities. Although remarketings of VRDOs may be primary offerings,<sup>49</sup> the Commission did not impose paragraphs (a) and (b)(1)–(4) of the Rule on Participating Underwriters of each remarketing—of which hundreds could occur on the same day—because it potentially would have made it impractical and unduly burdensome for Participating Underwriters to comply with these Rule provisions.<sup>50</sup>

Generally, there are no continuing disclosure agreements in place with respect to VRDOs, because primary offerings of these securities are exempt from the Rule.<sup>51</sup> Under the proposed amendments, the Participating Underwriter of a primary offering of VRDOs would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement with respect to the submission to the MSRB of continuing disclosure documents. The proposed amendment modifying the exemption for VRDOs would apply to any initial offering of VRDOs occurring on or after the effective date of any final amendments that the Commission may adopt. In addition, the proposed amendment also would apply to any remarketing of VRDOs that are primary offerings<sup>52</sup> occurring on or after the effective date of any final amendments that the Commission may adopt, including any such remarketing of VRDOs that initially were issued prior to any such effective date. Consequently, the initial issuance of VRDOs, and any remarketing that is a primary offering of VRDOs, following the effective date of any final amendments would require the Participating Underwriter to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement reflecting the proposed new provisions of the Rule.

<sup>49</sup> See *supra* note 37.

<sup>50</sup> See 1994 Amendments Adopting Release, *supra* note 5. The Commission notes that, in the 1994 Amendments Adopting Release, it did not address the application of paragraph (b)(5) of the Rule to remarketing of VRDOs, including the practicality and burdens for Participating Underwriters to comply with this provision. The 1994 Amendments did not reconsider any of the exemptions contained in the Rule. As discussed above, since that time, there have been significant developments in the market related to demand securities.

<sup>51</sup> There may, however, be continuing disclosure agreements for VRDOs that were initially issued in an interest rate mode, such as a fixed rate mode, subject to the Rule that were subsequently converted to VRDOs in accordance with the provisions of the related indenture.

<sup>52</sup> 17 CFR 240.15c2-12(f)(7).

The Commission, however, preliminarily believes that the effect of the application of paragraphs (b)(5) and (c) of the Rule to VRDOs would not be significantly burdensome for Participating Underwriters in connection with the initial issuance and remarketing of VRDOs following the effective date of any final amendments. If the amendments are adopted, any primary offering (including a remarketing) that occurs on or after the effective date of the Rule would require a Participating Underwriter or a Participating Underwriter serving as a remarketing agent<sup>53</sup> for a particular VRDO issue to make a determination that an issuer or obligated person has entered into a continuing disclosure agreement for that issue reflecting the new provisions of the Rule. The Participating Underwriter or the remarketing agent (who often served as the underwriter in the initial issuance of the VRDOs) would need to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement in which it undertakes to provide continuing disclosure documents to the MSRB. However, once the Participating Underwriter has made such a determination for a particular VRDO issue, it would be aware of the existence of the continuing disclosure agreement reflecting the proposed amendment, and thus would easily be able to make the necessary determination for remarketings of that issue occurring thereafter.<sup>54</sup> Furthermore, remarketing agents who did not previously participate in a remarketing could confirm that the issuer has entered into an undertaking in conformity with the proposed amendment by obtaining an official statement from the issuer (which by definition must include a description of the issuer's undertakings),<sup>55</sup> from the MSRB (under its program that makes official statements for nearly every offering of municipal securities available on the Internet from the MSRB's EMMA system),<sup>56</sup> or from a

<sup>53</sup> A remarketing agent is a broker-dealer responsible for reselling to new investors securities (such as VRDOs) that have been tendered for purchase by their owner. The remarketing agent also typically is responsible for resetting the interest rate for a variable rate issue and also may act as tender agent. See MSRB, *Municipal Securities Rulemaking Board Glossary*, Second Edition (January 2004) (defining “remarketing agent”) (available at <http://www.msrb.org/msrb1/glossary>).

<sup>54</sup> See *infra* Section III. for a reaffirmation of the Commission's interpretations regarding Participating Underwriters' obligations under Rule 15c2-12.

<sup>55</sup> 17 CFR 240.15c2-12(f)(3).

<sup>56</sup> See Securities Exchange Act Release No. 59061 (December 5, 2008), 73 FR 75778 (December 12, 2008) (File No. SR-MSRB-2008-05) (order

variety of vendors. In addition, a remarketing agent could obtain a copy of the continuing disclosure agreement from the issuer or obligated person at the time that it enters into a contract to act as a remarketing agent.

According to an industry commentator, some rating agencies recommend that variable-rate debt not exceed 20 percent of the total debt outstanding of governmental issuers.<sup>57</sup> If governmental issuers follow this recommendation, it would be likely that state and local government issuers with VRDOs would have some fixed rate securities outstanding, at least some of which likely would be subject to continuing disclosure agreements under Rule 15c2-12. Because any existing continuing disclosure agreements for those other outstanding securities would obligate such issuers and obligated persons to provide annual filings, event notices and failure to file notices with respect to their outstanding securities, the Commission does not anticipate that the modification of the exemption for demand securities in the proposed amendments would increase significantly the obligation that they would incur to provide continuing disclosure documents to the MSRB.<sup>58</sup> Furthermore, the Commission notes that some annual filings, such as audited financial statements, are often prepared by issuers and obligated persons in the ordinary course of their business. In such cases, the obligation incurred by an issuer or obligated person to provide to the MSRB information that it has already prepared should be small.<sup>59</sup> Issuers and obligated persons of demand obligations that have not previously issued such securities, however, would be entering into a continuing disclosure agreement for the first time and would incur some costs to provide continuing disclosure documents electronically to the MSRB.<sup>60</sup>

For the reasons stated above, the Commission believes that application of paragraphs (b)(5) and (c) of the Rule would be appropriate in the case of demand securities. The Commission preliminarily believes that any additional burden on Participating

Underwriters, issuers or obligated persons, the MSRB or others would be justified by the improved availability of information to investors in demand securities, so that investors in these securities could make better informed investment decisions and thereby better protect themselves from misrepresentations and fraudulent activities. Investors now would have better access to baseline information and material events regarding VRDOs. The availability of such information also would assist brokers, dealers and municipal securities dealers in fulfilling their responsibilities to their customers,<sup>61</sup> such as disclosing material facts about transactions and securities; making suitable recommendations in transactions for municipal securities; and complying with other sales practice obligations.<sup>62</sup>

The Commission requests comment on whether it is appropriate to revise the Rule's exemption for demand securities by proposing to apply paragraphs (b)(5) and (c) of the Rule to the offering of demand securities.<sup>63</sup> Further, the Commission requests comment regarding investors' and other municipal market participants' need for continuing disclosure information relating to demand securities. In addition, the Commission requests comment on the extent to which the proposed amendment would provide benefits to investors and other municipal market participants. The Commission also requests comment regarding the effect of the proposed amendment on Participating Underwriters, issuers and obligated persons, and others.

#### *B. Time Frame for Submitting Event Notices Under a Continuing Disclosure Agreement*

The Commission proposes to modify paragraph (b)(5)(i)(C) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB<sup>64</sup> "in a timely manner not in excess of ten business days after the occurrence of the event," instead of "in a timely manner"

as the Rule currently provides. The Commission proposes a similar revision to the limited undertaking in paragraph (d)(2)(ii)(B) of the Rule<sup>65</sup> to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB<sup>66</sup> "in a timely manner not in excess of ten business days after the occurrence of the event," instead of "in a timely manner" as the Rule currently provides. Therefore, under the proposed amendments, a Participating Underwriter would need to reasonably determine that the continuing disclosure agreement provides for the submission of notices to the MSRB within a period up to and including ten business days after the occurrence of the event. In the 1994 Amendments, the Commission noted that it had not established a specific time frame with respect to "timely" because of the wide variety of events and issuer circumstances.<sup>67</sup> The Commission stated that, 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.<sup>68</sup> It has been reported that some event notices have not been submitted until months after the events occurred.<sup>69</sup> The Commission believes that these delays can, among other things, deny investors important information that they need in order to make informed decisions regarding whether to buy or sell municipal securities. More timely information would aid brokers, dealers and municipal securities dealers to be better able to satisfy their obligations to have a reasonable basis to recommend the

<sup>65</sup> 17 CFR 240.15c2-12(d)(2)(ii)(B).

<sup>66</sup> See *supra* note 11 and accompanying text.

<sup>67</sup> See 1994 Amendments, *supra* note 5, 59 FR at 59601.

<sup>68</sup> *Id.*

<sup>69</sup> See, e.g., Elizabeth Carvlin, *Trustee for Vigo County, Ind., Agency Taps Reserve Fund for Debt Service*, The Bond Buyer, April 2, 2004, page 3 (reporting the filing of a material event notice regarding a draw on debt service reserve fund that occurred in February); Alison L. McConnell, *Two More Deals Under Audit By TEB Office*, The Bond Buyer, April 5, 2006 (event notice of tax audit filed nine months after audit was opened); Susanna Duff Barnett, *IRS Answers Toxic Query; Post 1986 Radioactive Waste Debt Not Exempt*, The Bond Buyer, November 2, 2004 (material event notice filed October 29, 2004 regarding IRS technical advice memorandum dated August 27, 2004 that bonds issued to finance certain radioactive solid waste facilities were taxable; related preliminary adverse determination letter was issued in January, 2002); and Michael Stanton, *IRS: Utah Pool Bonds Taxable; Issuer Disputes Facts of Case*, The Bond Buyer, December 8, 1997 (issuer's receipt of August, 1997 IRS technical advice memorandum concluding certain bonds were taxable was disclosed on December 5, 1997).

approving the MSRB's proposed rule change to make permanent a pilot program for an Internet-based public access portal for the consolidated availability of primary offering information about municipal securities).

<sup>57</sup> See Douglas Skarr, *Auction Rate Securities: A Primer For Finance Officers*, Government Finance Review, August 2005.

<sup>58</sup> See *infra* Section V. for a discussion of the collection of information burdens and costs as they relate to the proposed amendment regarding demand securities.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> For example, brokers, dealers and municipal securities dealers with access to current information contained in event notices submitted to the MSRB would be able to use such information when deciding whether or not to recommend the purchase or sale of a particular demand security.

<sup>62</sup> See MSRB, *Reminder of Customer Protection Obligations in Connection with Sales of Municipal Securities*, Interpretative Notice of Rule G-17, dated May 30, 2007 (available at <http://www.msrb.org/msrb1/rules/notg17.htm>).

<sup>63</sup> See *supra* note 35.

<sup>64</sup> See *supra* note 11 and accompanying text.

purchase or sale of municipal securities and aid investors in determining whether the price they pay or receive for their transactions is appropriate, and thereby better protect themselves from misrepresentations and other fraudulent activities.

The Commission believes that longer delays in providing notice of the events set forth in paragraph (b)(5)(i)(C) of the Rule undermine the effectiveness of the Rule. Indeed, market participants have emphasized the importance of the prompt availability of such information.<sup>70</sup> In addition to helping to reduce opportunities for fraudulent activities, the Commission anticipates that, in providing for a maximum time frame within which event notices should be disclosed under a continuing disclosure agreement, the proposed amendment should foster the availability of up-to-date information about municipal securities, thereby promoting greater transparency and investor confidence in the municipal securities market as a whole.

The Commission notes that, with respect to Participating Underwriters, the proposed amendment simply would require them to reasonably determine that issuers and obligated persons have contractually agreed to submit event notices “in a timely manner not in excess of ten business days after the occurrence of the event,” rather than in a “timely manner.” On the other hand, there would be a significant benefit to investors and municipal market participants, who would be able to obtain information about municipal securities within a specific time frame of an event’s occurrence. Indeed, while issuers and obligated persons under continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt already would have committed to submit event notices in a timely manner, the proposed amendment would help to make the timing of such submissions more certain in the case of issuers and obligated persons that enter into continuing

<sup>70</sup> See, e.g., National Federation of Municipal Analysts, *Recommended Best Practices in Disclosure for General Obligation and Tax-Supported Debt* (December 2001) (“Any material event notices, including those required under SEC Rule 15c2–12, should be released as soon as practicable after the information becomes available.”) (available at <http://www.nfma.org/disclosure.php>); Peter J. Schmitt, Letter to the Editor, *To the Editor: MuniFilings.com: The Once and Future Edgar?*, *The Bond Buyer*, October 9, 2007, Commentary, Vol. 362 No. 32732, at 36 (“We suggest \* \* \* that the true problem is issuer compliance \* \* \* filing issues are the sole cause of lack of transparency and disclosure availability in the industry. These filing issues include \* \* \* late filing, \* \* \*”).

disclosure agreements on or after the effective date of any final amendments that the Commission may adopt.<sup>71</sup>

The Commission believes that the proposed change regarding the time frame for submission of event notices would continue to provide an issuer or obligated person with adequate time to become aware of the event and, pursuant to its undertaking, submit notice of the event’s occurrence to the MSRB. In proposing that event filings be provided “in a timely manner not in excess of ten business days after the occurrence of the event,” the Commission intends to strike a balance between the need for such information to be disseminated promptly and the need to allow adequate time for an issuer or other obligated person to become aware of the event and to prepare and file such a notice. The Commission preliminarily believes that the proposed ten business day time frame would provide a reasonable amount of time for issuers to comply with their obligations under their continuing disclosure agreements, while also allowing event notices to be made available to investors, underwriters, and other market participants in a timely manner.

By their nature, the events currently listed in (and proposed to be added to) subparagraph (b)(5)(i)(C) of the Rule are significant and should become known to the issuer or obligated person expeditiously.<sup>72</sup> For example, some events, such as payment defaults, tender offers and bankruptcy filings, generally involve the issuer’s or obligated person’s participation.<sup>73</sup> Other events, such as the failure of a credit or liquidity provider to perform, are of such importance that an issuer or obligated person likely would become aware of such events within the proposed ten business day time frame<sup>74</sup>

<sup>71</sup> The Commission notes that the proposed ten business day time frame would not apply to continuing disclosure agreements entered into with respect to primary offerings that occurred prior to the effective date of any final amendments that the Commission may adopt.

<sup>72</sup> See *supra* note 9 for a description of events currently contained in Rule 15c2–12(b)(5)(i)(C); See *infra* Section II.E. for a description of events proposed to be added to the Rule.

<sup>73</sup> In addition, issuer or obligated person involvement is often required for substitution of credit or liquidity providers; modifications to rights of security holders; release, substitution, sale of property securing repayment of the securities; and optional redemptions. See Form Indenture and Commentary, National Association of Bond Lawyers, 2000.

<sup>74</sup> For example, issuers or obligated persons should have direct knowledge of principal and interest payment delinquencies, receipt of preliminary or proposed determinations of taxability from the IRS, tender offers that they initiate, and bankruptcy filings.

or would expect an indenture trustee, paying agent or other transaction participant to bring the event to the issuer’s or obligated person’s attention within the proposed time frame for submission of event notices.<sup>75</sup> Although a few events, such as rating changes, are not directly within the issuer’s control, the Commission expects that issuers and obligated persons usually would become aware of the events specified in paragraph (b)(5)(i)(C) of the Rule within the proposed ten business day time frame.<sup>76</sup> Accordingly, the Commission believes that the proposed ten business day time frame within which issuers or obligated persons would submit notices pursuant to a continuing disclosure agreement would provide an adequate amount of time for issuers or obligated persons to prepare and submit event notices to the MSRB. While the proposed maximum time period for submitting event notices would be ten business days, in many instances it is likely that a notice could be submitted in fewer than ten business days. This, however, would depend upon the particular facts and circumstances of each event.

The Commission requests comment concerning the ability of issuers and obligated persons to obtain information regarding the occurrence of events currently specified in, and that the proposed amendments would add to, paragraph (b)(5)(i)(C) of the Rule, in sufficient time to prepare and file a notice of such an occurrence in a timely manner not in excess of ten business days. If commenters believe that the time frame that would be set forth in continuing disclosure agreements for submission of event notices should be longer or shorter, they should provide suggestions for the appropriate time and the reasons for their views. For example, should the time frame be four business days, which is generally commensurate with the time period required by Form 8–K?<sup>77</sup> Would a shorter period of time raise difficulties for smaller municipal

<sup>75</sup> The Commission believes that indenture trustees generally would be aware of principal and interest payment delinquencies; material non-payment related defaults, unscheduled draws on credit enhancements reflecting financial difficulties; the failure of credit or liquidity providers to perform; and adverse tax opinions or events affecting the tax-exempt status of the security.

<sup>76</sup> Those issuers or obligated persons required by Section 13(a) or Section 15(d) of the Exchange Act to report certain events on Form 8–K (17 CFR 249.308) would already make such information public in the Form 8–K. The Commission believes that such persons should be able to file material event notices, pursuant to the issuer’s or obligated person’s undertakings, within a short time after the Form 8–K filing. See 15 U.S.C. 78m and 78o(d).

<sup>77</sup> 17 CFR 249.308.

issuers and obligated persons, and if so, why would it? Furthermore, comment is requested regarding the need to establish such a time frame for submissions of event notices. Should the trigger for the ten business day time frame begin when the issuer or obligated person knew or should have known of the occurrence of the event, rather than the actual occurrence of the event? Comment is also requested on whether an issuer's need to monitor for events that would trigger an event notice would impose any new burdens or costs. Comment is requested on whether the proposal would help to reduce untimely submissions of event notices, or whether untimely submissions of event notices are caused by other factors. Comment is also requested on whether there are alternative ways to modify a Participating Underwriter's obligations that would result in more prompt availability of event notices to investors.

### C. Materiality Determinations Regarding Event Notices

In the 1994 Proposing Release, the Commission stated that the list of events in paragraph (b)(5)(i)(C) of the Rule consists of recognized material events that reflect on the creditworthiness of the issuer of the municipal security or any significant obligor, as well as on the terms of the securities that they issue.<sup>78</sup> The Commission is proposing to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of *all* of the listed events need be made only "if material." In connection with the proposed deletion of the materiality condition, the Commission has reviewed each of the Rule's current specified events to determine whether or not a materiality determination should be retained for that particular event and preliminarily believes such a determination is still appropriate for certain listed events, as discussed below.<sup>79</sup> As a result of this proposed change, for those events listed in paragraph (b)(5)(i)(C) that are not proposed to contain the "if material" condition, the Participating Underwriter must reasonably determine that the issuer or other obligated person has agreed to submit event notices to the MSRB whenever such an event occurs.

<sup>78</sup> See Securities Exchange Act Release No. 33742 (March 9, 1994), 59 FR 12759, 12761-2 (March 17, 1994).

<sup>79</sup> The discussion in this section pertains to materiality determinations for events currently specified in paragraph (b)(5)(i)(C) of the Rule. For events proposed to be added to the Rule, whether a materiality determination would be included is noted in the discussion below for each such proposed event.

The Commission now believes, based on its experience with the operation of paragraph (b)(5)(i)(C) of the Rule, that notice of certain events currently listed in paragraph (b)(5)(i)(C) need not be preceded by a materiality determination and always should be available because of their importance to investors and other market participants. These events include: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes. The availability of this information to investors would enable them to better protect themselves from misrepresentations and fraud. Furthermore, the availability of this information would assist brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis on which to recommend municipal securities.

The Commission believes that the proposal to remove the materiality condition for the aforementioned events should not alter greatly the current practice. Because of the significant nature of these events and their importance to investors in the marketplace, the Commission believes that issuers and obligated persons would already be providing notice of most, if not all, such events pursuant to existing continuing disclosure agreements.

More specifically, the Commission believes that notice of principal and interest payment delinquencies should always be provided to aid investors in protecting themselves from fraud and to assist brokers, dealers and municipal securities dealers in satisfying their obligation to have a reasonable basis to recommend municipal securities. Even a small payment default may indicate that an issuer or other obligated party has begun to experience financial distress. Further, a payment default often adversely affects the market value of a municipal security. Similarly, unscheduled draws on debt service reserves reflecting financial difficulties and unscheduled draws on credit enhancements reflecting financial difficulties often have an adverse impact on the market value of a security and therefore should always be available to investors to protect against fraud and to other market participants to satisfy their securities law obligations. The Commission believes that investors should always be provided with these

notice of events because such events likely indicate that the financial condition of a municipal securities issuer or obligor has deteriorated and therefore that there is potentially an increased risk of a payment default or, in the case of default by an issuer or other obligated party that results in payment of the securities by the provider of credit enhancement (such as a standby letter of credit), premature redemption. Bondholders and other market participants also would be concerned with the sufficiency of the amount of debt service and other reserves available to support an issuer or obligor through a period of temporary difficulty, along with the present financial condition of the provider of any credit enhancement.

The identity of credit or liquidity providers and their ability to perform is important to investors. The Commission understands that credit ratings of municipal securities are typically based on the higher of the issuer's (or other obligor's) rating or the rating of the credit provider.<sup>80</sup> With occasional exceptions, credit enhancement is obtained from a credit provider with a higher rating than that of the issuer or other obligor. When a credit enhancer such as a bond insurer is downgraded, the market value and liquidity of the securities that it has enhanced generally decline.<sup>81</sup> Similarly, the identity and

<sup>80</sup> See, e.g., *Municipal Structured Finance Criteria Report: Dual-Party Pay Criteria for Long-Term Ratings on LOC-Supported U.S. Public Finance Bonds*, Fitch Ratings, Public Finance, June 11, 2009 (noting that "U.S. public finance bonds supported by bank letters of credit (LOC) are assigned long-term ratings one-to-two notches higher than the rating on the LOC provider or the underlying rating of the bond, whichever is higher, if [certain] conditions hold true[.]" )

<sup>81</sup> See, e.g., Alistair Varr, *Moody's Warning Ripples Through Municipal Bond Market*, MarketWatch, December 17, 2007 (noting that "when a security is cut to AA from AAA, the value of the bond would go down.") (available at <http://www.marketwatch.com/story/moodys-bond-insurer-call-has-unprecedented-effect-on-muni-market>); Jeffrey R. Kosnett, *Why Municipal Bonds Are Stumbling*, Kiplinger.com, December 4, 2007 (stating that municipal bonds normally meriting a triple-B or single-A rating being upgraded to triple-A status as a result of having bond insurance) (available at <http://www.kiplinger.com/columns/balance/archive/2007/balance1204.html>); "[T]he municipal industry chose to use bond insurance to enhance an issuer's lower credit rating to that of the higher insurance company's rating. The last 18 months have exposed the risks of this choice when insurance company downgrades, and auction-rate security failures, forced numerous leveraged investors to unwind massive amounts of debt into an illiquid secondary market. The consequence was that issuers of new debt were forced to pay extremely high interest rates and investors were confused by volatile evaluations of their investments." *Enhancing Investor Protection and the Regulation of Securities Markets: Before the S.*

ability of a liquidity provider to perform is typically critical to investors. Investors in VRDOs, for example, depend on liquidity providers to satisfy holders' right to "put" their securities in a timely manner. As a result, the Commission preliminarily believes that notice of the substitution of credit or liquidity providers, or their failure to perform, should always be provided in an event notice to aid investors to protect against fraud and brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis to recommend municipal securities.

Further, the Commission preliminarily believes, for the same purposes, that defeasances and rating changes should always be available to investors and other market participants. Defeasances secured by a pool of U.S. Treasury securities sufficient to pay principal and interest commonly result in a bond receiving the highest rating<sup>82</sup> and thus can affect the security's market value. Rating changes more generally may affect the market price of the security, making it important both to bondholders and to investors who may be considering the purchase of a particular security.

The Commission, however, believes that a materiality determination should be retained for other events currently listed in paragraph (b)(5)(i)(C) because the occurrence of such events, in some circumstances, may not be of such importance to investors that they always should be disclosed. Experience with the operation of the Rule has not provided information to propose a change at this time, and the Commission continues to believe that information

*Comm. on Banking, Housing and Urban Affairs, 111th Cong., March 10, 2009 (statement of Thomas Doe, Founder and CEO Municipal Market Advisors) (available at [http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing\\_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76&Witness\\_ID=64207b41-3512-414b-8085-ae4b71520b0a](http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=faf91bea-ca58-4bc1-873d-33739dbb4f76&Witness_ID=64207b41-3512-414b-8085-ae4b71520b0a)).*

<sup>82</sup> Such defeasances are known as "advance refundings" or "pre-refundings". See MSRB, *Municipal Securities Rulemaking Board Glossary*, Second Edition (January 2004) (defining "advance refunding" and "defeasance") (available at <http://www.msrb.org/msrb1/glossary>). See also MSRB, EMMA Education Center, FAQ: "How am I affected if my bond is advance refunded?" (available at <http://emma.msrb.org/EducationCenter/FAQs.aspx?topic=AboutARD>); Fitch Ratings, *Municipal Structured Finance Criteria Report: Guidelines for Rating Prerefunded Municipal Bonds*, April 2, 2009 (available at [http://www.fitchratings.com/corporate/reports/report\\_frame.cfm?rpt\\_id=431370&sector\\_flag=&marketsector=3&detail=](http://www.fitchratings.com/corporate/reports/report_frame.cfm?rpt_id=431370&sector_flag=&marketsector=3&detail=)); and Moody's Investors Service, *Rating Methodology: Refunded Bonds*, June, 2007 (available at [http://www.moody.com/moodys/cust/research/MDCdocs/29/2006700000441141.pdf?doc\\_id=2006700000441141&frameOfRef=municipal](http://www.moody.com/moodys/cust/research/MDCdocs/29/2006700000441141.pdf?doc_id=2006700000441141&frameOfRef=municipal)).

about these events may, depending on the facts and circumstances, not need to be available to investors and other market participants in all instances to accomplish the Rule's goals.<sup>83</sup>

Therefore, the Commission proposes to modify the text of subparagraph (b)(5)(i)(C) and subparagraphs (b)(5)(i)(C)(2), (7), (8), and (10) of the Rule, with regard to the Participating Underwriter's obligations, to specify that a determination of materiality would be retained for event notices regarding non-payment related defaults; modifications to rights of security holders; bond calls; and the release, substitution, or sale of property securing repayment of the securities.

The Commission requests comment on the proposed amendment to delete the phrase "if material" in the case of notices for the following events: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes. Are these events of such importance to investors that their occurrence always should be disclosed? Are there situations in which notice of the occurrence of these events would not need to be available to investors to protect themselves from fraud and to brokers, dealers and municipal securities dealers to aid them in satisfying their obligations under the securities laws? Are there other events listed in the Rule as to which the materiality determination should be eliminated because their occurrence always should be disclosed to investors? Should a materiality determination be retained for event notices regarding non-payment related defaults; modifications to rights of security holders; bond calls; and the release, substitution, or sale of property securing repayment of the securities? Does the proposed amendment to eliminate the materiality determination for certain events create or eliminate any burdens on issuers?

<sup>83</sup> For example, a release of substitution of property may involve a small amount of property that is not particularly valuable or important to the business of the issuer or obligated person, and minor modifications to the rights of securities holders are often made pursuant to the provisions of trust indentures that allow them only if they are not materially adverse to the interests of bondholders.

#### *D. Amendment Relating to Event Notices Regarding Adverse Tax Events Under a Continuing Disclosure Agreement*

The Commission proposes to modify paragraph (b)(5)(i)(C)(6) of the Rule, which presently requires Participating Underwriters reasonably to determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice for "[a]dverse tax opinions or events affecting the tax-exempt status of the security," if material.<sup>84</sup> The proposed amendment would revise paragraph (b)(5)(i)(C)(6) of the Rule to provide specifically for the disclosure of adverse tax opinions, the issuance, by the Internal Revenue Service ("IRS"), of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities, or other events affecting the tax-exempt status of the security.<sup>85</sup> As stated above, such disclosure would be made to the MSRB.

In adopting the 1994 Amendments, the Commission noted 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. \* \* \*" <sup>86</sup> While the Commission continues to believe that "events affecting the tax-

<sup>84</sup> 17 CFR 240.15c2-12(b)(5)(i)(C)(6).

<sup>85</sup> The Commission understands that when determining whether interest on a bond issue is taxable, the IRS first issues an audit letter to the issuer (which may indicate whether or not IRS staff suspects a problem with the particular transaction). In the event that, as a result of the audit, IRS staff believes that it has found a reasonable basis to declare the interest on a bond issue under audit to be taxable, IRS staff issues a Notice of Proposed Issue (IRS Form 5701-TEB), which it recently began to use instead of a letter referred to as a "preliminary determination of taxability." If, following subsequent discussions with, and review of additional documents provided by, the entity under audit, IRS staff continues to believe that interest on the bonds should be declared taxable and no settlement has been reached, it issues a letter to the issuer referred to as a "proposed determination of taxability." Unless appealed to the Office of Appeals of the IRS, a proposed determination of taxability becomes a final determination of taxability in 30 days. Final determinations of taxability are not appealable to the IRS and may not be appealed in a federal court by an issuer. A bondholder who has received a tax assessment on account of such a final determination may take an appeal in federal court. See Internal Revenue Manual ("IRM") 4.81.14 to 4.81.1.19. See also IRM 4.18.5.9 (setting forth Office of Tax-Exempt Bonds' current practice regarding the issuance of a Notice of Proposed Issue (IRS Form 5701-TEB) in instances in which preliminary determinations of taxability would previously have been issued).

<sup>86</sup> See 1994 Amendments, *supra* note 5, 59 FR at 59600.

exempt status of the security” in paragraph (b)(5)(i)(C)(6) of the Rule<sup>87</sup> can include an audit, and thus an audit should be the subject of an event notice when it is material, the Commission recognizes that not all audits are indications of a risk to the tax-exempt status of interest on a municipal security. The IRS Office of Tax Exempt Bonds, through its examination classification process, initiates examinations in various market segments with a view toward ensuring broad examination coverage of the various tax-exempt bond segments.<sup>88</sup> However, determinations by the IRS, such as proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB), indicating that the IRS believes the securities are or may be taxable and has begun a formal administrative process in that regard, indicate that there could be a significant risk to the tax-exempt status of a security. Accordingly, the Commission believes that proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) by the IRS relating to the taxability of a municipal security are of such importance that they always should be disclosed pursuant to a continuing disclosure agreement.

Investors consider the tax-exempt status of a municipal security, specifically the issuance of such IRS notices, to be of great importance when making investment decisions.<sup>89</sup> Because

the interest rate on a tax-exempt municipal security generally is significantly lower than the interest rate on a comparable taxable security because of the value of the municipal security’s tax exemption, investors are sensitive to factors that could affect the value of the return that they would receive from such an investment, such as the tax exempt status of interest earned on a municipal security that they currently own or may purchase.<sup>90</sup> A determination by the IRS that interest may, in fact, be taxable on a municipal security purchased as tax-exempt not only could reduce the security’s market value, but also could adversely affect each investor’s federal and, in some cases, state income tax liability.<sup>91</sup> The tax-exempt status of a municipal security is also important to many mutual funds whose governing documents, with certain exceptions, limit their investment to tax-exempt municipal securities.<sup>92</sup> Mutual funds may liquidate securities that become taxable, which could have adverse consequences for the fund and its holders. Therefore, retail and institutional investors alike are extremely interested in events that

*Bond Tax Audit Disclosure*, at 10 (August 2002) (settled action) (available at [http://www.gfoa.org/downloads/Tax\\_Audit\\_Study\\_August\\_2002.pdf](http://www.gfoa.org/downloads/Tax_Audit_Study_August_2002.pdf)) (study examining the effect of IRS audit announcements on the secondary market for municipal bonds and discussing the concerns of investors and other municipal market participants); Lynn Hume, *Panel: This Top 10 List Doesn't Have Buy-Side Players Laughing*, The Bond Buyer, May 5, 2006, NFMA Annual Conference, Vol. 356 No. 32375, at 7 (“\* \* \* and issuers’ failures to disclose Internal Revenue Service notices that bonds are taxable are among the ‘10 top things that drive the buy side crazy,’ analysts and lawyers said \* \* \* during a panel session at the National Federation of Municipal Analysts’ 23rd annual meeting . \* \* \*”).

<sup>90</sup> See, e.g., Lori Trawinski, et al., *The Bond Market Association, Secondary Market Effects of Municipal Bond Tax Audit Disclosure*, at 10 (August 2002); Kathleen Pender, *State Energy Bonds Could Be Hard Sell; Treasurer says most won't be tax-exempt*, The San Francisco Chronicle, February 21, 2001, at D1; and John Gin, *Compare apples to apples when looking at bonds; Tax-equivalent yield is the test*, The Times-Picayune, September 5, 2007, Money; Money Watch, at 1; and SIFMA, *Calculator: Tax-Free vs. Taxable Yield Comparison* (available at <http://www.investinginbonds.com/learnmore.asp?catid=8&subcatid=80>).

<sup>91</sup> For example, investors in such a circumstance may have to include interest on such a security as income when computing their federal income taxes for current and future tax years and may have to pay additional taxes for prior tax years.

<sup>92</sup> See Investment Company Institute, *Frequently Asked Questions About Money Market Funds* (available at [http://www.ici.org/home/faqs\\_money\\_funds.html#TopOfPage](http://www.ici.org/home/faqs_money_funds.html#TopOfPage)) (“Typically, tax-exempt money market funds, which seek to pay dividends that are exempt from federal income tax and/or state income tax, invest in instruments issued by state and local governments (‘municipal securities’).”).

could adversely affect the tax-exempt status of the bonds that they own or may purchase.

Subsequent to a 1993 Report of the General Accounting Office,<sup>93</sup> the IRS established an Office of Tax-Exempt Bonds with more than 60 staff members devoted to audits and tax collections related to tax-exempt municipal securities.<sup>94</sup> Staff of the Office of Tax-Exempt Bonds has identified numerous offerings in which bonds sold as tax-exempt were determined to be taxable.<sup>95</sup> As a result, the IRS has collected a significant amount of taxes—generally through settlements with issuers and obligated persons, but also with bondholders.<sup>96</sup> Furthermore, staff of the IRS Office of Tax-Exempt Bonds has established a Bondholder Unit to increase the staff’s efficiency in identifying bondholders in the case of bonds determined to be taxable.<sup>97</sup>

<sup>93</sup> See U.S. General Accounting Office, *Tax Policy and Administration—Improvements for More Effective Tax-Exempt Bond Oversight*, Report of the General Accounting Office to the Chairman, Subcommittee on Human Resources and Intergovernmental Relations, Committee on Government Operations, House of Representatives, May 10, 1993 (available at <http://archive.gao.gov/t2pbat5/149322.pdf>) (which recommended, in part, that the existing bond audit program be redirected and that program staffing levels, locations and training needs be reassessed in light of the program’s future).

<sup>94</sup> E-mail from Clifford Gannett, Director, Office of Tax-Exempt Bonds, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>95</sup> E-mail communications among Clifford Gannett, Director, Office of Tax-Exempt Bonds, Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008 and December 9, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>96</sup> *Id.*

<sup>97</sup> According to the 2008 Work Plan for the IRS Office of Tax-Exempt Bonds, the bondholder identification process is expected to be initiated no later than the date a proposed adverse determination is issued (available at [http://www.irs.gov/pub/irs-tege/teb\\_fy08\\_work\\_plan.pdf](http://www.irs.gov/pub/irs-tege/teb_fy08_work_plan.pdf)). See, e.g., Susanna Duff Barnett and Lynn Hume, *IRS to Warn Mutual Funds of Taxability Letters Being Sent to Over 12 Companies*, The Bond Buyer, March 30, 2004, Washington, at 1 (“More mutual funds can be expected to be contacted in the future.”) and Susanna Duff Barnett, *A Growing Caseload; More Challenges Face IRS Bond Office in '05*, The Bond Buyer, December 23, 2004, Washington, Vol. 350 No. 32036, at 1 (“One result

Continued

<sup>87</sup> 17 CFR 240.15c2-12(b)(5)(i)(C)(6).

<sup>88</sup> E-mail communication among Clifford Gannett, Director, Office of Tax-Exempt Bonds, Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on December 9, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>89</sup> See *In the Matter of Neshannock Township School District*, Securities Act Release No. 8411 and Securities Exchange Act Release No. 49600, AP 3-11461 (April 22, 2004) (settled action) (“A substantial risk to the tax-exempt status of securities which have been sold as tax-exempt is a material item.”); *In the Matter of Rauscher Pierce Refsnes, Inc., Dain Rauscher Inc., and James R. Feltham*, Securities Act Release No. 7844 and Securities Exchange Act Release No. 42644, A.P. File No. 3-10182 (April 6, 2000) (settled action) (“\* \* \* an essential feature of the 1992B [Certificates of Participations] was the tax-exempt status of the interest component to be paid to investors”); and *In re: County of Orange, California; Orange County Flood Control District and County of Orange, California Board of Supervisors*, Securities Act Release No. 7260 and Securities Exchange Act Release No. 36760, AP 3-8937 (January 1, 1996) (identifying tax-exempt status of offering of securities as a material fact). See also, e.g., Lori Trawinski, et al., *The Bond Market Association, Secondary Market Effects of Municipal*

IRS staff has indicated<sup>98</sup> that during the period from April 2007 through July 2008, approximately 80% of the audits that received a preliminary determination of taxability (now IRS Form 5701-TEB<sup>99</sup>) and were resolved were settled through closing agreements with the IRS. During the same period, of those cases that received a proposed determination of taxability and were closed: approximately 25% were settled through a closing agreement with IRS; approximately 37.5% received final determinations that the bonds were taxable; and approximately 37.5% were appealed to the IRS Office of Appeals. In light of the foregoing discussion, the Commission believes that the risk of taxability following the issuance of proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) is significant.

Despite the possibility that these events could adversely affect the tax-exempt status of the bonds that investors own or may purchase and thus could significantly affect the pricing of those municipal securities,<sup>100</sup> it has

that has stemmed from the lengthier audits is the IRS' aggressive search for bondholder names earlier in an audit cycle through so-called John Doe summonses and other methods.").

<sup>98</sup> E-mail from Robert Henn, Manager, Office of Tax-Exempt Bonds Field Operation, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated July 14, 2009.

<sup>99</sup> The IRS Office of Tax-Exempt Bonds now issues Notices of Proposed Issue (IRS Form 5701-TEB) in instances in which it previously would have issued preliminary determinations of taxability. E-mail from Clifford Gannett, Director, Office of Tax-Exempt Bonds, IRS, to Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, dated August 26, 2008. Information in e-mail confirmed in telephone conversation between Robert E. Henn, Manager, Office of Tax-Exempt Bonds Field Operations, Office of Tax-Exempt Bonds, IRS, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, on May 29, 2009.

<sup>100</sup> See, e.g., Susanna Duff Barnett and Lynn Hume, *IRS to Warn Mutual Funds of Taxability Letters Being Sent to Over 12 Companies*, The Bond Buyer, March 30, 2004, Washington, at 1 ("The bondholder community has been saying for years that they want prompt disclosure of audits and issuer discussions with the IRS relating to the tax-exempt status of the bonds."—Tom Metzold, president and portfolio manager at Eaton Vance Management; "It's vital to disclose the risk of taxability to the entire marketplace to protect potential investors."—Gerard J. Lian, then chairman of the National Federation of Municipal Analysts and vice president and senior analyst at Morgan Stanley Investment Management.); and National Federation of Municipal Analysts, *NFMA releases results of member survey* (November 30, 2001) (available at [http://www.nfma.org/publications/survey\\_results.pdf](http://www.nfma.org/publications/survey_results.pdf)) ("Over 54% of analysts responding to the survey felt that all IRS audits, whether routine, targeted or based on external information, should be disclosed to the market."). See also, Lori Trawinski, et al., *The Bond Market Association, Secondary Market Effects of Municipal Bond Tax Audit Disclosure* (August 2002) (available

been reported that notices regarding such tax events are not always filed.<sup>101</sup> The Commission believes that the issuance of proposed and final determinations of taxability and Notices of Proposed Issue (IRS Form 5701-TEB) by the IRS is important information that should be made available to investors and therefore should be part of a Participating Underwriter's obligation to determine whether such events are included in a continuing disclosure agreement.

The Commission requests comment on the proposed amendment to modify the provision of the Rule regarding the submission of a notice with respect to adverse tax opinions to include the 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 the tax-exempt status of the securities, or other events affecting the tax-exempt status of the security. Comment is requested on whether the proposed amendment would further the disclosure of such events and thereby aid investors to protect themselves from misrepresentations and fraud and brokers, dealers and municipal securities dealers to carry out their obligations. The Commission requests comment regarding the extent to which investors and other market participants would find it useful to be informed of the issuance of proposed and final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities by the IRS. Commenters should advise whether the proposal would aid investors in their understanding of potential adverse tax consequences that may arise with respect to a particular municipal security. In addition, commenters should address whether such information is important to investors of various types of municipal securities, such as fixed and variable rate securities or demand securities. Should the

at [http://www.foia.org/downloads/Tax\\_Audit\\_Study\\_August\\_2002.pdf](http://www.foia.org/downloads/Tax_Audit_Study_August_2002.pdf)) ("This study clearly demonstrates that effect for certain variable-rate tax-exempt bonds, where rates paid by state and local bond issuers have risen significantly when news of the audit is made public. While anecdotal evidence suggests similar effects for long-term, fixed-rate bonds, empirical evidence is inconclusive.").

<sup>101</sup> See, e.g., Susanna Duff Barnett, *IRS Answers Toxic Query; Post 1986 Radioactive Waste Debt Not Exempt*, The Bond Buyer, November 2, 2004 (material event notice filed October 29, 2004 regarding IRS technical advice memorandum dated August 27, 2004 that bonds issued to finance certain radioactive solid waste facilities were taxable; related preliminary adverse determination letter was issued in January, 2002).

continuing disclosure agreement specify that a copy of the determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices issued by the IRS be provided to the MSRB, or would a notice of any such determination provide sufficient information to investors? What would be the benefit of disclosing a copy of any such determination? What drawbacks, if any, might such disclosure entail? Should the Rule be amended to require a Participating Underwriter to reasonably determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice of tax audits? If so, why?

#### *E. Addition of Events To Be Disclosed Under a Continuing Disclosure Agreement*

The Commission also proposes to amend paragraph (b)(5)(i)(C) of the Rule by including notice of four additional events the Participating Underwriter must reasonably determine that the issuer or other obligated person has agreed to provide in its continuing disclosure agreement. These would include: (1) Tender offers; (2) bankruptcy, insolvency, receivership or similar proceeding of the obligated person; (3) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (4) appointment of a successor or additional trustee, or the change of name of a trustee, if material.

#### 1. Tender Offers

The Commission proposes to add tender offers to the list of events in subparagraph (b)(5)(i)(C)(8) of the Rule.<sup>102</sup> Under the proposed amendment, the Participating Underwriter must reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to provide notice of tender

<sup>102</sup> Generally, municipal securities are not subject to Commission rules governing tender offers, including Rule 13e-4 under the Exchange Act, 17 CFR 240.13e-4, which sets forth disclosure, time periods, and other requirements governing tender offers by issuers. In passing the Williams Act, P.L. 90-439, in 1968, Congress recognized that regulation of tender offers was necessary for the purposes of disclosure of material information and substantive protection to investors. See Rep. No. 550, 90th Cong., 1st Sess. 3 (1967) at 1.

offers to the MSRB.<sup>103</sup> The Commission believes that notice of the existence of tender offers for municipal securities would help investors to be better able to protect themselves from misrepresentations and fraud, including deciding whether to tender their holdings to the issuer or its representative, and assist brokers, dealers and municipal securities dealers to carry out their obligations. Tender offers typically require an investor to respond within a limited time frame.<sup>104</sup> Tender offers may provide an avenue of liquidity to investors, such as during periods of market turmoil.<sup>105</sup> The Commission believes that communication of the existence of a tender offer to municipal securities investors is important to assist each investor to make an informed, timely decision whether or not to tender.<sup>106</sup>

Indeed, the recent events in the market for ARS could be seen as an example of the need to provide timely notice within ten business days of a tender offer. Since approximately mid-February of 2008, the market for ARS has experienced severe illiquidity, with consequences to investors who purchased what they may have believed to be liquid, cash equivalent investments.<sup>107</sup> Some issuers and

obligated persons have offered to purchase some or all of their outstanding ARS from investors who desire liquidity.<sup>108</sup> Notices about these tender offers may not always be widely disseminated. Had this information been available from the then-existing information repositories, it may have become more widely known to the market through these repositories and through private information vendors and news media who obtain information from the repositories.

During a tender offer for municipal securities, such as ARS, some investors may be left in doubt whether their securities were the subject of the offer. To determine the facts about such offers, it often is necessary for investors to seek the information independently by contacting the issuer or other obligated person directly. Some investors may not have been able to learn of the existence of a tender offer for municipal securities that they hold, in a timely fashion and, in such a case, may not have been able to tender their securities. The Commission believes that the proposed amendment requiring Participating Underwriters to reasonably determine that such notices are provided pursuant to a continuing disclosure agreement would help ensure the consistent availability of this information to investors when they make investment decisions, and thereby assist them to be better able to protect themselves from misrepresentation and fraud.

The Commission believes that the proposed amendment requiring Participating Underwriters to reasonably determine that issuers and other obligated persons have agreed in their continuing disclosure agreements to provide notice of tender offers to the MSRB<sup>109</sup> would result in this information being more widely available to investors through the MSRB. In addition, the proposal to revise paragraph (b)(5)(i)(C) of the Rule to specify that event notices be submitted in a timely manner not in excess of ten business days after the event's occurrence, as discussed above, would help to improve the timely availability of tender offer information so that investors would be afforded the

opportunity to make more informed decisions whether to hold or tender their securities. The Commission believes that its proposal regarding notice of tender offer disclosures would enhance the ability of issuers, other obligated persons, or others making such tender offers to effectively communicate their offers to a wider constituency of bondholders and thereby would increase the likelihood that those holders would be informed of the offer.

The Commission requests comment regarding all aspects of the proposed amendment of subparagraph (b)(5)(i)(C)(8) of the Rule to include tender offers. For example, would specifying in Rule 15c2–12 the submission to the MSRB of a notice of a tender offer assist issuers and other obligated persons in providing tender offer information to bondholders on a wider basis? Is there a benefit or drawback to adding tender offers as an event item in subparagraph (b)(5)(i)(C)(8) of the Rule? Would the proposal help prevent fraud? If so, would the proposed amendment to modify subparagraph (b)(5)(i)(C)(8) to include notice of tender offers to the MSRB be an appropriate avenue to address this objective? If a tender offer is open for a short period of time, is the proposed “ten business day” standard appropriate in the context of a tender offer or would another time frame be more appropriate? The Commission seeks comment regarding whether tender offers should be added to this provision of Rule 15c2–12 and requests suggestions concerning alternative methods to address the concerns stated above with regard to tender offers for municipal securities. In addition, comment is requested about the existence and prevalence of exchange offers for municipal securities and whether exchange offers also should be included in this provision. Further, the Commission requests comment regarding whether it should specify that the Participating Underwriter reasonably determine that the issuer or obligated person has agreed to provide particular information regarding a tender offer that should be included in such notices, such as: The offer price; change in offer price; withdrawal rights; identity of the offeror; an offeror's ability to finance the offer; conditions to the offer; and the time frame and manner for tendering securities and the method for acceptance (e.g., whether all securities tendered would be accepted and, if not, the method for determining which securities would be accepted). Are there other items of information that

<sup>103</sup> See *supra* note 11 and accompanying text.

<sup>104</sup> See Edward N. Gadsby, *et al.*, *Regulation of Tender Offers, Federal Securities Exchange Act of 1934*, § 7A.03 (David Colby, *et al.*, ed., Matthew Bender & Company, Inc.) (2008) (describing that usually a time limit is placed on a tender offer).

<sup>105</sup> See, e.g., Caitlin Devitt, *Midwest Health Systems Use New ARS Strategy; Two Systems See to Ease ARS Sting*, *The Bond Buyer*, March 7, 2008, *The Regions*, Vol. 363 No. 32833, at 1 (describing an issuer's use of a tender offer in its auction rate securities to provide liquidity).

<sup>106</sup> The Commission proposes to retain in Rule 15c2–12(b)(5)(i)(C)(8) the requirement that Participating Underwriters reasonably determine that the issuer or obligated person has agreed in a continuing disclosure agreement to provide to the MSRB notice of bond calls, if material. Thus, unlike with respect to tender offers, the issuer would make a materiality determination with respect to a notice regarding a bond call. The Commission believes that this distinction is appropriate in light of the various types of bond calls (e.g., sinking fund redemptions, extraordinary redemptions, and optional redemptions) that can occur. In addition, the specific amounts to be redeemed and dates for some redemptions (i.e., sinking fund redemptions) are generally included in official statements; therefore, information about such events is already available to investors.

<sup>107</sup> See, e.g., MSRB Notice 2008–09 (February 19, 2008) (reminding brokers, dealers and municipal securities dealers of the application of MSRB disclosure and suitability requirements that apply to all customer transactions in municipal ARS and stating, for example, that it may be a material fact for an investor that an ARS recently was subject to a failed auction); Press Release 2009–127, Commission, *SEC Finalizes ARS Settlements With Bank of America, RBC, and Deutsche Bank* (June 3, 2009) (announcing settlement of SEC's complaints alleging that Bank of America, RBC Capital Markets,

and Deutsche Bank failed to make their customers aware of risks in ARS investments.).

<sup>108</sup> See, e.g., notice dated March 28, 2008 of Nationwide Children's Hospital regarding the intent of the hospital to bid for auction rate bonds (available at <https://www.nationalcity.com/content/private-client-group/products-services/create-grow-wealth/pages/documents/2008-03-28.pdf>) and Caitlin Devitt, *Midwest Health Systems Use New ARS Strategy; Two Systems Seek To Ease ARS Sting*, *The Bond Buyer*, March 7, 2008, *The Regions*, Vol. 363 No. 32833, at 1.

<sup>109</sup> See *supra* note 11 and accompanying text.

should be included in the notice to help accomplish the purposes of the Rule or would some of the items listed above be unnecessary in this context? If so, please specify which ones and explain the rationale as to why they should or should not be included.

## 2. The Occurrence of Bankruptcy, Insolvency, Receivership or Similar Events Regarding an Issuer or an Obligated Person

The Commission proposes to add new subparagraph (b)(5)(i)(C)(12) to the Rule to require a Participating Underwriter to reasonably determine that the continuing disclosure agreement requires a notice to be submitted to the MSRB,<sup>110</sup> in the case of bankruptcy, insolvency, receivership or similar event of the obligated person. Rule 15c2–12 would state in a Note following the events specified in subparagraph (b)(5)(i)(C)(12) that, for the purposes of the subparagraph (b)(5)(i)(C)(12), the event would be considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the issuer or obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan or reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.<sup>111</sup> Although issuers and other obligated persons of municipal securities rarely are involved in

bankruptcy, insolvency, receivership or similar events, the Commission notes that the occurrence of such events, even if rare, can significantly impact the value of the municipal securities. Information about these events is important to investors and other market participants,<sup>112</sup> and knowledge of the bankruptcy, insolvency, receivership or similar event involving an issuer or other obligated person would allow investors to make informed decisions about whether to buy, sell or hold the municipal security and help prevent fraud.<sup>113</sup> Accordingly, the Commission believes that Participating Underwriters should be required to reasonably determine that such information is provided pursuant to a continuing disclosure agreement.

Under current Rule 15c2–12(b)(5)(i)(C)(2), notice of a material “non-payment related default” is to be provided to the MSRB pursuant to a continuing disclosure agreement. The Commission understands that the governing documents for some municipal securities include bankruptcy, insolvency, receivership or similar events involving an issuer or obligated person as a “non-payment related default.”<sup>114</sup> However, the Commission further understands that this may not be uniformly the case. The proposed amendment would help improve the availability of notice of bankruptcy, insolvency, receivership, or similar events to all investors. The proposed Note, as described above, is intended to clarify the scope of the event item contained in new subparagraph (b)(5)(i)(C)(12) of the Rule. Moreover, because of the importance of

such events to investors and their possible impact on the value of the security, a materiality condition would not be added to proposed subparagraph (b)(5)(i)(C)(12).

The Commission requests comment regarding all aspects of the proposed addition of the event relating to bankruptcy, insolvency, receivership or similar proceeding of the issuer or other obligated person in the Rule. In particular, the Commission requests comment regarding whether there are other similar events or proceedings affecting the financial condition of issuers or other obligated persons that should be included as events requiring notice. The Commission seeks input regarding whether commenters believe that the items contained in proposed subparagraph (b)(5)(i)(C)(12) of the Rule are already addressed by current subparagraph (b)(5)(i)(C)(2) of the Rule and thus whether it is unnecessary to revise the Rule in this regard. The Commission also seeks comment on whether it is appropriate to exclude a materiality determination from this proposed event item.

## 3. Merger, Consolidation, Acquisition, and Sale of All or Substantially All Assets

The Commission proposes to add subparagraph (b)(5)(i)(C)(13) to the Rule, which would require a Participating Underwriter reasonably to determine that the continuing disclosure agreement provides for the submission of notice to the MSRB<sup>115</sup> of any of the following events with respect to the securities being offered: the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material.<sup>116</sup> Although mergers,

<sup>110</sup> See *supra* note 11 and accompanying text.

<sup>111</sup> See Form 8–K, Item 1.03 for provisions relating to bankruptcy or receivership that are applicable to entities subject to Exchange Act reporting requirements. 17 CFR 249.308. Item 1.03 of Form 8–K requires the registrant to provide specified items of disclosure on Form 8–K if a receiver, fiscal agent or similar officer has been appointed for a registrant or its parent, in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state and federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the registrant or its parent, or if such jurisdiction has been assumed by leaving the existing directors and officers in possession but subject to the supervision and orders of a court or governmental authority. The proposed Rule 15c2–12 event item is intended to be consistent with the Form 8–K, Item 1.03 provisions applicable to entities subject to the reporting requirements of the Exchange Act.

<sup>112</sup> See, e.g., Letter from Karrie McMillan, General Counsel, ICI, to Florence E. Harmon, Secretary, Commission (September 22, 2008) (“ICI Letter”) (available at <http://www.sec.gov/comments/s7-21-08/s72108-12.pdf>) (suggesting that disclosure information should include information relating to bankruptcy and receivership); National Federation of Municipal Analysts, *Recommended Best Practices in Disclosure for Land Secured Debt Transactions*, June 2000 (available at <http://data.memberclicks.com/site/nfma/DC.BP.landsecuredpractices.doc.pdf>) (recommending best practice disclosures, including disclosures of bankruptcy).

<sup>113</sup> The Commission is aware that bonds are often secured by letters of credit, bond insurance, and other forms of credit enhancement that some have argued could reduce the importance of the creditworthiness of an issuer or obligated person. However, the Commission has long been of the view that information regarding obligated persons generally is material to investors in credit enhanced offerings. See 1989 Adopting Release, *supra* note 3, 54 FR at 28812 (“The presence of credit enhancements generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds.”). See also Regulation AB, 17 CFR 229.1100 *et seq.*

<sup>114</sup> See National Association of Bond Lawyers (NABL) Form Indenture, dated June 1, 2002 (“NABL Form Indenture”).

<sup>115</sup> See *supra* note 11 and accompanying text.

<sup>116</sup> Although the Commission’s disclosure rules that are applicable to reporting companies do not apply to municipal securities, the Commission notes that reporting companies are required to make disclosures upon the occurrence of similar events. See Items 1.01 and 2.01 of Form 8–K relating to entry into a material definitive agreement and completion of the acquisition or disposition of assets, respectively, which require entities subject to Exchange Act reporting requirements to disclose specified information within four business days of the occurrence of such events. 17 CFR 249.308. Item 1.01 of Form 8–K requires the registrant to provide specified items of disclosure on Form 8–K if the registrant has entered into a material definitive agreement not made in the ordinary course of business of the registrant, or into any amendment

consolidations, acquisitions, and substantial asset sales are events believed to be rare among governmental issuers,<sup>117</sup> they are not uncommon for obligated persons such as health care institutions, other non-profit entities, and for-profit businesses.<sup>118</sup> Currently, Rule 15c2-12 does not require Participating Underwriters to reasonably determine that continuing disclosure agreements provide for notice of a merger, consolidation, acquisition and substantial asset sales involving such obligated persons, if material.<sup>119</sup> Investors often are not readily able to obtain information about such actions by obligated persons.

The Commission believes that notice of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any

of such agreement that is material to the registrant. For purposes of Item 1.01, a "material definitive agreement" means an agreement that provides for obligations that are material to and enforceable against the registrant, or rights that are material to the registrant and enforceable by the registrant against one or more parties to the agreement, in each case whether or not subject to conditions. Item 2.01 of Form 8-K requires the registrant to provide specified items of disclosure on Form 8-K if the registrant or any of its majority-owned subsidiaries has completed the acquisition or disposition of a significant amount of assets, other than in the ordinary course of business.

<sup>117</sup> But see Illinois Finance Authority, which was created on January 1, 2004 following the consolidation of seven existing state authorities. See Illinois Finance Authority, *Illinois Finance Authority Bond Program Handbook*, November 1, 2004 (available at <http://www.il-fa.com/policies/BondHandbook11-1-04.pdf>).

<sup>118</sup> For example, according to the American Hospital Association, more than 680 hospital mergers were announced from 1998-2006. See American Hospital Association, *TRENDWATCH CHARTBOOK 2008—Trends in the Overall Health Care Market, Chart 2.10: Announced Hospital Mergers and Acquisitions, 1998-2006* (available at <http://www.aha.org/aha/trendwatch/chartbook/2008/08chart2-10.pdf>).

<sup>119</sup> The materiality of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions must be determined through a review of the particular facts and circumstances of such event. Although in a number of instances such events may be determined to be material, it is possible for such an event to be so sufficiently insignificant that an event notice would not be required. For example, a merger or acquisition of a small entity by one of substantial size may not be material to investors in bonds for which the larger entity is the obligated person, absent other circumstances. On the other hand, such a merger or acquisition may be material to investors in bonds for which the small entity is the obligated person.

such actions, other than pursuant to its terms, if material, is important information for investors and market participants.<sup>120</sup> The foregoing events may signal that a significant change in the obligated person's corporate structure could occur or has occurred. In the case of such event, investors may want to have information about the identity and financial stability of the obligated person that would be responsible, following such event, for payment of a municipal security. Further, municipal security holders generally may wish to know about the obligated person's creditworthiness, particularly its ability to support payment of the security following such event when they assess whether to buy, sell or hold a municipal security. A notice regarding such an event, if material, would help further the availability of relevant information to bondholders, market professionals, and the public generally. Accordingly, the Commission believes that it is appropriate to include in the Rule the proposed event item relating to the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions other than pursuant to its terms, if material. The Commission does not believe that all mergers are necessarily of sufficient importance that information on mergers needs to be made available in all instances. For example, a merger could involve the combination of a shell corporation or other small entity into a very large healthcare organization that is a conduit borrower. Such a merger generally would not have a significant impact on the business or financial condition of the larger corporation and, under all of the applicable facts and circumstances, would not be important to investors.

The Commission requests comment regarding all aspects of the proposed addition to the Rule with respect to the consummation or entry into or termination of a definitive agreement involving a merger, consolidation, acquisition, or the sale of all or substantially all of the assets of the obligated person. The Commission requests comment regarding the frequency of such events, and whether this information would be meaningful to

investors. The Commission further requests comment on whether a determination of materiality for such events is an appropriate condition to add to this proposed provision. The Commission also requests comments regarding the benefits and drawbacks of this proposed event item.

#### 4. Successor, Additional, or Change in Trustee

Finally, the Commission proposes to add subparagraph (b)(5)(i)(C)(14) to the Rule to require Participating Underwriters to reasonably determine that the issuer or other obligated person has contractually agreed to submit notice to the MSRB<sup>121</sup> when there is an appointment of a successor or additional trustee, or a change of name of a trustee, if material.<sup>122</sup> The proposed amendment reflects the Commission's belief in the importance of an investor's ability to learn of a material change in the trustee's identity, given the significant function and role of the trustee for the holders of the municipal security. The trustee makes critical decisions that impact investors and has a duty to represent the interests of bondholders. For example, the trustee often must determine whether: Proposed amendments to the governing documents of the municipal security are permissible without bondholder consent; parity obligations could be issued; security could be released; or an event of default has occurred.<sup>123</sup> In addition, a trustee is responsible for sending payments to investors and computing applicable interest rates. In some cases, a trustee may be responsible for taking certain actions at the direction of a designated percentage of bondholders.<sup>124</sup> A trustee may also be responsible for providing information requested by investors; often the trustee serves as the issuer's dissemination agent for continuing disclosures. Although the identity of the trustee may have little or no influence on a decision whether to buy or sell a security under normal circumstances, bondholders would need to know the identity of a trustee to be able to contact the trustee for various reasons, particularly when

<sup>121</sup> See *supra* note 11 and accompanying text.

<sup>122</sup> The materiality of the name change of a trustee must be determined through a review of the particular facts and circumstances of such event. For instance, it is possible for a name change by a trustee to be so minor that an event notice would not be required. For example, a name change such as "ABC National Bank and Trust Company of XYZ," to "ABC National Bank and Trust Company" may not be material in the absence of other factors, such as a change of the location at which the trustee can be reached.

<sup>123</sup> See NABL Form Indenture, *supra* note 114.

<sup>124</sup> *Id.*

<sup>120</sup> See ICI Letter, *supra* note 112 (suggesting that disclosure information should include information relating to material acquisitions and dispositions).

an issuer or other obligated person may be experiencing financial difficulty. These factors support the need for investors to know the identity of the trustee. Yet, the Commission is unaware of any method by which investors, particularly individual investors, presently have a consistent means of obtaining up-to-date information about changes to the identity of the trustee. The proposed amendment therefore would require that the Participating Underwriter reasonably determine that the continuing disclosure agreement provide that a notice concerning a change in the identity of the trustee be submitted to the MSRB.

The Commission requests comment regarding all aspects of the proposed addition of subparagraph (b)(5)(i)(C)(14) concerning the appointment of a successor or additional trustee or the change of name of a trustee. In particular, the Commission requests comment relating to the frequency of such an event and the importance of such information to investors. Commenters should advise whether the continuing disclosure agreement should set forth other information regarding the trustee that should be disclosed and whether a determination of materiality for such events is an appropriate condition to add to this proposed provision. Commenters are requested to provide their views on the benefits and drawbacks of this aspect of the proposal.

#### F. Effective Date and Transition

The proposed amendments to Rule 15c2-12 would impact only continuing disclosure agreements that are entered into in connection with primary offerings occurring on or after the effective date of these proposed amendments, if they were adopted by the Commission. The Commission understands that existing undertakings by issuers and obligated persons that were entered into prior to the effective date of any final amendments would not require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or other obligated person had agreed to provide notice of specified events in a timely manner not in excess of ten business days of the event's occurrence or include the additional items discussed above that are proposed to be added to paragraph (b)(5)(i)(C) of the Rule. In addition, such existing undertakings would provide for the submission of the events specified in paragraph (b)(5)(i)(C) of the Rule, "if material."

Further, the Commission is aware that, prior to the effective date of any final amendments, a broker, dealer, or municipal securities dealer in primary

offerings of demand securities in authorized denominations of \$100,000 would not be required reasonably to determine that the issuer or other obligated person had entered into a continuing disclosure agreement, as prescribed by the Rule. The Commission requests comment regarding the potential effects and implications of existing continuing disclosure agreements having different terms (e.g., lacking the proposed additional events for which notices would be sent to the MSRB and the specified ten business day deadline for doing as discussed above) than continuing disclosure agreements entered into on or after any effective date of the proposed amendments, should the proposed amendments be adopted by the Commission.

The Commission preliminarily believes that, if the proposed amendments to Rule 15c2-12 were adopted, it would be preferable to implement them expeditiously. If the Commission were to approve the proposed amendments, the Commission is preliminarily considering an effective date that would be no earlier than three months after any final adoption of the proposed amendments in order to permit sufficient time for the MSRB to make necessary modifications to the EMMA system and for Participating Underwriters to comply with the new Rule. The Commission requests comment on such an effective date and whether another effective date might be preferable, if the Commission were to adopt the proposed rule amendments. In particular, comment is requested regarding any transition issues with respect to the proposed amendments, such as whether there would be any conflicts with respect to terms in existing continuing disclosure agreements.

The Commission notes that under paragraph (c) of the Rule, a broker, dealer, or municipal securities dealer cannot 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 paragraphs (b)(5)(i)(C) and (D) and paragraph (d)(2)(ii)(B) of the Rule with respect to the security. The Commission recognizes that continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt would not reflect changes made to the Rule by such amendments, including with respect to event notices. As a result, event items covered by a continuing

disclosure agreement entered into prior to the effective date of any amendments that the Commission may adopt may be different from those event items covered by a continuing disclosure agreement entered into on or after the effective date of any final amendments that the Commission may adopt. Thus, in the case of municipal securities subject to a continuing disclosure agreement entered into prior to the effective date of any final amendments that the Commission may adopt, the recommending broker, dealer or municipal securities dealer would receive notice solely of those events covered by that continuing disclosure agreement, namely, the eleven events specified in the current Rule. Because, in that case, the continuing disclosure agreement would not cover any of the items proposed to be added to the Rule, it would not be necessary for the recommending broker, dealer, or municipal securities dealer to have procedures in place that provide reasonable assurance that it received prompt notice of events proposed to be added to the Rule. The Commission requests comment on the impact of the proposed amendments with respect to brokers, dealers, and municipal securities dealers that recommend the purchase or sale of municipal securities. The Commission also requests comment on what changes, if any, brokers, dealers and municipal securities dealers would have to make to their procedures as a result of any final amendments that the Commission may adopt relating to the receipt of event notices. The Commission also requests comment on whether it should amend the Rule or otherwise provide further guidance to take into account differences in event notices included in continuing disclosure agreements entered into prior to the effective date of any final amendments that the Commission may adopt and those event notices included in continuing disclosure agreements entered into on or after the effective date of any final amendments that the Commission may adopt.

The Commission seeks comment on any other transition issues in connection with the proposed amendments to Rule 15c2-12. For example, in connection with the 2008 Amendments, one commenter suggested that continuing disclosure agreements executed following the effective date of the 2008 Amendments should amend all prior continuing disclosure agreements of the same issuer to incorporate the changes to the Rule made in the 2008 Amendments. In the event that the proposed amendments were to be

adopted, would transitional issues be minimized by the fact that over time fewer bonds would be subject to continuing disclosure agreements entered into prior to the effective date? Would an effective date that is no earlier than three months after any final approval of the proposed amendments, should the Commission determine to adopt the proposed amendments, provide adequate time for issuers and underwriters to become informed about the proposed amendments and adapt to them?

### III. Interpretive Guidance With Respect to Obligations of Participating Underwriters

As noted above in Section I.B., the Commission is aware that municipal securities industry participants have expressed concern that some municipal issuers and other obligated persons may not consistently submit continuing disclosure documents, particularly event notices and failure to file notices, in accordance with their undertakings in continuing disclosure agreements.<sup>125</sup>

Municipal security holders' access to meaningful information promotes informed investment decision-making about whether to buy, sell or hold municipal securities<sup>126</sup> and thereby better protection against misrepresentations and fraudulent activities. Availability of that information also will aid brokers, dealers, and municipal securities dealers to satisfy their obligations under the federal securities laws to have a reasonable basis for recommending municipal securities. In the Commission's view, the flow of municipal securities disclosure to investors and other market participants depends on issuers and obligated persons abiding by their undertakings in continuing disclosure agreements.<sup>127</sup> Accordingly, the Commission emphasizes that it is important for an underwriter in a municipal offering to evaluate carefully the likelihood that the issuer or obligated person will comply on a timely basis with the undertakings it has made.

In prior releases, the Commission set forth its interpretations of the obligations of municipal underwriters

under the antifraud provisions of the federal securities laws.<sup>128</sup> The Commission discussed the duty of underwriters to the investing public to have a reasonable basis for recommending any municipal securities and, in fulfilling that obligation, it is their responsibility to review the issuer's or obligated person's disclosure documents in a professional manner with respect to the accuracy and completeness of statements made in connection with the offering.<sup>129</sup> The Commission today reaffirms its previous interpretations and provides additional guidance with respect to underwriters' responsibilities under the antifraud provisions of the federal securities laws.<sup>130</sup>

The provisions of paragraph (b) of Rule 15c2-12 are intended to assist a municipal underwriter in meeting its "reasonable basis" obligations, including the requirement that an underwriter receive and review a nearly complete final official statement prior to bidding for or purchasing securities in connection with the offering.<sup>131</sup> Under paragraph (b)(5)(i)(C) of the Rule, the underwriter is obligated to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract for the benefit of the bondholders, to provide continuing disclosure documents to the MSRB.<sup>132</sup> Further, the Rule's definition of "final official statement" provides for the disclosure of any instances in the previous five years in which any person identified in the continuing disclosure agreement has failed to comply, in all

<sup>128</sup> See Securities Exchange Act Release No. 26100 (September 22, 1988), 53 FR at 37787-91 (September 28, 1988) ("1988 Proposing Release"); the 1989 Adopting Release, *supra* note 3, 54 FR at 28811-12; and the 1994 Interpretive Release, *supra* note 5, 59 FR at 12757-58 (reaffirming the Commission's interpretation of the obligations of municipal underwriters under the antifraud provisions of the federal securities laws).

<sup>129</sup> See 1989 Adopting Release, *supra* note 3, 54 FR at 28811. See also 1988 Proposing Release, *supra* note 128, 53 FR at 37787.

<sup>130</sup> In light of the underwriter's obligation, as discussed in the 1988 Proposing Release, *supra* note 128, 53 FR at 37787-91, the 1989 Adopting Release, *supra* note 3, 54 FR 28811-12, and the 1994 Interpretive Release, *supra* note 5, 59 FR 12757-58, to review the official statement and to have a reasonable basis for its belief in the accuracy and completeness of the official statement's key representations, the Commission noted that disclaimers by underwriters of responsibility for the information provided by the issuer or other parties without further clarification regarding the underwriter's belief as to accuracy, and the basis therefore, are misleading and should not be included in official statements. See 1994 Interpretive Release, *supra* note 5, 59 FR 12758 n.103.

<sup>131</sup> See 1988 Proposing Release, *supra* note 128, 53 FR at 37790.

<sup>132</sup> Under the 2008 Amendments, the MSRB is the sole information repository.

material respects, with any previous informational undertakings in the continuing disclosure agreement.<sup>133</sup> When the Commission in 1994 adopted these provisions of the Rule, it stated its belief that the failure of the issuer or other obligated person to comply in all material respects with prior informational undertakings is information that is important to the market, and should, therefore, be disclosed in the final official statement.<sup>134</sup> As the Commission noted at that time, the provision in the Rule regarding disclosure of a prior history of material non-compliance by issuers or other obligated persons with their undertakings was specifically intended to serve as an incentive for them to comply with their undertakings to provide secondary market disclosure.<sup>135</sup> Moreover, such disclosure would assist underwriters and others in assessing the reliability of issuers' or obligated persons' disclosure representations.<sup>136</sup> The Commission continues to believe in the importance of these Rule provisions and would like to remind underwriters of their obligations under Rule 15c2-12.

The Commission previously has stated that, in its view, the reasonableness of a belief in the accuracy and completeness of the key representations in the final official statement, and the extent of a review of the issuer's or other obligated person's situation necessary to arrive at that belief, will depend upon all the circumstances.<sup>137</sup> In both negotiated and competitively bid municipal offerings, the Commission expects, at a minimum, that underwriters will review the issuer's disclosure documents in a professional manner for possible inaccuracies and omissions.<sup>138</sup> The Commission previously has provided a non-exclusive list of factors that it believes generally would be relevant in determining the reasonableness of an underwriter's basis for assessing the truthfulness of key representations in final official statements.<sup>139</sup> These factors include: (1) The extent to which the underwriter relied upon municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts; (2) the role of the underwriter (manager, syndicate member, or selected dealer);

<sup>133</sup> Rule 15c2-12(f)(3), 17 CFR 15c2-12(f)(3).

<sup>134</sup> See 1994 Amendments Adopting Release, *supra* note 5, 59 FR at 59594-5.

<sup>135</sup> *Id.* at 59595.

<sup>136</sup> *Id.*

<sup>137</sup> See 1988 Proposing Release, *supra* note 128, 53 FR at 37789 and 1989 Adopting Release, *supra* note 3, 54 FR 28811-12.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>125</sup> See the comments of participants at the 2001 SEC Municipal Market Roundtable—Secondary Market Disclosure for the 21st Century, (available at <http://www.sec.gov/info/municipal/roundtables/thirdmuniround.htm>). See also E-mail from Peter J. Schmitt, CEO, DPC Data Inc., to SEC, Rule-Comments, dated September 19, 2008, regarding the 2008 Proposed Amendments.

<sup>126</sup> See *e.g.*, 2008 Amendments Adopting Release, *supra* note 11, 73 FR at 76129.

<sup>127</sup> See 1994 Amendments Adopting Release, *supra* note 5, 59 FR at 59594-5.

(3) the type of bonds being offered (general obligation, revenue, or private activity); (4) the past familiarity of the underwriter with the issuer; (5) the length of time to maturity of the bonds; and (6) whether the bonds are competitively bid or are distributed in a negotiated offering.<sup>140</sup> Sole reliance on the representations of the issuer will not suffice.<sup>141</sup>

The Commission has determined further to expound upon its prior interpretations regarding municipal underwriter's responsibilities. As articulated in a prior interpretation, the Commission believes that it is doubtful that an underwriter could form a reasonable basis for relying on the accuracy or completeness of the issuer's or obligated person's ongoing disclosure representations, if such issuer or obligated person has a history of persistent and material breaches or if it has not remedied such past failures by the time the offering commences.<sup>142</sup> The Commission believes that, if the underwriter finds that the issuer or obligated person has on multiple occasions during the previous five years,<sup>143</sup> failed to provide on a timely basis continuing disclosure documents, including event notices and failure to file notices, as required in continuing disclosure agreements for prior offerings, it would be very difficult for the underwriter to make a reasonable determination that the issuer or obligated person would provide such information under a continuing disclosure agreement in connection with a subsequent offering. In the Commission's view, it is doubtful that an underwriter could meet the reasonable belief standard without the underwriter affirmatively inquiring as to that filing history.<sup>144</sup> The underwriter's reasonable belief would be based on its independent judgment, not solely on representations of the issuer or obligated person as to the materiality of any failure to comply with any prior undertaking. If the underwriter finds that the issuer or obligated person has failed to provide such information, the underwriter should take that failure into account in forming its reasonable belief in the accuracy and completeness of

representations made by the issuer or obligated person.

Comment is solicited regarding whether there are alternative or additional ways in which an underwriter could satisfy its obligations, including obligations to ascertain whether issuers or obligated persons are abiding by their municipal disclosure commitments. Commenters should address the current practices used by underwriters to satisfy their "reasonable basis" obligation and any aspects of such practices that could be addressed through further Commission interpretation or rulemaking.

#### IV. Request for Comments

The Commission seeks comment on all aspects of the proposed amendments to the Rule. In addition to the comments requested throughout this release, comment is requested on whether the proposed amendments would further the Commission's goal of enhancing the availability to investors important information regarding municipal securities and their issuers in a prompt manner, and whether the proposed amendments would improve investors' ability to obtain such information. Further, the Commission seeks comment regarding the impact of the proposed amendments on Participating Underwriters, issuers and obligated persons, institutional and individual investors, the MSRB, information vendors, and others that may be affected by the proposed amendments.

In addition, the Commission requests comment on whether there are additional events for which notices should be provided, and alternative approaches or modifications to the Commission's proposed approach to improving the public's ability to obtain important information about municipal securities that the Commission should consider. Commenters are requested to indicate their views and to provide any other suggestions that they may have.

#### V. Paperwork Reduction Act

Certain provisions of the proposed amendments to the Rule contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>145</sup> In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission has submitted revisions to the currently approved collection of information titled "Municipal Securities Disclosure" (17 CFR 240.15c2-12) (OMB Control No. 3235-0372) to OMB. An agency may not conduct or sponsor, and a person is not required to respond

to, a collection of information unless it displays a currently valid control number.

#### A. Summary of Collection of Information

Under paragraph (b) of Rule 15c2-12, a Participating Underwriter currently is required: (1) To obtain and review an official statement "deemed final" by an issuer of the securities, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (2) in non-competitively bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (3) to send, upon request, a copy of the final official statement to potential customers for a specified period of time; (4) to contract with the issuer to receive, within a specified time, sufficient copies of the final official statement to comply with the Rule's delivery requirement, and the requirements of the rules of the MSRB; and (5) before purchasing or selling municipal securities in connection with an offering, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices (*i.e.*, continuing disclosure documents) to the MSRB in an electronic format as prescribed by the MSRB.<sup>146</sup> Under paragraph (c) of the Rule, a broker-dealer that recommends the purchase or sale of a municipal security must have procedures in place that provide reasonable assurance that it will receive prompt notice of any event specified in paragraph (b)(5)(i)(C) of the Rule and any failure to file annual financial information regarding the security.<sup>147</sup>

Under paragraph (d)(1)(iii) of the Rule, a primary offering of municipal securities in authorized denominations of \$100,000 or more is exempt from the Rule, if the securities, at the option of the holder thereof, may be tendered to

<sup>146</sup> As noted above, the Commission recently approved amendments to Rule 15c2-12 that, among other things, established the MSRB as the sole repository for continuing disclosure documents and provided that those documents are to be submitted to the MSRB in an electronic format. See 2008 Amendments Adopting Release, *supra* note 11. Previously, continuing disclosure documents were to be submitted to the NRMSIRs and the appropriate SID, if any. The 2008 Amendments became effective on July 1, 2009. The Commission proposes that the effective date of the proposed amendments discussed herein would be no earlier than three months after the final approval of the proposed amendments, should the Commission adopt them.

<sup>147</sup> 17 CFR 240.15c2-12(c).

<sup>140</sup> *Id.*

<sup>141</sup> See 1988 Proposing Release, *supra* note 128, 53 FR at 37789.

<sup>142</sup> See 1994 Amendments Adopting Release, *supra* note 5, 59 FR at 59595.

<sup>143</sup> 17 CFR 240.15c2-12(f)(3).

<sup>144</sup> The Commission notes that, in light of the adoption of the 2008 Amendments and their effective date of July 1, 2009, for disclosures made on or after July 1, 2009, an underwriter could verify that the information has been submitted electronically to the MSRB.

<sup>145</sup> 44 U.S.C. 3501 *et seq.*

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.<sup>148</sup> These securities are referred to as demand securities or variable rate demand obligations (“VRDOs”). The Commission proposes to modify the exemption for demand securities by adding proposed paragraph (d)(5) to the Rule, which would apply current paragraphs (b)(5) and (c) of the Rule to a primary offering of demand securities in authorized denominations of \$100,000 or more.

Under the current Rule, a Participating Underwriter must reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide an event notice to the MSRB when any of the following events with respect to the securities being offered in an offering occurs, if material: (1) Principal and interest payment delinquencies; (2) non-payment related defaults; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse opinions or events affecting the tax-exempt status of the security; (7) modifications to rights of security holders; (8) bond calls; (9) defeasances; (10) release, substitution, or sale of property securing repayment of securities; and (11) rating changes.<sup>149</sup>

Under the proposed amendments, Participating Underwriters would be required to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide event notices to the MSRB, in an electronic format as prescribed by the MSRB, in a timely manner not in excess of ten business days, rather than only in “a timely manner.” In addition, the Commission proposes to add the following event items to paragraph (b)(5)(i)(C) of the Rule: (1) the 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 the tax-exempt status of the securities; (2) tender offers; (3) bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; (4) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale

of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (5) appointment of a successor or additional trustee, or the change of name of a trustee, if material. Further, the Commission proposes to delete the generally applicable “if material” condition from paragraph (b)(5)(i)(C) of the Rule and instead indicate in specific event items listed in that paragraph whether notice of such event must be made only to the extent that such event is material. In this regard, Participating Underwriters would need to reasonably determine that notice of the following events would be made in all circumstances: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.

#### *B. Proposed Use of Information*

By specifying the time period for submission of event notices, expanding the Rule’s current categories of events, and modifying an exemption in the current Rule used for demand securities, the proposed amendments are intended to promptly make available to broker-dealers, institutional and retail investors, and others important information about significant events relating to municipal securities and their issuers. The proposed amendments would help enable investors and other municipal securities market participants to be better informed about important events that occur with respect to municipal securities and their issuers, including with respect to demand securities, and thus would allow investors to better protect themselves against fraud. In addition, the proposed amendments would provide brokers, dealers, and municipal securities dealers with access to important information about municipal securities that they can use to carry out their obligations under the securities laws. This information could be used by individual and institutional investors; underwriters of municipal securities; other market participants, including broker-dealers and municipal securities dealers; analysts; municipal securities issuers; the MSRB; vendors of information regarding municipal

securities; Commission’s staff; and the public generally.

#### *C. Respondents*

In December 2008, OMB approved a revision to the collection of information associated with the Rule in accordance with 2008 Amendments to the Rule. The current paperwork collection associated with Rule 15c2–12 applies to broker-dealers, issuers of municipal securities, and the MSRB. The paperwork collection associated with today’s proposed amendments applies to the same respondents.

The proposal would require that a Participating Underwriter in a primary offering of municipal securities reasonably determine that the issuer or an obligated person has undertaken in a continuing disclosure agreement to submit event notices in a timely manner not in excess of ten business days of their occurrence to the MSRB, as well as to submit such notices for proposed additional disclosure items. The proposal also would revise the Rule with respect to whether or not a materiality condition would apply to each of the Rule’s specified events prompting submission of notices to the MSRB. In addition, the proposed amendments would revise the Rule with respect to its treatment of demand securities. The Commission gathered updated information regarding the paperwork burden associated with Rule 15c2–12 in connection with the Commission’s adoption of the 2008 Amendments and is using these estimates in preparing the paperwork collection associated with its current proposal. In the 2008 Amendments Adopting Release, the Commission estimated that the number of respondents impacted by the paperwork collection associated with the Rule consists of 250 broker-dealers and 10,000 issuers.<sup>150</sup> The Commission’s staff expects that the proposed amendments would not change the number of broker-dealer respondents described in the 2008 Amendments Adopting Release. The Commission’s staff expects that the proposed amendments would increase the number of issuer respondents in comparison to the Rule’s paperwork current collection, as set forth in the 2008 Amendments Adopting Release. This is because the proposed amendments would expand the types of securities covered under subparagraphs (b)(5) and (c) of the Rule, thus increasing the number of issuers having a paperwork burden. Specifically, the

<sup>148</sup> 17 CFR 240.15c2–12(d)(1)(iii).

<sup>149</sup> 17 CFR 240.15c2–12(b)(5)(i)(C).

<sup>150</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

Commission's staff estimates that the proposed revision of the Rule's exemption for demand securities would increase the number of issuers with a paperwork burden by 2,000 issuers, for a total of 12,000 issuer respondents.<sup>151</sup> The Commission's 2008 Amendments Adopting Release included a paperwork collection burden for the MSRB and, for purposes of the proposed amendments, the Commission's staff expects that the MSRB also would be a respondent.

#### D. Total Annual Reporting and Recordkeeping Burden

In the 2008 Amendments Adopting Release, the Commission included estimates for the hourly burdens that the Rule imposes upon broker-dealers, issuers of municipal securities, and the MSRB. The Commission's staff has relied on these estimates to prepare the analysis discussed below for each of the aforementioned entities.

The Commission's staff estimates the aggregate information collection burden for the amended Rule would consist of the following:

##### 1. Broker-Dealers

The Commission's staff estimates that approximately 250 broker-dealers potentially could serve as Participating Underwriters in an offering of municipal securities.<sup>152</sup> Therefore, the Commission's staff estimates that, under the proposed amendments, the maximum number of broker-dealer respondents would be 250.

##### a. Proposed Amendment To Modify the Exemption for Demand Securities

Under the current Rule, the Commission has estimated that the total annual burden on all 250 broker-dealers is 250 hours (1 hour annually per broker-dealer).<sup>153</sup> The Commission believes that the proposed amendment to modify the exemption from the Rule

<sup>151</sup> In 2008, there were approximately 2,000 offerings of demand securities. See *Two Decades of Bond Finance: 1989–2008*, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., SourceMedia, Inc.) (2009). To provide estimates that would not be under-inclusive, the Commission's staff has elected to assume that all 2,000 offerings of demand securities were issued by separate issuers and that each of those issuers currently is not a party to a continuing disclosure agreement that provides for the submission of continuing disclosure documents to the MSRB. Thus, the Commission's staff estimates that approximately 2,000 additional issuers would be affected by the proposed amendments to the Rule. These 2,000 additional issuers represent a 20% increase in the total number of issuers affected by the Rule.  $10,000$  (number of issuers under current Rule)  $\div$   $2,000$  (number of additional issuers under proposed amendments to the Rule)  $\times$   $100 = 20\%$ .

<sup>152</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>153</sup> *Id.*

for a primary offering of demand securities in authorized denominations of \$100,000 or more, would increase the number of issuers with municipal securities offerings that are subject to the Rule annually by 20%, based on the Commission's staff estimate of the ratio of demand securities outstanding in relation to the municipal security market generally.<sup>154</sup> The Commission's staff estimates that this 20% increase in the number of issuers with offerings subject to the Rule also would increase the estimated average annual burden for each broker-dealer by 20%, or .20 hours (12 minutes = 60 minutes  $\times$  .20 (20%)) and the total estimated annual paperwork burden for all broker-dealers by 20%, or 50 hours.<sup>155</sup> This increased burden represents the estimated additional time broker-dealers would need annually to review the continuing disclosure agreements associated with the additional municipal securities offerings that would be subject to the amended Rule. As discussed in more detail below,<sup>156</sup> the Commission notes that the continuing disclosure agreements that are reviewed by broker-dealers as part of their obligation under the Rule are form agreements. The proposed changes to the Rule would result in minor changes to certain provisions of these continuing disclosure agreements. However, because these continuing disclosure agreements are form agreements, the Commission does not believe that there would be a substantial increase in the annual hourly burden for broker-dealers under the proposed amendments to the Rule. Accordingly, the Commission's staff estimates that 250 broker-dealers would incur an estimated average burden of 300 hours per year to comply with the Rule, as proposed to be amended.<sup>157</sup>

##### b. Proposed Amendments to Events To Be Disclosed Under a Continuing Disclosure Agreement

The proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would not alter a broker-dealer's obligation to reasonably determine that the issuer or obligated

<sup>154</sup> See *supra* note 151.

<sup>155</sup>  $250$  hours (total annual burden for all broker-dealers under the current Rule)  $\times$   $.20$  (20% increase in total hourly burden) =  $50$  hours. This estimated increase in the annual burden for broker-dealers also accounts for their review of continuing disclosure agreements in connection with remarketings of VRDOs that are primary offerings.

<sup>156</sup> See Section V.D.2., *infra*.

<sup>157</sup>  $250$  hours (total estimated annual hourly burden for all broker-dealers under the current Rule) +  $50$  hours (total estimated additional annual hourly burden for all broker-dealers under the proposed amendments to the Rule) =  $300$  hours.

person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB. As described above, the proposed amendments to paragraph (b)(5)(i)(C) of the Rule would add four new event disclosure items to the Rule, as well as amend an existing event disclosure item currently contained in the Rule, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would change the timing for filing event notices from "in a timely manner" to "in a timely manner not to exceed ten business days." The Commission believes that these amendments would not change the obligation of broker-dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB.<sup>158</sup> Accordingly, the Commission does not believe that the proposed amendments relating to the timing and scope of event notices would affect the annual paperwork burden for broker-dealers.

##### c. One-Time Paperwork Burden

The Commission's staff estimates that a broker-dealer would incur a one-time paperwork burden to have its internal compliance attorney prepare and issue a notice advising its employees about the proposed revisions to Rule 15c2–12, if they are adopted by the Commission. In the 2008 Amendments Adopting Release, the Commission estimated that it would take a broker-dealer's internal compliance attorney approximately 30 minutes to prepare and issue a notice describing the broker-dealer's obligations in light of the 2008 Amendments to the Rule.<sup>159</sup> The Commission's staff believes that this 30 minute estimate to prepare a notice would also apply to a broker-dealer's internal compliance attorney to prepare such a notice for these current amendments to the Rule. The Commission's staff believes that the task of preparing and issuing a notice

<sup>158</sup> The Commission notes that while the proposed amendments to the Rule do not change this obligation, broker-dealers would need to reasonably determine that the written agreement or contract entered into by an issuer or obligated person contains the proposed change to the timing for filing event notices.

<sup>159</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

advising the broker-dealer's employees about the proposed amendments, if they are adopted, is consistent with the type of compliance work that a broker-dealer typically handles internally.

Accordingly, the Commission's staff estimates that 250 broker-dealers would each incur a one-time, first-year burden of 30 minutes to prepare and issue a notice to its employees regarding the broker dealer's obligations under the proposed amendments.

#### d. Total Annual Burden for Broker-Dealers

Under the proposed amendments, the total burden on broker-dealers would be 425 hours for the first year<sup>160</sup> and 300 hours for each subsequent year.<sup>161</sup>

#### 2. Issuers

Issuers' undertakings regarding the submission of annual filings, event notices, and failure to file notices that are set forth in continuing disclosure agreements contemplated by the existing Rule, as well as the proposed amendments to the Rule, impose a paperwork burden on issuers of municipal securities.

##### a. Proposed Amendment To Modify the Exemption for Demand Securities

The Commission's staff believes that the proposed amendment to delete paragraph (d)(1)(iii) from the Rule, which contains an exemption from the Rule for a primary offering of demand securities in authorized denominations of \$100,000 or more, and add new paragraph (d)(5) to the Rule to apply paragraphs (b)(5) and (c) of the Rule to a primary offering of demand securities in authorized denominations of \$100,000 or more, would increase the number of issuers with a paperwork burden under the Rule. In the 2008 Amendments Adopting Release, the Commission estimated that the Rule affected approximately 10,000 issuers.<sup>162</sup> Using the estimate of 10,000 issuers from the 2008 Amendments Adopting Release, the Commission's staff estimates that, under the proposed amendments, the number of issuers with a paperwork burden would increase by approximately 20%<sup>163</sup> to

<sup>160</sup> (250 (broker-dealers impacted by the proposed amendments to the Rule) × 1.20 hours) + (250 (broker-dealers impacted by the proposed amendments to the Rule) × .5 hour (estimate for one-time burden to issue notice regarding broker-dealer's obligations under the proposed amendments to the Rule)) = 425 hours.

<sup>161</sup> 250 (broker-dealers impacted by the proposed amendments to the Rule) × 1.20 hours = 300 hours.

<sup>162</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>163</sup> See *supra* note 151.

12,000 issuers.<sup>164</sup> These additional issuers would increase the aggregate number of annual filings, event notices and failure to file notices submitted each year. In the 2008 Amendments Adopting Release, the Commission estimated the hourly burdens for an issuer to prepare and submit an annual filing (45 minutes), an event notice (45 minutes) and a failure to file notice (30 minutes).<sup>165</sup> The proposed modification to the Rule's exemption for demand securities would not alter these hourly burdens. Thus, the Commission's staff estimates that the aggregate number of annual filings, event notices and failure to file notices submitted by issuers also would increase by 20% from the estimates contained in the 2008 Amendments Adopting Release.<sup>166</sup>

##### (i) Annual Filings

In the 2008 Amendments Adopting Release, the Commission estimated that Rule 15c2-12 imposed a total paperwork burden of 11,250 hours on 10,000 issuers to prepare and submit annual filings in any given year.<sup>167</sup> In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that issuers would prepare and submit a total of approximately 15,000 annual filings yearly.<sup>168</sup> Under the proposed amendment to modify the current exemption for demand securities contained in the Rule, the Commission's staff estimates that 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 18,000 annual filings yearly.<sup>169</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit annual filings to the MSRB in an electronic format would require

<sup>164</sup> 10,000 (number of issuers under current Rule) 1.20 (20% increase) = 12,000. To provide estimates that would not be under-inclusive, the Commission's staff has elected to use an estimate that assumes that all issuers of demand securities currently are not a party to a continuing disclosure agreement that provides for the submission of continuing disclosure documents to the MSRB.

<sup>165</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>166</sup> The Commission's staff believes that this estimated 20% increase in the number of each type of continuing disclosure document filed by issuers is appropriate since it maintains the same ratio between the number of issuers and the number of each type of document submitted by these issuers as set forth in the 2008 Amendments Adopting Release.

<sup>167</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>168</sup> *Id.*

<sup>169</sup> 15,000 (annual filings under 2008 Amendments Adopting Release) × 1.20 (20% increase in filings under proposed amendments) = 18,000 annual filings.

approximately 45 minutes.<sup>170</sup> The proposed amendments to the Rule would not change the way annual filings are prepared and submitted. The Commission's staff estimates that, under the proposed amendments, an issuer would still require approximately 45 minutes to prepare and submit annual filings to the MSRB in an electronic format. Therefore, under the proposed amendments, the total burden on issuers of municipal securities to prepare and submit 18,000 annual filings to the MSRB in an electronic format is estimated to be 13,500 hours.<sup>171</sup>

##### (ii) Event Notices

In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that issuers would prepare and submit a total of approximately 60,000 event notices yearly.<sup>172</sup> Under the proposed amendments to modify the exemption for demand securities contained in the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 72,000 event notices yearly.<sup>173</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit event notices to the MSRB in an electronic format would require approximately 45 minutes.<sup>174</sup> Since the proposed amendments to the Rule would not change the way event notices are prepared and submitted, the Commission's staff estimates that, under today's proposed amendments, an issuer still would require approximately 45 minutes to prepare and submit an event

<sup>170</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>171</sup> 18,000 (estimated number of annual filings under proposed amendments) × .75 hours (45 minutes) (estimated time to prepare and submit annual filings under the 2008 Amendments Adopting Release) = 13,500 hours. To provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff elected to use the higher end of the estimate for the total number of annual filings estimated to be submitted each year.

<sup>172</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>173</sup> 60,000 (number of event notices under 2008 Amendments Adopting Release) × 1.20 (20% increase in filings under proposed amendments) = 72,000 event notices. The Commission's staff's estimates of the additional event notices associated with the proposed amendments relating to the materiality condition and additional event disclosure items contained in paragraph (b)(5)(1)(C) of the Rule are discussed in Sections V.D.2.a.iii. through vii. *infra*. As discussed below, the total number of event notices estimated to be submitted to the MSRB in connection with the proposed amendments is 78,757 notices.

<sup>174</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

notice. Therefore, under today's proposed amendments relating to demand securities, the total burden on issuers of municipal securities to prepare and submit 72,000 event notices to the MSRB is estimated to be 54,000 hours.<sup>175</sup>

### (iii) Failure To File Notices

In the 2008 Amendments Adopting Release, the Commission estimated that Rule 15c2-12 currently imposes a total paperwork burden of 1,000 hours on 10,000 issuers to submit failure to file notices in any given year.<sup>176</sup> In determining the paperwork burden for issuers under the 2008 Amendments Adopting Release, the Commission estimated that 10,000 issuers would prepare and submit a total of approximately 2,000 failure to file notices yearly.<sup>177</sup> Under the proposed amendment to modify the exemption for demand securities contained in the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure agreements would prepare and submit approximately 2,400 failure to file notices yearly.<sup>178</sup>

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to submit failure to file notices would require approximately 30 minutes.<sup>179</sup> Since the proposed amendments to the Rule would not change the way failure to file notices are prepared and submitted, the Commission's staff estimates that, under today's proposed amendments, an issuer would require approximately 30 minutes to prepare and submit a failure to file notice. Therefore, under the proposed amendments, the total burden on issuers of municipal securities to prepare and submit 2,400 failure to file notices to the MSRB is estimated to be 1,200 hours.<sup>180</sup>

### b. Proposed Amendments to Event Notice Provisions of the Rule

The Commission proposes to modify paragraph (b)(5)(i)(C) of the Rule, which presently requires Participating Underwriters to reasonably determine

that an issuer or obligated person has entered into a continuing disclosure agreement that, among other things, contemplates the submission of an event notice to the MSRB in an electronic format upon the occurrence of any events set forth in the Rule, if such event is material. The current Rule contains eleven such events. The proposed amendments to this paragraph of the Rule would add four new event disclosure items and revise an existing event disclosure item. In addition, the proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) would revise the Rule to state that event notices should be submitted in a timely manner "not to exceed ten business days after the occurrence of the event," rather than simply in a timely manner, as set forth in the current Rule, and would apply to some (but not all) events the materiality condition that applies to the current eleven events. In the 2008 Amendments Adopting Release, the Commission estimated that 60,000 event notices would be prepared and submitted annually. As described above, the Commission's staff estimates that the proposed amendments to modify the Rule's exemption for demand securities would increase the number of event notices to be prepared and submitted to 72,000 annually.<sup>181</sup> The Commission's staff believes that these proposed amendments to paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule would further increase the current annual paperwork burden for issuers because they would result in an increase in the number of event notices to be prepared and submitted.<sup>182</sup>

#### (i) Time Frame for Submitting Event Notices Under a Continuing Disclosure Agreement

Currently, paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule state that notice of an event should be provided in "a timely manner." The proposed amendment would revise these provisions to state that such notice should be provided "in a timely manner not in excess of ten business days after the occurrence of the event." As noted above, the Commission's staff estimates that an issuer can prepare and submit an event notice in 45 minutes, which is the hourly burden noted in the 2008 Amendments Adopting Release.<sup>183</sup> The proposed revision to the Rule regarding the time period for submission of event notices would not change this estimated burden of 45 minutes, which is the amount of time under the Rule's current

paperwork collection to prepare and submit event notices. Rather, the change in burden hours results from the fact that more event notices are expected to be filed under the proposed amendments. The Commission's staff believes that the proposed change to "not in excess of ten business days after the occurrence of the event" to submit a event notice would not affect the length of time it takes an issuer to prepare and submit the notice and thus would not have any impact on the current paperwork burden with respect to the length of time it would take an issuer to prepare and submit an event notice.

#### (ii) Modification With Regard to Those Events for Which a Materiality Determination Is Necessary

As discussed earlier, the Commission believes that it is appropriate to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of all of the listed events need be made only "if material." In connection with the proposed deletion of the materiality condition, the Commission has reviewed each of the Rule's current specified events to determine whether a materiality determination should be retained for that particular event and preliminarily believes such a determination is still appropriate for certain listed events.<sup>184</sup> As a result of this proposed change, for those events listed in paragraph (b)(5)(i)(C) that are not proposed to contain the "if material" condition, the Participating Underwriter must reasonably determine that the issuer or other obligated person has agreed to submit event notices to the MSRB whenever such an event occurs. These events include: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.<sup>185</sup> The Commission, however, believes that for other events currently listed in paragraph (b)(5)(i) a materiality determination should be retained.

<sup>184</sup> The discussion in this section pertains to materiality determinations for events currently specified in paragraph (b)(5)(i)(C) of the Rule. For events proposed to be added to the Rule, whether a materiality determination is specified is included in the discussion below for each such proposed event.

<sup>185</sup> See *supra* Section II.C. for a discussion of the Commission's rationale regarding why the Commission proposes not to retain a materiality condition for these events.

<sup>175</sup> 72,000 (estimated number of material event notices under proposed amendments) × .75 hours (45 minutes) (estimated time to prepare and submit material event notices under the 2008 Amendments Adopting Release) = 54,000 hours.

<sup>176</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>177</sup> *Id.*

<sup>178</sup> 2,000 (failure to file notices) × 1.20 (20% increase in filings) = 2,400 failure to file notices.

<sup>179</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>180</sup> 2,400 (estimated number of failure to file notices under proposed amendments) × .5 hours (30 minutes) (estimated time to prepare and submit failure to file notices under the 2008 Amendments Adopting Release) = 1,200 hours.

<sup>181</sup> See *supra* note 173.

<sup>182</sup> *Id.*

<sup>183</sup> See *supra* note 174 and accompanying text.

In a telephone conversation between the Commission's staff and MSRB staff on June 12, 2009, Commission staff was advised that the increase in the number of event notices in connection with the proposal to modify the materiality condition would result in an increase of no more than 1,000 event notices, taking into account the increase in event notices that would result from the proposed amendment relating to demand securities.<sup>186</sup> Therefore, the Commission's staff estimates that this proposed change to the materiality condition would increase the total number of event notices to be submitted annually by issuers by 1,000 notices.

(iii) Amendment to the Submission of Event Notices Regarding Adverse Tax Events Under a Continuing Disclosure Agreement

Subparagraph (b)(5)(i)(C)(6) of the Rule refers to an event notice in the case of adverse tax events. Under the proposed amendments, subparagraph (b)(5)(i)(C)(6) of the Rule would be amended to include "the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities." This proposed amendment would address the circumstances in which issuers would submit an event notice to the MSRB with respect to IRS determinations of taxability or other material notices or determinations with respect to the tax status of a municipal security. As discussed above,<sup>187</sup> the Commission believes that the proposed amendment to subparagraph (b)(5)(i)(C)(6) of the Rule would clarify that IRS determinations of taxability or other material notices or determinations with respect to the tax status of a municipal security are events that currently should be disclosed under a continuing disclosure agreement. The Commission's staff estimates that the proposed amendments to paragraph (b)(5)(i)(C)(6) of the Rule would increase the total number of event notices to be submitted by issuers annually by approximately 130 notices.<sup>188</sup>

<sup>186</sup> Telephone conversation between Ernesto A. Lanza, General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, June 12, 2009. The MSRB staff believes that the potential increase could be much smaller; however, the Commission's staff is using the estimate of 1,000 event notices to provide a conservative estimate.

<sup>187</sup> See *supra* Section II.C.

<sup>188</sup> During conversations with the Commission's staff in December 2008, the staff of the IRS indicated that during a 12-month period it issues approximately 130 notices of determinations of

(iv) Tender Offers

Subparagraph (b)(5)(i)(C)(8) of the Rule refers to notice of an event in the case of bond calls. Under the proposed amendments, subparagraph (b)(5)(i)(C)(8) of the Rule would be amended to include tender offers. The inclusion of tender offers in this subparagraph of the Rule would expand the circumstances in which issuers would submit an event notice to the MSRB. The Commission's staff estimates that proposed amendments to subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices to be submitted by issuers annually by approximately 100 notices.<sup>189</sup>

(v) The Occurrence of Bankruptcy, Insolvency, Receivership or Similar Event Regarding an Issuer or an Obligated Person

Under the proposed amendments, subparagraph (b)(5)(i)(C)(12) would be added to the Rule and would contain a new disclosure event in the case of bankruptcy, insolvency, receivership or similar event of the issuer or obligated person. The proposed addition to the Rule of bankruptcy, insolvency, receivership or similar event of the issuer or obligated person would expand the circumstances in which issuers would submit an event notice. Based on a review of industry sources by the Commission's staff, the Commission's staff estimates that the proposed amendment to add the new bankruptcy, insolvency, receivership or similar event of the issuer or obligated person in subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 24 notices.<sup>190</sup>

taxability. To provide an estimate that is not under-inclusive, the Commission's staff has estimated that event notices are not currently submitted for any of these IRS notices. Accordingly, the Commission's staff estimates that approximately 130 additional event notices would be submitted under the proposed amendments to subparagraph (b)(5)(i)(C)(6) of the Rule.

<sup>189</sup> Based on industry sources that included lawyers, trade associations and vendors of municipal disclosure information, the Commission's staff has estimated that there are typically no more than 100 tender offers annually in the municipal securities market. The Commission's staff believes that the actual number of tender offers annually is significantly less than 100. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff has elected to use the higher end of the estimate with respect to the number of municipal tender offers that occur each year.

<sup>190</sup> The Commission's staff based this estimate on the following: (i) 917 (number of issuances of municipal securities that defaulted during the 1990's based on statistics contained in Standard

(vi) Merger, Consolidation, Acquisition, and Sale of All or Substantially All Assets

Under the proposed amendments, subparagraph (b)(5)(i)(C)(13) would be added to the Rule and would contain a new disclosure event in the case of a merger, consolidation, acquisition involving an obligated person or sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material. The proposed addition to the Rule of the merger, consolidation, acquisition, or sale of all or substantially all of the assets to the Rule would expand the circumstances in which issuers would submit an event notice. The Commission's staff believes that the proposed amendment to add the new event of merger, consolidation, acquisition, or sale of all or substantially all of the assets in subparagraph (b)(5)(i)(C)(13) of the Rule would increase the total number of event notices submitted by issuers annually. Based on a review of industry sources, the Commission's staff estimates that the proposed amendment to add the new bankruptcy, insolvency, receivership or similar event of the issuer or obligated person in subparagraph (b)(5)(i)(C)(8) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 1,783 notices.<sup>191</sup>

and Poor's "A Complete Look at Monetary Defaults in the 1990s" (June, 2000)/10 (number of years in a decade) = 91.7 (estimated number of issuances defaulting per year) (rounded to 92); (ii) 92 (estimated number of issuances defaulting per year)/50,000 (estimated total number of municipal issuers) = .002 (.2%) (estimated percentage of all issuers that default annually); and (iii) 12,000 (estimated number of issuers under proposed amendments to the Rule) × (.002) (.2%) (estimated percentage of all issuers that default annually) × 1 (estimated number of material event notices that an issuer would file) = 24 notices. The Commission's staff notes that not all issuers that default eventually enter bankruptcy. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission staff has elected to use the number of defaults as a basis for this estimate.

<sup>191</sup> The Commission's staff based this estimate on the following: (i) 2,201 (total number of merger transactions reported under the Hart-Scott-Rodino Act in 2007 contained in the *Hart-Scott-Rodino Annual Report Fiscal Year 2007* (November 2008) available at <http://www.ftc.gov/os/2008/11/hsrreportfy2007.pdf> ("HSR Report")) × 81% (percentage of mergers in industries in which municipal securities may exist) = 1782.81 notices (rounded to 1783). The Commission staff estimated the percentage of mergers in the municipal industry based on data contained in the HSR Report. The

## (vii) Successor or Additional Trustee, or Change in Trustee Name

Under the proposed amendments, paragraph (b)(5)(i)(C)(14) would be added to the Rule and would contain a new disclosure event related to the appointment of a successor or additional trustee or the change of name of a trustee, if material. The proposed addition to the Rule of the event relating to trustee changes would expand the circumstances in which issuers would submit an event notice to the MSRB. The Commission's staff believes that a change affecting the largest trustee of municipal securities would provide a reasonable estimate of the number of additional event notices that would be submitted annually under this proposed amendment to the Rule. The largest trustee covered approximately 31% of the municipal issuances in 2008.<sup>192</sup> The Commission's staff believes that this percentage represents a reasonable estimate of the percentage of issuers covered by the largest trustee. Thus, the Commission's staff estimates that a change to the largest trustee would cover approximately 31% of issuers, or 3,720 issuers, which would serve as a conservative proxy for the number of event notices to be submitted regarding a change in trustee.<sup>193</sup> Therefore the Commission's staff estimates that the proposed amendment to add the new disclosure event contained in paragraph (b)(5)(i)(C)(14) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 3,720 notices.<sup>194</sup>

HSR Report contained data regarding the percentage of merger transactions reported from nine industry segments. Of these nine segments, the only segment that does not issue municipal securities is the banking and insurance industry segment which accounted for 19% of reported merger transactions. The Commission notes that each of the mergers reported under the other industry segments may not involve entities that have issued municipal securities. However, to provide an estimate that is not under-inclusive, the Commission's staff has estimated that all of the reported mergers in the remaining industry segments would involve entities that have issued municipal securities.

<sup>192</sup> See *Two Decades of Bond Finance: 1989–2008*, The Bond Buyer/Thomson Reuters 2009 Yearbook 7 (Matthew Kreps ed., SourceMedia, Inc.) (2009) and *Top 50 Trustee Banks: 2008*, The Bond Buyer/Thomson Reuters 2009 Yearbook 89 (Matthew Kreps ed., SourceMedia, Inc.) (2009).

<sup>193</sup> The Commission's staff based this estimate on the following: 12,000 (estimated number of issuers under proposed amendments) × .31 (31%) (estimated percentage of issuers that would be impacted by a change to the largest trustee of municipal securities) = 3,720 issuers.

<sup>194</sup> The Commission's staff based this estimate on the following: 3,720 (estimated number of issuers that would be impacted by a change to the largest trustee of municipal securities) × 1 (estimated number of event notices that an issuer would file) = 3,720 notices. The Commission staff believes that the actual number of changes involving the trustee

## c. Total Burden on Issuers for Proposed Amendments to Event Notices

In the 2008 Amendments Adopting Release, the Commission estimated that the process for an issuer to prepare and submit event notices to the MSRB in an electronic format would require approximately 45 minutes.<sup>195</sup> As discussed above, under the proposed amendment to modify the Rule's exemption for demand securities, the total number of issuers affected by the Rule would increase to 12,000, the total number of event notices submitted by issuers would increase to 72,000, and the annual paper work burden for issuers to submit event notices would increase to 54,000 hours. Under the proposed amendments to paragraph (b)(5)(i)(C) of the Rule, the Commission's staff estimates that the 12,000 municipal issuers with continuing disclosure agreements would prepare an additional 6,757 event notices annually,<sup>196</sup> raising the total number of event notices prepared by issuers annually to approximately 78,757.<sup>197</sup> This increase in the number of event notices would result in an increase of 5,068 hours in the annual paperwork burden for issuers to submit event notices.<sup>198</sup> This increase would result in an annual paperwork burden for issuers to submit event notices of approximately 59,068 hours (54,000 hours + 5,068 hours).

that occur annually is significantly less than 3,720. However, to provide an estimate for the paperwork burden that would not be under-inclusive, the Commission's staff has elected to use an estimate that takes into account a change involving the largest trustee.

<sup>195</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>196</sup> 1000 (estimated number of additional notices submitted under change to events materiality condition) + 130 (estimated number of adverse tax event notices under proposed amendments) + 100 (estimated number of tender offers event notices under proposed amendments) + 24 (estimated number of bankruptcy/insolvency event notices under proposed amendments) + 1,783 (estimated number of merger or acquisition event notices under proposed amendments) + 3,720 (estimated number of appointment/change of trustee event notices under proposed amendments) = 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule).

<sup>197</sup> 72,000 (number of event notices under proposed amendments modifying the exemption for demand securities exemption) + 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) = 78,757 event notices.

<sup>198</sup> 6,757 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) × .75 hours (45 minutes) (estimated time to prepare an event notice under 2008 Amendments Adopting Release) = 5,067.75 hours (rounded to 5,068 hours).

## d. Total Burden for Issuers

Accordingly, under the proposed amendments, the total burden on issuers to submit annual filings, event notices and failure to file notices would be 73,768 hours.<sup>199</sup>

## 3. MSRB

In the 2008 Amendments Adopting Release, the Commission estimated that the MSRB incurred an annual burden of approximately 7,000 hours to collect, index, store, retrieve, and make available the pertinent documents under the Rule.<sup>200</sup> As discussed above, the Commission's staff anticipates that the proposed amendments to modify the Rule's exemption for demand securities would increase filings submitted by approximately 20% annually.<sup>201</sup> In addition, the Commission's staff estimates that the proposed amendments to the event notice provisions of the Rule would increase filings submitted by approximately an additional 9% annually.<sup>202</sup> Accordingly, the Commission's staff estimates that the total burden on the MSRB of collecting, indexing, storing, retrieving and disseminating information requested by the public also would increase by approximately 29% or 2,030 hours (7,000 hours × .29). Thus, the Commission's staff estimates that the total burden on the MSRB to collect, store, retrieve, and make available the disclosure documents covered by the proposed amendments to the Rule would be 9,030 hours annually.<sup>203</sup>

## 4. Annual Aggregate Burden for Proposed Amendments

The Commission's staff estimates that the ongoing annual aggregate information collection burden for the proposed amendments to the Rule would be 83,098 hours.<sup>204</sup>

<sup>199</sup> 13,500 hours (estimated burden for issuers to submit annual filings) + 59,068 hours (estimated burden for issuers to submit event notices) + 1,200 hours (estimated burden for issuers to submit failure to file notices) = 73,768 hours.

<sup>200</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>201</sup> See *supra* note 151.

<sup>202</sup> 6,757 (estimated additional event notices under the proposed event notice amendments)/77,000 (estimated number of continuing disclosure documents submitted under current Rule (60,000 (event notices) + 15,000 (annual filings) + 2,000 (failure to file notices) = 77,000)) = .087 × 100 = approximately 9%.

<sup>203</sup> Annual burden for MSRB: 7000 hours (annual burden under 2008 Amendments Adopting Release) + 2,030 hours (additional hourly burden under proposed amendments) = 9,030 hours.

<sup>204</sup> 300 hours (total estimated burden for broker-dealers) + 73,768 hours (total estimated burden for issuers) + 9,030 hours (total estimated burden for MSRB) = 83,098 hours. The initial first-year burden would be 83,223 hours: 425 hours (total estimated burden for broker-dealers in the first year) + 73,768

### E. Total Annual Cost Burden

#### 1. Broker-Dealers and the MSRB

The Commission does not expect broker-dealers to incur any additional external costs associated with the proposed amendments to the Rule since the proposed amendments do not change the obligation of broker-dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices to the MSRB.

The Commission believes that the MSRB may incur costs to modify the indexing system in its EMMA system to accommodate the proposed changes to the Rule that would add additional material disclosure events. Based on information provided to the Commission's staff by MSRB staff in a telephone conversation on November 7, 2008, the MSRB staff estimated that the MSRB's costs to update its EMMA system to accommodate the proposed changes to the material disclosure events of the Rule would be no more than approximately \$10,000.<sup>205</sup>

#### 2. Issuers

##### (a) Current Issuers

The Commission expects that some issuers that currently submit continuing disclosure documents to the MSRB in an electronic format (referred to herein as "current issuers") could be subject to some additional costs associated with the proposed amendments to the Rule. For current issuers that convert their annual filings, event notices and/or failure to file notices into the MSRB's prescribed electronic format through a third party there would be costs associated with any additional submissions of event notices and failure to file notices.

The cost for an issuer to have a third-party vendor convert paper continuing disclosure documents into the MSRB's prescribed electronic format could vary depending on what resources are required to transfer the documents into the appropriate electronic format. One example of such a transfer would be the scanning of paper-based continuing disclosure documents into an electronic format. In the 2008 Amendments Adopting Release, the Commission

hours (total estimated burden for issuers) + 9,030 hours (total estimated burden for MSRB) = 83,223 hours.

<sup>205</sup> Telephone conversation between Harold Johnson, Deputy General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, November 7, 2008.

estimated that the cost for an issuer to have a third-party vendor scan documents would be \$6 for the first page and \$2 for each page thereafter.<sup>206</sup> In the 2008 Amendments Adopting Release, the Commission also estimated that event notices and failure to file notices consist of one to two pages.<sup>207</sup> Accordingly, the approximate cost for an issuer to use a third party vendor to scan an event notice or failure to file notice would be \$8 per notice. The Commission believes these estimates are still accurate. In the 2008 Amendments Adopting Release, the Commission estimated that the high end of the estimate for the number of event notices submitted by an issuer annually is three.<sup>208</sup> Under the proposed amendments to the Rule, some current issuers would need to prepare additional event notices for submission to the MSRB. Some current issuers could need to submit these additional event notices to a third party to convert into an electronic format for submission to the MSRB. Under the proposed amendments to the Rule, the Commission's staff estimates that a conservative estimate of the number of additional event notices that an issuer would need to submit annually under the proposed amendments would be one, increasing the total estimate to four.<sup>209</sup> Each of these issuers would incur an annual cost of \$8 to convert the additional event notice into an electronic format for submission to the MSRB.<sup>210</sup> The Commission believes that current issuers that already have the technology resources to convert continuing disclosure documents into an electronic format for submission to the MSRB would not incur any additional external costs associated with the proposed amendments to the Rule.

There may be some costs incurred by issuers to revise their current template for continuing disclosure agreements to reflect the proposed amendments to the Rule, if they are adopted. The

<sup>206</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

<sup>209</sup> 6,757 (estimated additional event notices submitted under proposed amendments to event notices)/12,000 (estimated number of issuers under proposed amendments) = .563 notices per issuer (rounded up to 1) (estimated number of additional event notices submitted annually per issuer). To provide an estimate that would not be under-inclusive, the Commission's staff has elected to use an estimate that expects each issuer would submit one additional event notice as a result of the proposed amendments.

<sup>210</sup> \$8 (cost to have third party convert an event notice or failure to file notice into an electronic format) × 1 (maximum estimated number of additional event or failure to file notices filed per year per issuer) = \$8.

Commission understands that models currently exist for continuing disclosure agreements that are relied upon by legal counsel to issuers and, accordingly, these documents are likely to be updated by outside attorneys to reflect the proposed amendments, if the Commission should adopt them. Based on a review of industry sources, the Commission believes that continuing disclosure agreements are form agreements. Based on a review of industry sources, the Commission's staff estimates that it would take an outside attorney approximately 15 minutes to revise the template for continuing disclosure agreements for a current issuer, if the proposed amendments are adopted. Thus, the Commission's staff estimates that the approximate cost of revising a continuing disclosure agreement to reflect the proposed amendments for each current issuer would be approximately \$100,<sup>211</sup> for a one-time total cost of \$1,000,000<sup>212</sup> for all current issuers, if an outside counsel were used to revise the continuing disclosure agreement.

##### (b) VRDO Issuers

As discussed above, the Commission's staff estimates that the proposal relating to demand securities would increase the number of issuers affected by the Rule by approximately 20% or 2,000 issuers (referred to herein as "VRDO issuers"). VRDO issuers may have some external costs associated with the preparation and submission of annual filings, event notices and failure to file notices. Under the Rule, Participating Underwriters are required to reasonably determine that an issuer has entered into a continuing disclosure agreement to provide continuing disclosure documents to the MSRB in an electronic format as prescribed by the MSRB. Under the proposed amendments to the Rule, Participating Underwriters of VRDO issuers would need to reasonably determine that these VRDO issuers have entered into continuing disclosure agreements. The Commission understands that models currently exist for continuing disclosure agreements that are relied upon by legal counsel to issuers and, accordingly, these documents are likely to be updated by

<sup>211</sup> 1 (continuing disclosure agreement) × \$400 (hourly wage for an outside attorney) × .25 hours (estimated time for outside attorney to revise a continuing disclosure document in accordance with the proposed amendments to the Rule) = \$100. The \$400 per hour estimate for an outside attorney's work is based on the Commission's staff review of industry sources.

<sup>212</sup> \$100 (estimated cost to revise a continuing disclosure agreement in accordance with the proposed amendments to the Rule) × 10,000 (number of current issuers) = \$1,000,000.

outside attorneys to reflect the proposed amendments, if the Commission should adopt them. Based on a review of industry sources, the Commission believes that continuing disclosure agreements are form agreements. Also, based on a review of industry sources, the Commission's staff estimates that it would take an outside attorney approximately 1.5 hours to draft a continuing disclosure agreement. Thus, the Commission's staff estimates that the approximate cost of preparing a continuing disclosure agreement for each VRDO issuer would be approximately \$600,<sup>213</sup> for a one-time total cost of \$1,200,000<sup>214</sup> for all VRDO issuers, if an outside counsel were to prepare the entire agreement.

The Commission believes that VRDO issuers generally would not incur any other external costs associated with the preparation of annual filings, event notices (including those notices for the new event disclosure items included in the proposed amendments) and failure to file notices. The Commission believes that VRDO issuers would prepare the information contained in these continuing disclosure documents internally and that these internal costs have been accounted for in the hourly burden section above.<sup>215</sup>

The Commission believes that the only external costs VRDO issuers could incur in connection with the submission of continuing disclosure documents to the MSRB would be the costs associated with converting them into an electronic format. The Commission believes that many issuers of municipal securities currently have the computer equipment and software necessary to convert paper copies of continuing disclosure documents to electronic copies and to electronically transmit the documents to the MSRB. VRDO issuers that presently do not have the ability to prepare their annual filings, event notices and/or failure to file notices in an electronic format could incur some costs to obtain electronic copies of such documents if they are prepared by a third party (e.g., accountant or attorney) or, alternatively, to have a paper copy converted into an electronic format. These costs would vary depending on how the VRDO issuer elected to convert its continuing disclosure documents into an electronic

format. An issuer could elect to have a third-party vendor transfer its paper continuing disclosure documents into the appropriate electronic format. An issuer also could decide to undertake the work internally, and its costs would vary depending on the issuer's current technology resources. An issuer also could elect to use a designated agent to submit its continuing disclosure documents to the MSRB. In the 2008 Amendments Adopting Release, the Commission estimated that 30% of issuers would elect to use designated agents to submit continuing disclosure documents to the MSRB.<sup>216</sup> Generally, when issuers utilize the services of a designated agent, they enter into a contract with the agent for a package of services, including the submission of continuing disclosure documents, for a single fee. Based on a review of industry sources, the Commission's staff estimates this fee to range from \$100 to \$500 per year depending on which designated agent an issuer uses.<sup>217</sup> Accordingly, the Commission's staff estimates that the high end of the total annual cost that could be incurred by VRDO issuers that use the services of a designated agent would be approximately \$300,000.<sup>218</sup>

The cost for an issuer to have a third-party vendor transfer its paper continuing disclosure documents into an appropriate electronic format could vary depending on what resources are required to transfer the documents into the appropriate electronic format. One example of such a transfer would be the scanning of paper-based continuing disclosure documents into an electronic format. In the 2008 Amendments Adopting Release, the Commission estimated that the approximate cost for an issuer to use a third party vendor to scan an event notice or failure to file notice would be \$8 per notice, and that the maximum number of event notices or failure to file notices that an issuer would submit annually is three.<sup>219</sup> The Commission still believes these estimates are accurate. Under the proposed amendments to the Rule, the

Commission's staff estimates that the maximum number of event notices and failure to file notices submitted by issuers would increase to four.<sup>220</sup> Accordingly, the Commission's staff estimates that the maximum external costs for a VRDO issuer who elects to have a third-party scan continuing event notices or failure to file notices into an electronic format under the proposed amendments would be \$32.<sup>221</sup> In the 2008 Amendments Adopting Release, the Commission estimated that the approximate cost for an issuer to use a third party vendor to scan an average-sized annual financial statement would be \$64 per annual statement, and that the maximum number of annual filings submitted per year is two.<sup>222</sup> The Commission believes that these estimates are still accurate. The proposed amendments to the Rule would increase the number of issuers submitting annual filings each year. However, the proposed amendments to the Rule would not increase the number of annual filings each issuer submits yearly. Thus, the Commission expects that the number of annual filings submitted yearly, per issuer, under the proposed amendments to the Rule would remain the same. Accordingly, the Commission's staff estimates that the maximum external costs for a VRDO issuer who elects to have a third-party scan annual filings into an electronic format under the proposed amendments would be \$128.<sup>223</sup>

Alternatively, a VRDO issuer that currently does not have the appropriate technology to convert paper continuing disclosure documents into an electronic format could elect to purchase the resources to do so.<sup>224</sup> In the 2008

<sup>220</sup> 6,757 (estimated additional event notices submitted under proposed amendments)/12,000 (estimated number of issuers under proposed amendments) = .563 notices per issuer (rounded up to 1) (estimated number of additional event notices submitted annually per issuer). To provide an estimate that would not be under-inclusive, the Commission's staff has elected to use an estimate that expects each issuer would submit one additional material event notice as a result of the proposed amendments.

<sup>221</sup> The maximum cost is the cost to scan and convert four material event or failure to file notices: 4 (number of notices submitted annually) × \$8.00 (cost to scan and convert each notice) = \$32.

<sup>222</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>223</sup> The maximum cost is the cost to scan and convert two annual filings: 2 (number of annual filings submitted annually) × \$64.00 (cost to scan and convert each annual filing) = \$128.

<sup>224</sup> Generally, the technology resources necessary to transfer a paper document into an electronic format are a computer, scanner and possibly software to convert the scanned document into the appropriate electronic document format. Most scanners include a software package that is capable of converting scanned images into multiple electronic document formats. An issuer would only

<sup>213</sup> 1 (continuing disclosure agreement) × \$400 (hourly wage for an outside attorney) × 1.5 hours (estimated time for outside attorney to draft a continuing disclosure document) = \$600. The \$400 per hour estimate is based on the Commission's staff review of industry sources.

<sup>214</sup> \$600 (cost for continuing disclosure agreement) × 2,000 (number of VRDO issuers) = \$1,200,000.

<sup>215</sup> See *supra* Section V.D.

<sup>216</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>217</sup> This estimated range of the annual fee for the services of a designated agent is based on the Commission's staff review of industry sources in December 2008.

<sup>218</sup> 2,000 (number of VRDO issuers) × .30 (percentage of issuers that use designated agents) × \$500 (estimated annual cost for issuer's use of a designated agent) = \$300,000. In order to provide a total cost estimate that is not under-inclusive the Commission's staff elected to use the higher end of the estimated range of annual fees for designated agent's services.

<sup>219</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

Amendments Adopting Release, the Commission estimated that an issuer's initial cost to acquire these technology resources could range from \$750 to \$4,300.<sup>225</sup> Some VRDO issuers may have the necessary hardware to transmit documents electronically to the MSRB, but may need to upgrade or obtain the software necessary to submit documents to the MSRB in the electronic format that it prescribes. In the 2008 Amendments Adopting Release, the Commission estimated that an issuer's cost to update or acquire this software could range from \$50 to \$300.<sup>226</sup> The Commission believes these estimates are still accurate.

In addition, VRDO issuers without direct Internet access could incur some costs to obtain such access to submit the documents. In the 2008 Amendments Adopting Release, the Commission noted that Internet access is now broadly available to and utilized by businesses, governments, organizations and the public, and the Commission expects that most issuers of municipal securities currently have Internet access.<sup>227</sup> In the event that a VRDO issuer does not have Internet access, it could incur costs in obtaining such access, which the Commission estimates to be approximately \$50 per month, based on its limited inquiries to Internet service providers.<sup>228</sup> Otherwise, there are multiple free or low cost locations that an issuer could utilize, such as various commercial sites, which could help an issuer to avoid the costs of maintaining continuous Internet access solely to comply with the proposed amendments to the Rule.<sup>229</sup>

Accordingly, the Commission estimates that the costs to some of the VRDO issuers to acquire technology necessary to convert continuing disclosure documents into an electronic format to submit to the MSRB could include: (i) An approximate cost of \$8 per notice to use a third party vendor to scan an event notice or failure to file notice, and an approximate cost of \$64 to use a third party vendor to scan an average-sized annual financial statement, (ii) an approximate cost ranging from \$750 and \$4,300 to acquire technology resources to convert

need to purchase software if the issuer (i) has a scanner that does not include a software package that is capable of converting scanned images into the appropriate electronic format, or (ii) purchases a scanner that does not include a software package capable of converting documents into the appropriate electronic format.

<sup>225</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

continuing disclosure documents into an electronic format, (iii) \$50 to \$300 solely to upgrade or acquire the software to submit documents in an electronic format; and (iv) approximately \$50 per month to acquire Internet access. The Commission included these estimates in the 2008 Amendments Adopting Release and the Commission believes that they are still accurate.<sup>230</sup>

For a VRDO issuer that does not have Internet access and elects to have a third party convert continuing disclosure documents into an electronic format ("Category 1"), the total maximum external cost such issuer would incur would be \$760 per year.<sup>231</sup> For an issuer that does not have Internet access and elects to acquire the technological resources to convert continuing disclosure documents into an electronic format internally ("Category 2"), the total maximum external cost such VRDO issuer would incur would be \$4,900 for the first year and \$600 per year thereafter.<sup>232</sup> To be conservative for purposes of the PRA, the Commission estimates that any VRDO issuers that incur costs associated with converting continuing disclosure documents into an electronic format would choose the Category 2 option.<sup>233</sup> The Commission's staff estimates that approximately no more than 400 VRDO issuers would incur costs associated with acquiring technology resources to convert

<sup>230</sup> *Id.*

<sup>231</sup> The total maximum external cost for a Category 1 VRDO issuer would be calculated as follows: [\$64 (cost to have third party convert annual filing into an electronic format) × 2 (maximum estimated number of annual filings filed per year per issuer)] + [\$8 (cost to have third party convert material event notice or failure to file notice into an electronic format) × 4 (maximum estimated number of event or failure to file notices filed per year per issuer)] + [\$50 (estimated monthly Internet charge) × 12 months] = \$760. The Commission's staff estimates that an issuer would file one to six continuing disclosure documents per year. These documents generally would consist of no more than two annual filings and four event or failure to file notices. The Commission's staff estimates the maximum number of documents filed annually per issuer as follows: 5 documents (consisting of 2 annual filings and 3 event or failure to file notices based on the Commission's estimate from the 2008 Amendment Adopting Release) + 1 document (consisting of the additional event notice that would be filed under the proposed amendments to the Rule).

<sup>232</sup> The total maximum external cost for a Category 2 VRDO issuer would be calculated as follows: [\$4300 (maximum estimated one-time cost to acquire technology to convert continuing disclosure documents into an electronic format)] + [\$50 (estimated monthly Internet charge) × 12 months] = \$4900. After the initial year, issuers who acquire the technology to convert continuing disclosure documents into an electronic format internally would only have the cost of obtaining Internet access. \$50 (estimated monthly Internet charge) × 12 months = \$600.

<sup>233</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

continuing disclosure documents into an electronic format.<sup>234</sup> Additionally, the Commission's staff estimates that the estimated maximum annual costs for those VRDO issuers that need to acquire technology resources to submit documents to the MSRB would be approximately \$1,960,000<sup>235</sup> for the first year after the adoption of the proposed amendments and approximately \$240,000<sup>236</sup> for each year thereafter.

#### (c) Current and VRDO Issuers

Lastly, some current and VRDO issuers may incur a one-time external cost associated with the proposed amendment to change the timing requirement for submitting event notices in the Rule from "in a timely manner" to "in a timely manner not to exceed ten business days after the occurrence of the event." In particular, some current and VRDO issuers may incur a one-time external cost associated with monitoring for a change in the name of the issuer's trustee. One way an issuer may monitor a change in the name of its trustee cost would be to have outside counsel add a notice provision to the issuer's trust indenture requiring the trustee to provide the issuer with notice of any change in the trustee's name. Based on a review of industry sources, the Commission's staff estimates that it would take an outside attorney approximately 15 minutes to draft and add a notice provision for a change in name of the trustee to an indenture agreement. Thus, the Commission's staff estimates that the approximate cost of adding this notice provision to an issuer's trust indenture for each issuer would be approximately \$100,<sup>237</sup> for a one-time annual cost of \$1,200,000<sup>238</sup> for all issuers.

#### F. Retention Period of Recordkeeping Requirements

As an SRO subject to Rule 17a-1 under the Exchange Act,<sup>239</sup> the MSRB is

<sup>234</sup> 2,000 VRDO issuers × 20% = 400 VRDO issuers. The Commission used a 20% estimate in the 2008 Amendment Adopting Release. See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104. The Commission believes that this estimate is still appropriate.

<sup>235</sup> 400 (Category 2 issuers) × \$4,900 = \$1,960,000.

<sup>236</sup> 400 (Category 2 issuers) × \$600 = \$240,000.

<sup>237</sup> 1 (continuing disclosure agreement) × \$400 (hourly wage for an outside attorney) × .25 hours (estimated time for outside attorney to draft and add a change of name notice provision to a trust indenture) = \$100. The \$400 per hour estimate for an outside attorney's work is based on the Commission's staff review of industry sources.

<sup>238</sup> \$100 (estimated cost to have outside counsel add a change of name notice provision to a trust indenture) × 12,000 (number of issuers under the proposed amendments) = \$1,200,000.

<sup>239</sup> 17 CFR 240.17a-1.

required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place. The proposed amendments to the Rule would contain no recordkeeping requirements for any other persons.

#### *G. Collection of Information Is Mandatory*

Any collection of information pursuant to the proposed amendments to the Rule would be a mandatory collection of information.

#### *H. Responses to Collection of Information Will Not Be Kept Confidential*

The collection of information pursuant to the proposed amendments to the Rule would not be confidential and would be publicly available. The collection of information that would be provided pursuant to the continuing disclosure documents under the proposed amendments would be accessible through the MSRB's EMMA system and would be publicly available via the Internet.

#### *I. Request for Comments*

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments regarding: (1) Whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the Commission's estimate of the burden of the revised collections of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The Commission has submitted to OMB for approval the proposed revisions to the current collection of information titled "Municipal Securities Disclosure." Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-0609, with reference to File No. S7-15-09, and to the Securities and Exchange Commission, Public Reference Room,

100 F Street, NE., Washington, DC 20549. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, should refer to File No. S7-15-09, and be submitted to the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE., Washington, DC 20549.

#### **VI. Costs and Benefits of Proposed Amendment to Rule 15c2-12**

The Commission is proposing amendments to Rule 15c2-12 that would amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the issuer's municipal securities, to provide to the MSRB. Specifically, the proposed amendments would require a broker, dealer, or municipal securities dealer to reasonably determine that the issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days after the event's occurrence, would amend the list of events for which a notice must be provided, and would modify the events that are subject to a materiality determination before triggering a notice to the MSRB. In addition, the amendments would revise an exemption from the rule for certain offerings of municipal securities with put features. These proposed amendments are intended to help improve the availability of timely and important information to investors and other market participants regarding municipal securities, including demand securities, so that investors could make more knowledgeable investment decisions, effectively manage and monitor their investments, and help protect themselves against fraud, and so brokers, dealers, and municipal securities dealers could satisfy their obligation to have a reasonable basis on which to recommend a municipal security.

The Commission is sensitive to the costs and benefits of the proposed rule amendments and requests comment on the costs and benefits of the proposed amendments to Rule 15c2-12 discussed

above. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data regarding any such costs or benefits.

#### *A. Benefits*

The proposed amendments would modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule to provide that a Participating Underwriter must reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide event notices to the MSRB in a timely manner not to exceed ten business days after the occurrence of the event. The current provisions of the Rule state that a Participating Underwriter must reasonably determine that the continuing disclosure agreement provides that event notices are to be provided "in a timely manner" to the MSRB in an electronic format. As discussed above, the Commission preliminarily believes that more timely availability of such significant information would assist investors in making better informed investment decisions and should help reduce instances of fraud. The Commission also anticipates that, in providing for a maximum time frame within which event notices should be disclosed under a continuing disclosure agreement, the proposed amendment should foster the availability of up-to-date information about municipal securities, thereby further promoting greater transparency and investor confidence in the municipal securities market as a whole, and assisting investors to better protect themselves against fraud. Moreover, brokers, dealers and municipal securities dealers should be able to more readily carry out their responsibilities under the securities laws. The Commission believes that the proposed change regarding the maximum time frame for submission of event notices should continue to provide an issuer with adequate time to become aware of the event and, pursuant to its undertaking, submit notice of the event's occurrence to the MSRB. In proposing that event notices be provided "in a timely manner not in excess of ten business days after the occurrence of the event," the Commission intends to strike a balance between the need for such information to be disseminated promptly and the need to allow adequate time for an issuer to become aware of the event and to prepare and file such a notice. The Commission preliminarily believes that the proposed time frame of ten business days after the occurrence of the event would provide a reasonable amount of time for issuers to comply with their

obligations under their continuing disclosure agreements, while also allowing event notices to be made available to investors in a more timely manner. The Commission notes that issuers would not be precluded from submitting subsequent notices as additional information relating to the event becomes available.

The proposed amendments would modify subparagraph (b)(5)(i)(C)(6) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB of the issuance of proposed and final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of securities by the Internal Revenue Service, as well as adverse tax opinions and other events affecting the tax-exempt status of such securities. As discussed earlier, the Commission believes that the tax-exempt status of municipal securities is of significant importance to investors and other participants in the municipal securities market.<sup>240</sup> The Commission believes that this tax-exempt status has a significant impact on the value of municipal securities, as well as on the potential tax liability a municipal security holder may incur if such status were to change. Accordingly, the Commission believes that this amendment to subparagraph (b)(5)(i)(C)(6) of the Rule would clarify a Participating Underwriter's obligation to determine that the issuer has undertaken in its continuing disclosure agreements to provide notice of these events that could affect the tax-exempt status of its municipal securities.

The Commission is proposing to delete the condition in paragraph (b)(5)(i)(C) of the Rule that presently provides that notice of all of the listed events need be made only "if material." The Commission has reviewed each of the Rule's current disclosure event items and determined six instances in which no materiality evaluation should be necessary.<sup>241</sup> Issuers would not need to undertake the determination of materiality for these six events, which should help speed the disclosure of these events to investors and the public

and eliminate the costs presently required of an issuer to make such a determination.

The proposed amendments would add tender offers to subparagraph (b)(5)(i)(C)(8) of the Rule, which currently covers bond calls.<sup>242</sup> The Commission believes that the need to reach all investors with important information regarding a tender offer, which necessitates that an investor decide whether or not to tender within the prescribed time period, makes its proposed addition to the Rule appropriate. As a result, the proposal would help improve the ability of issuers and other obligated persons to communicate tender offers to bondholders effectively and of bondholders to respond within the tender offer period. In addition, the proposed amendment to subparagraph (b)(5)(i)(C)(8) of the Rule could help eliminate the possibility of any investor confusion regarding whether a certain municipal security is the subject of a tender offer. In all these ways, the availability of this information would help investors protect themselves from misrepresentation and fraud, and would also aid brokers, dealers and municipal securities dealers to satisfy their obligation to have a reasonable basis to recommend a municipal security.

The proposed addition of subparagraph (b)(5)(i)(C)(12) to the Rule would require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB, upon its bankruptcy, insolvency, receivership or similar event.<sup>243</sup> The Commission notes that, while bankruptcy, insolvency, receivership or similar event of the issuer or obligated person are uncommon in the municipal market, these events can have a significant impact on the price of the municipal issuer's securities. The Commission believes that the potential severity of the consequences to investors from bankruptcy, insolvency, receivership or similar event of the issuer or obligated person, and the corresponding benefit of the availability of that information to help prevent fraud, supports its proposal that the Participating Underwriter should be required to reasonably determine that the issuer or obligated person has undertaken in its continuing disclosure agreement to provide notice to the MSRB if such an event should occur.

In addition, the proposed amendments would add subparagraph

(b)(5)(i)(C)(13) to the Rule, which would require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB, if material, of the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms.<sup>244</sup> As with bankruptcy, insolvency, receivership or similar event of the issuer or obligated person, there can be a potential impact on the price of a municipal security as a result of the consummation of a material merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms. In such a circumstance, the Commission believes that the proposed amendment would help to ensure that investors and other market participants could obtain knowledge of the identity of the entity that would have responsibility for municipal security repayment obligations after the transaction is consummated. In addition, investors and other market participants would have the opportunity to review the creditworthiness and other aspects of the acquiring entity that would support repayment of the security following the transaction. Thus, the proposed amendment would help to prevent fraud.

Proposed subparagraph (b)(5)(i)(C)(14) to the Rule would add the appointment of a successor or additional trustee or the change of name of a trustee to the list of events contained in the Rule, if material. As discussed earlier, the Commission believes that the trustee of a municipal security performs important functions for investors in that security.<sup>245</sup> The Commission notes that the proposed amendment would benefit investors by helping to ensure that the continuing disclosure agreement would provide that investors be made aware of the identity of and contact information for the most current trustee for a municipal security and that any changes to the trustee's identity would be made

<sup>240</sup> See *supra* Section II.C.

<sup>241</sup> These events are: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.

<sup>242</sup> See *supra* Section II.E.1.

<sup>243</sup> See *supra* Section II.E.2.

<sup>244</sup> See *supra* Section II.E.3.

<sup>245</sup> See *supra* Section II.E.4.

known to investors in a timely manner, not in excess of ten business days of the event's occurrence.

Further, the Commission proposes to modify the exemption in the Rule for demand securities. As discussed above, when the Commission adopted this exemption, demand obligations made up a relatively small portion of the municipal market.<sup>246</sup> Recently, issuances of demand securities have increased.<sup>247</sup> The Commission believes that it is important that there be greater information regarding these securities available to investors, market professionals, and the public generally. Accordingly, the Commission believes that modifying the Rule's exemption for demand securities would be beneficial to investors and the prevention of fraud. The modification of the Rule's exemption for demand securities would provide investors with notice of the events set forth in the Rule regarding demand securities that may not have been available previously. In addition, this proposal would restrict a broker, dealer or municipal securities dealer from making recommendations regarding such securities unless it has procedures in place that provide reasonable assurance that it would receive prompt notice of the events set forth in the Rule,<sup>248</sup> which should benefit investors because the broker, dealer or municipal securities dealer should have available to it continuing disclosure information regarding the demand obligation it recommends.

The Commission believes that the proposed amendments would benefit individual and institutional investors who would be able to obtain greater information about municipal securities that they could use to make informed investment decisions. Moreover, this information would aid investors by helping them to determine that they are not the subject of fraudulent or manipulative acts or practices with respect to municipal security transactions. In addition, the Commission believes that the proposed amendments could assist broker-dealers and others, such as mutual funds, with their compliance with regulatory requirements because they would have access to greater information about municipal securities. Moreover, municipal securities vendors could benefit from the proposed amendments because additional information about municipal securities and their issuers would be made available, which they then could use in developing or

enhancing value-added products to offer to interested parties.

In the Commission's view, the proposed amendments would have a positive impact on the municipal securities market and participants in that market sector. It is possible that, with more information available to market professionals, individual investors, and others regarding municipal securities, including VRDOs, there could be greater competition in the marketplace with respect to the offer and sale of municipal securities, to the benefit of these individuals and entities. Greater information enhances the ability of market professionals, investors and others to make investment-related decisions about particular municipal securities, which in turn can promote competition in the marketplace. Moreover, individual and institutional investors might take into account the fact that more information would be available about municipal securities, including VRDOs, when they decide whether to purchase municipal securities.

The Commission seeks comment on the anticipated benefits of the proposed amendments.

#### B. Costs

##### 1. Broker-Dealers

The proposed amendments to paragraph (b)(5)(i)(C) of the Rule would add events that would require Participating Underwriters to reasonably determine that issuers or obligated persons agreed to provide notice of and would specify the maximum time period in which such notices would need to be submitted to the MSRB. The Commission does not believe that the proposed amendments to paragraph (b)(5)(i)(C) of the Rule would cause broker-dealers to incur any additional recurring external or internal costs in connection with their implementation, if the proposals are adopted, because they would not significantly alter the existing Rule's requirements for broker-dealers. Under the Rule, broker-dealers already must reasonably determine that issuers or obligated persons have undertaken to provide notice of specified events in their continuing disclosure agreements and the addition of a few more events that would require notice to the MSRB and the addition of a provision regarding the timeliness of such notices should not significantly increase broker-dealers' obligations and thus their costs. As noted above, continuing disclosure documents generally are form documents. The broker-dealer must reasonably determine that provisions relating to the

issuer's or obligated person's undertaking to provide notice of those events that are specified in the current Rule, as well as those events that are proposed to be added to the Rule, are contained in the continuing disclosure agreement.

The proposed amendments also would modify the Rule's exemption for demand securities. The Commission preliminarily believes that these proposed amendments would not result in any external recurring costs for broker-dealers but could result in their incurring a small increase in internal recurring costs because these proposals would increase the number of municipal securities offerings subject to paragraphs (b)(5) and (c) of the Rule. The proposed deletion of paragraph (d)(1)(iii) of the Rule and the addition of new paragraph (d)(5) to the Rule, would modify an exemption from the Rule for primary offerings of demand securities. As noted above, the Commission's staff estimates that the modification of this exemption from the Rule would increase the number of issuers with municipal securities offerings subject to the Rule by 20%.<sup>249</sup> The Commission's staff estimates that the annual information collection burden for each broker-dealer under this proposed amendment to the Rule would be 1.20 hours (1 hour and 12 minutes).<sup>250</sup> Accordingly, the Commission's staff estimates that it would cost each broker-dealer \$324 annually to comply with the Rule, which represents a cost increase of \$54 annually over each broker-dealer's current annual cost to comply with the Rule.<sup>251</sup>

In addition, the Commission's staff estimates that a broker-dealer could have a one-time internal cost associated with having an in-house compliance attorney prepare and issue a memorandum advising the broker-dealer's employees about the proposed revisions to Rule 15c2-12. The Commission's staff estimates it would take internal counsel approximately 30

<sup>249</sup> See *supra* Section V.D.1.a.

<sup>250</sup> *Id.*

<sup>251</sup> 1.20 hours (estimated annual information collection burden for each broker-dealer) × \$270 (hourly cost for a broker-dealer's internal compliance attorney) = \$324. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Cost increase for Broker-Dealers under the proposed amendments to the Rule: \$324 (annual cost under amended rule) – \$270 (annual cost under current Rule) = \$54. This estimated cost for broker-dealers also accounts for their review of continuing disclosure agreements in connection with remarketings of VRDOs that are primary offerings.

<sup>246</sup> See *supra* Section II.A.

<sup>247</sup> *Id.*

<sup>248</sup> See 17 CFR 240.15c2-12(c).

minutes to prepare this memorandum,<sup>252</sup> for a cost of approximately \$135.<sup>253</sup> The Commission further believes that the ongoing obligations of broker-dealers under the Rule would be handled internally because compliance with these obligations is consistent with the type of work that a broker-dealer typically handles internally.

The Commission seeks comment on any other potential costs that may result from the proposal amendments, including whether there would be any change to the cost of underwriting variable rate demand obligations or other types of municipal securities for which greater information would be available as a result of the Commission's proposals and, if so, whether there would be any effect on a broker-dealer's business and revenues. The Commission seeks comment on whether the proposed amendments would adversely affect the ability of broker-dealers to serve as Participating Underwriters in municipal securities offerings, particularly in the case of offerings of variable rate demand obligations. While the Commission does not anticipate that there would be any adverse consequences to a broker-dealer's business, activities or financial condition as a result of the proposed amendments, it seeks commenters' views regarding the possibility of any such impact. The Commission requests comment on any direct or indirect costs broker-dealers could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

## 2. Issuers

### (a) Current Issuers

The Commission expects that some current issuers could be subject to some internal and external costs associated with the proposed amendments to the Rule. As noted above, the proposed revisions to the Rule regarding the time period for submission of event notices and regarding the materiality condition for such notices would not change the substance of an event notice, the method for filing an event notice, or the location to which an event notice

would be submitted.<sup>254</sup> Accordingly, the Commission preliminarily does not believe that issuers would incur any costs associated with the proposed change to the timing provision of the Rule, except to the extent that some issuers may need to submit notices more speedily than they do currently and may need to be cognizant of events not within their direct control, such as a rating change, that would prompt submission of an event notice. The Commission preliminarily believes that the costs for current issuers would result from the proposed amendments to the Rule associated with the proposed new and modified event notice provisions and the elimination of the materiality determination for certain event notices in the current Rule.<sup>255</sup> Current issuers would incur internal costs associated with the preparation of the additional event notices that may result from these proposed changes to the event notice provisions of the Rule. Current issuers also would incur costs if they issue demand obligations, as discussed below.

For current issuers that convert their annual filings, event notices and/or failure to file notices into the MSRB's prescribed electronic format through a third party there would be additional costs associated with any additional submissions of event notices and failure to file notices. As noted above, the Commission estimates that each current issuer would submit one additional event notice annually as a result of the proposed amendments.<sup>256</sup> If the current issuer uses a third-party vendor to scan the additional event notice into an electronic format for submission to the MSRB, the Commission estimates that such issuer would have an additional annual cost of \$8 per notice.<sup>257</sup> For current issuers that convert their annual filings, event notices and/or failure to file notices into the MSRB's prescribed electronic format internally there would be no additional external costs associated with the conversion of the

event notice into the MSRB's prescribed electronic format.

As discussed above,<sup>258</sup> some current issuers may incur a one-time cost of \$100 associated with the need to revise the template for continuing disclosure agreements, if the proposed amendments are adopted.<sup>259</sup>

The Commission also believes that current issuers could incur some internal labor costs associated with the preparation and submission of the additional event notice. As discussed above,<sup>260</sup> the Commission's staff estimates that a current issuer would submit a maximum of one additional event notice annually.<sup>261</sup> Thus, the Commission staff estimates that the maximum annual labor cost to prepare and submit the additional event notice is approximately \$47 per current issuer.<sup>262</sup>

The Commission seeks comment on any other costs that the proposed addition of several new event items, the proposed maximum time frame to submit event notices, and the revisions with respect to the materiality condition would have on issuers. While the Commission preliminarily does not believe that these proposals would have a significant cost impact on issuers, it seeks commenters' views on any direct or indirect cost consequences as a result of the proposals. For example, would the proposed amendments in any way make it more likely or less likely for issuers to obtain needed financing or to obtain a broker-dealer to conduct a primary offering on their behalf? Would there be any costs incurred by investors, market professionals or others as a result of the proposed amendments? Are

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* The Commission's staff estimates that there is an approximate cost of \$100 associated with revising each continuing disclosure agreement by the current issuer's outside counsel. Thus, the total cost for revising continuing disclosure agreements for all current issuers by the current issuers' outside counsel would be approximately \$1,000,000.

<sup>260</sup> *Id.*

<sup>261</sup> This estimate includes additional event notices that may be submitted as a result of the proposed modification of the materiality condition in paragraph (b)(5)(i)(C) of the Rule.

<sup>262</sup> 1 (maximum estimated number of additional material event notices submitted per year per issuer) × \$63 (hourly wage for a compliance clerk) × .75 hours (45 minutes) (estimated time for compliance clerk to prepare and submit a material event notice) = \$47.25 (rounded to \$47). The \$63 per hour estimate for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead. In order to provide an estimate of total costs for issuers that would not be under-inclusive, the Commission's staff elected to use the higher end of the estimate of annual submissions of continuing disclosure documents. See *supra* note 220.

<sup>254</sup> See *supra* Section V.D.2.b.i. See *infra* Section V.I.B.2.b. for a discussion of the costs associated with an increase in the number of issuers as a result of the proposed amendment modifying the exemption for demand securities.

<sup>255</sup> As to two of the proposed new events, the amendments would include a materiality determination. Such a materiality determination could result in costs to investors, market professionals and others to the extent the issuer or obligated person determined that the event was not material and thus did not submit a notice to the MSRB. If investors, market professionals and others would have considered the information important and had access to it, they might have made a different investment decision.

<sup>256</sup> See *supra* Section V.E.2.a.

<sup>257</sup> *Id.*

<sup>252</sup> See *supra* Section V.D.1.c.

<sup>253</sup> .5 hours (estimated annual information collection burden for each broker-dealer) × \$270 (hourly cost for a broker-dealer's internal compliance attorney) = \$135. The hourly rate for the compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2008, modified by the Commission's staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

there other internal or external costs not identified by the Commission that could result from the proposed amendments? The Commission requests comment on any direct or indirect costs issuers could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

#### (b) VRDO Issuers

As discussed above, the Commission estimates that the proposed modification of the Rule's exemption for demand securities would increase the number of issuers affected by the Rule by approximately 20% or 2,000 issuers.<sup>263</sup> These VRDO issuers may have some costs associated with the preparation and submission of continuing disclosure documents. As discussed above, the Commission believes that each VRDO issuer may have a one-time external cost of \$600 associated with entering into a continuing disclosure agreement.<sup>264</sup> The Commission believes that the only other external costs for VRDO issuers would be the costs associated with converting continuing disclosure documents into an electronic format to submit to the MSRB. As noted earlier, the Commission believes that many issuers of municipal securities currently have the computer equipment and software necessary to convert paper copies of continuing disclosure documents to electronic copies and to electronically transmit the documents to the MSRB.<sup>265</sup> VRDO issuers that presently do not have the ability to prepare their annual filings, event notices and/or failure to file notices in an electronic format could incur some costs to obtain electronic copies of such documents if they are prepared by a third party (e.g., accountant or attorney) or, alternatively, to have a paper copy converted into an electronic format. These costs would vary depending on how the VRDO issuer elected to convert its continuing disclosure documents into an electronic format. An issuer could elect to have a third-party vendor transfer its paper continuing disclosure documents into the appropriate electronic format. An issuer also could decide to undertake the work internally, and its costs would vary depending on the issuer's current technology

resources. An issuer also could use the services of a designated agent to submit its continuing disclosure documents to the MSRB. In the 2008 Amendments Adopting Release, the Commission noted that approximately 30% of municipal issuers rely on the services of a designated agent to submit continuing disclosure documents for them.<sup>266</sup> Generally, when issuers utilize the services of a designated agent, they enter into a contract with the agent for a package of services, including the submission of continuing disclosure documents, for a single fee. As noted above, the Commission's staff estimates that the annual fees for designated agents range from \$100 to \$500 per issuer, for a total maximum annual cost of \$300,000 for all VRDO issuers.<sup>267</sup>

As noted above, the Commission estimates that the costs to some of the VRDO issuers may incur costs associated with converting continuing disclosure documents into an electronic format to submit to the MSRB. These costs could include: (i) An approximate cost of \$8 per notice to use a third party vendor to scan a event notice or failure to file notice, and an approximate cost of \$64 to use a third party vendor to scan an average-sized annual financial statement, (ii) an approximate cost ranging from \$750 and \$4,300 to acquire technology resources to convert continuing disclosure documents into an electronic format, (iii) \$50 to \$300 solely to upgrade or acquire the software to submit documents in an electronic format; and (iv) approximately \$50 per month to acquire Internet access.<sup>268</sup>

For a VRDO issuer that does not have Internet access and elects to have a third party convert continuing disclosure documents into an electronic format ("Category 1"), the total maximum external cost such issuer would incur would be \$760 per year.<sup>269</sup> For an issuer that does not have Internet access and elects to acquire the technological resources to convert continuing disclosure documents into an electronic format internally ("Category 2"), the total maximum external cost such VRDO issuer would incur would be \$4,900 for the first year and \$600 per year thereafter. As noted above, in order to provide a conservative cost estimate, the Commission has estimated that any VRDO issuer that incurs costs associated with converting continuing disclosure documents into the MSRB's prescribed electronic format would choose the

more expensive Category 2 approach.<sup>270</sup> The Commission's staff estimates that approximately 400 VRDO issuers would incur costs associated with acquiring technology resources to convert continuing disclosure documents into an electronic format.<sup>271</sup> Additionally, the Commission's staff estimates that the maximum annual costs for those VRDO issuers that need to acquire technology resources to submit documents to the MSRB would be approximately \$1,960,000 for the first year after the adoption of the proposed amendments and approximately \$240,000 for each year thereafter.<sup>272</sup>

Although the Commission preliminarily does not believe that there are any additional costs to issuers or obligated persons of VRDOs as a result of the proposed amendments, it requests comment regarding any possible direct or indirect costs that such issuers could incur, such as any potential impact on underwriting fees, interest costs, or other costs generally. Would the proposed amendments adversely affect the business, activities or financial condition of VRDO issuers or obligated persons, their ability to engage broker-dealers to underwrite or to act as remarketing agents of VRDOs, or to engage financial advisors?

#### (c) Current and VRDO Issuers

Lastly, as discussed above, some current and VRDO issuers may incur a one-time external cost associated with the proposed amendment to change the timing requirement for submitting event notices in the Rule from "in a timely manner" to "in a timely manner not to exceed ten business days after the occurrence of the event." In particular, some current and VRDO issuers may incur a one-time external cost associated with monitoring for a change in the name of the issuer's trustee. One way an issuer may monitor a change in the name of its trustee cost would be to have outside counsel add a notice provision to the issuer's trust indenture requiring the trustee to provide the issuer with notice of any change in the trustee's name. The Commission's staff estimates that the approximate cost of adding this notice provision to an issuer's trust indenture for each issuer would be approximately \$100,<sup>273</sup> for a one-time annual cost of \$1,200,000<sup>274</sup> for all issuers.

<sup>263</sup> See *supra* Section V.D.2.a.

<sup>264</sup> See *supra* Section V.E.2.b. The Commission's staff has estimated that there is an approximate cost of \$600 associated with drafting each continuing disclosure agreement by the VRDO issuer's outside counsel. Thus, the total cost for preparing continuing disclosure documents for all VRDO issuers by the VRDO issuers' outside counsel would be approximately \$1,200,000.

<sup>265</sup> *Id.*

<sup>266</sup> See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>267</sup> See *supra* Section V.E.2.b.

<sup>268</sup> *Id.*

<sup>269</sup> See *supra* note 231.

<sup>270</sup> See *supra* Section V.E.2.b.

<sup>271</sup> 2000 VRDO issuers × 20% = 400 VRDO issuers. See 2008 Amendments Adopting Release, *supra* note 11, 73 FR 76104.

<sup>272</sup> See *supra* Section V.E.2.b.

<sup>273</sup> See *supra* note 237.

<sup>274</sup> See *supra* note 238.

The Commission requests comment on any direct or indirect costs issuers or obligated persons could incur as a result of the proposed amendments and asks commenters to quantify those costs, where possible.

### 3. MSRB

Since the number of continuing disclosure documents submitted would increase as a result of the proposed amendments, the MSRB could incur costs associated with the proposed amendments. The Commission's staff estimates that these costs for the MSRB may include: (i) the cost to hire additional clerical personnel at an estimated annual cost of \$127,890 to process the additional submissions associated with the proposed amendments to the Rule<sup>275</sup> and (ii) the cost to update its EMMA system to accommodate indexing information in connection with the proposed changes to the material disclosure events of the Rule. Based on information provided to Commission staff by MSRB staff in a telephone conversation on November 7, 2008, the MSRB staff estimated that the MSRB's costs to update its EMMA system to accommodate the proposed changes to the material disclosure events of the Rule would be approximately \$10,000.<sup>276</sup> Therefore, in connection with the proposed amendments the MSRB would incur a one-time cost of approximately \$10,000 as well as a recurring annual cost of approximately \$127,890.<sup>277</sup>

Given that the MSRB has provided a preliminary estimate of the costs that it would incur in connection with the proposed amendments, the Commission does not believe that there are any other direct or indirect additional costs that the MSRB may incur as a result of the proposals. The Commission seeks comment on all direct and indirect costs that its proposals would impose on the MSRB and requests that those costs be quantified, where possible.

<sup>275</sup> 2,030 hours (estimated additional annual number of hours worked by a compliance clerk) × \$63 (hourly wage for a compliance clerk) = \$127,890 (annual salary for compliance clerk). The \$63 per hour estimate for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry 2008, modified by the Commission's staff to account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead. The estimate for additional annual hours worked by a compliance clerk is the estimated additional hourly burden the MSRB would incur on an annual basis under the proposed amendments to the Rule. See Section V.D.

<sup>276</sup> Telephone conversation between Harold Johnson, Deputy General Counsel, MSRB, and Martha M. Haines, Assistant Director and Chief, Office of Municipal Securities, Division, Commission, November 7, 2008.

<sup>277</sup> See *supra* notes 261 and 262.

### C. Request for Comment on Costs and Benefits

The Commission preliminarily believes that any additional burden or costs on broker-dealers, issuers, and the MSRB as a result of the proposed amendments would be justified by the improved availability of information to broker-dealers, mutual funds that hold municipal securities, analysts and other market professionals, institutional and retail investors, vendors of municipal securities information, and the public generally, all of which contribute to investors' ability to make more knowledgeable investment decisions, effectively manage and monitor their investments, and protect themselves from misrepresentation and fraud. This availability also would contribute to brokers, dealers and municipal securities dealers' reasonable basis to recommend the purchase or sale of municipal securities. To assist the Commission in evaluating the costs and benefits that could result from the proposed amendments to the Rule, the Commission requests comments on the potential costs and benefits identified in this proposal, as well as any other costs or benefits that could result from the proposed amendments to the Rule. In particular, comments are requested on whether there are costs or benefits to any entity not identified above. Commenters should provide analysis and data to support their views on the costs and benefits. In particular, the Commission requests comment on the costs and benefits of the proposed amendments on broker-dealers, issuers, the MSRB, other municipal securities information vendors, as well as any costs on others, including market participants and investors.

### VII. Consideration of Burden and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act<sup>278</sup> requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act<sup>279</sup> requires the Commission, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition. Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition

<sup>278</sup> 15 U.S.C. 78c(f).

<sup>279</sup> 15 U.S.C. 78w(a)(2).

not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed amendments to the Rule would revise paragraph (b)(5) of Rule 15c2-12 to require Participating Underwriters to reasonably determine that the issuer or obligated person has agreed at the time of a primary offering: (i) To provide notice of the events listed in paragraph (b)(5)(i)(C) of the Rule in a timely manner, but not later than ten business days after the occurrence of the event;<sup>280</sup> and (ii) to expand the list of events in paragraph (b)(5)(i)(C) of the Rule to include the following: the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the securities; a tender offer; bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; and the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material. The proposed amendments would delete the materiality condition for some, but not all, of the events currently listed in paragraph (b)(5)(i)(C) of the Rule. In addition, the proposed amendments would narrow the exemption currently contained in paragraph (d)(1)(iii) of the Rule for demand securities, by deleting paragraph (d)(1)(iii), and adding paragraph (d)(5) to the Rule to make the event disclosure provisions contained in section (b)(5)(i)(C) of the Rule applicable to this category of municipal securities.

As discussed below, the Commission preliminarily believes that the proposed amendments to the Rule should help make the municipal disclosure process more efficient because of the proposed new events to be added to paragraph (b)(5)(i)(C) of the Rule; the proposal that submissions of event notices to the MSRB must be made in a timely manner not in excess of ten business days of the event's occurrence; and the proposed

<sup>280</sup> The Commission proposes a similar revision to the limited undertaking in paragraph (d)(2)(ii)(B) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB "in a timely manner not in excess of ten business days after the occurrence of the event," instead of "in a timely manner" as the Rule currently provides.

modification of the exemption for demand securities through the elimination of paragraph (d)(1)(iii) of the Rule, and the addition of paragraph (d)(5) to the Rule. Currently, the Rule does not contain a specific time frame within which a continuing disclosure agreement must specify that event notices will be provided to the MSRB. Thus, the Commission believes the proposed change should help individuals or entities interested in obtaining information about events relating to municipal issuers to obtain this information from the MSRB within a specific time frame of the event's occurrence. In addition, certain events regarding municipal securities that may be important to investors, such as certain tender offers or the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material, are not currently included in the Rule. Further, certain events listed in paragraph (b)(5)(i)(C) of the rule would need to be disclosed, without the issuer having to make a materiality determination. Moreover, the Rule currently contains an exemption for demand securities, which means that broker-dealers are not required to reasonably determine that the issuer or obligated person has undertaken to provide the information set forth in paragraph (b)(5) of the Rule. As a consequence of the proposed amendments, greater information about municipal securities and their issuers should be more readily accessible on a more-timely basis to broker-dealers, mutual funds, analysts and other market professionals, institutional and retail investors, and the public generally. Thus, these individuals and entities should be able to obtain greater information about municipal securities within a specific ten business day time frame, which could aid them in making better informed and more efficient investment decisions and should help reduce instances of fraud.

The Commission preliminarily believes that this proposal could promote competition in the purchase and sale of municipal securities because the greater availability and timeliness of information as a result of the proposed amendments could instill greater investor confidence in the municipal securities market. As a result, more

investors could be attracted to this market sector and broker-dealers and municipal issuers could compete for their business. The proposed amendments also could encourage improvement in the completeness and timeliness of issuer disclosures and could foster additional interest in municipal securities by retail and institutional customers. In addition, the greater availability of information about municipal securities would be beneficial to vendors of municipal securities information as they develop their value-added products. Thus, the proposed amendments could promote competition among those vendors of municipal securities information that could utilize the information provided to the MSRB pursuant to continuing disclosure agreements and would compete with each other in creating and offering for sale value-added products relating to municipal securities. As discussed above,<sup>281</sup> the proposed amendments to the Rule could result in some additional cost and hourly burdens for broker-dealers, issuers and the MSRB. However, the Commission preliminarily believes that these increased burdens are justified by the positive competitive impact of the proposed amendments to the Rule. Accordingly, the Commission preliminarily does not believe that the proposed amendments would result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The proposed amendments to the Rule would provide investors and other municipal market participants with notice of additional events, to be provided in a timely manner not in excess of ten business days of the event's occurrence, which could have an impact on the value of the applicable municipal security. In addition, the proposed amendments would help to provide investors and other municipal market participants with access to important information about demand securities that previously were not subject to the Rule's disclosure provisions. The Commission believes that these proposals should help improve investors' ability to make informed investment decisions, which, in turn, should help promote capital formation generally. The proposed amendments could have a positive effect on capital formation because the greater availability of information about municipal securities could provide institutional and retail investors with more complete information regarding these securities. As a result, investors

could be more comfortable that they would have better access to important information about a particular municipal security when deciding whether to purchase that security.

Based on the analysis above, the Commission preliminarily believes that the proposed amendments to the Rule would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments to the Rule would place a burden on competition, as well as the effect of the proposed amendments on efficiency, competition, and capital formation. The Commission specifically seeks comment on whether the proposed amendments would place a burden on competition or have an effect on efficiency, competition, and capital formation with respect to issuers or obligated persons, the MSRB, broker-dealers, other market participants, investors, or others.

#### VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"<sup>282</sup> the Commission must advise the OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation.

The Commission requests comment on the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

#### IX. Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis ("IRFA") has been prepared in accordance with the provisions of the Regulatory Flexibility Act ("RFA").<sup>283</sup> It relates to proposed amendments to Rule 15c2-12,<sup>284</sup> under the Securities Exchange Act of 1934, as amended.<sup>285</sup> The proposed amendments would

<sup>282</sup> Public Law No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>283</sup> 5 U.S.C. 603(a).

<sup>284</sup> 17 CFR 240.15c2-12.

<sup>285</sup> 15 U.S.C. 78a *et seq.*

<sup>281</sup> See *supra* Sections V. and VI.

amend certain requirements regarding the information that a broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer of municipal securities or an obligated person has undertaken, in a written agreement or contract for the beneficial holders of the issuer's municipal securities, to provide, and revise an exemption from the rule. Specifically, the amendments would require a broker, dealer, or municipal securities dealer (or "Participating Underwriter," when used in connection with primary offerings), to reasonably determine that an issuer or obligated person has agreed to provide notice of specified events in a timely manner not in excess of ten business days of the occurrence of the event and amend the list of events for which notices would be provided. In addition, the proposal would modify the condition that event notices be submitted to the Municipal Securities Rulemaking Board, "if material," for some, but not all, of the Rule's specified events. Further, the amendments would modify an exemption from the rule for certain offerings of municipal securities with put features, by making the offering of such securities subject to continuing disclosure obligations set forth in the Rule.

#### A. Reasons for the Proposed Action

The main purpose of the proposal is to improve the availability of significant and timely information to the municipal securities markets and to help deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of transactions in municipal securities for which adequate information is not available on an ongoing basis.

The Commission proposes to modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of Rule 15c2-12 to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to provide event notices to the MSRB in an electronic format as prescribed by the MSRB, in a timely manner not in excess of ten business days after the occurrence of any such event, instead of "in a timely manner" as the Rule currently provides. In 1994, the Commission adopted amendments to Rule 15c2-12 and noted that it had not established a specific time frame with respect to "timely" because of the wide variety of events

and issuer circumstances.<sup>286</sup> However, the Commission stated that, 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.<sup>287</sup> It has been reported that there have been some instances in which event notices were not submitted until months after the events occurred.<sup>288</sup> The Commission believes that delays deny investors important information that they need in order to make informed decisions regarding whether to buy, sell, or hold their municipal securities and to aid them in determining whether the price that they pay or receive for their transactions is appropriate.<sup>289</sup>

The Commission preliminarily believes that codifying in the Rule a specific time within which event notices would be provided, in accordance with the continuing disclosure agreement, to the MSRB should result in these notices being made available more promptly than at present. Accordingly, the proposed amendments would require a broker, dealer, or municipal securities dealer (*i.e.*, a Participating Underwriter) to reasonably determine that an issuer or obligated person has agreed, in a continuing disclosure agreement, to provide notice of specified events in a timely manner not in excess of ten business days after the event's occurrence. The Commission believes this change would help promote more timely disclosure of this important information to municipal security investors.

The Commission proposes to modify paragraph (b)(5)(i)(C)(6) of the Rule, which presently requires Participating Underwriters reasonably to determine that the issuer or obligated person has entered into a continuing disclosure agreement to submit a notice for "[a]dverse tax opinions or events affecting the tax-exempt status of the security." The proposal would revise paragraph (b)(5)(i)(C)(6) of the Rule also to provide for the disclosure of the issuance of material "proposed or final determinations of taxability, Notices of Proposed Issue (IRS form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of securities" by the IRS to the MSRB under a continuing disclosure agreement. A determination by the IRS

that interest on a municipal security may, in fact, be taxable not only could reduce the security's market value, but also could adversely affect each investor's federal and, in some cases, state income tax liability.<sup>290</sup> The tax-exempt status of a municipal security is also important to many mutual funds whose governing documents, with certain exceptions, limit their investments to tax-exempt municipal securities.<sup>291</sup> Therefore, retail and institutional investors alike are extremely interested in events that could adversely affect the tax-exempt status of the municipal securities that they own or may wish to purchase.<sup>292</sup>

The Commission is proposing that no determination of materiality would be necessary for the following six existing events: (1) Principal and interest payment delinquencies with respect to the securities being offered; (2) unscheduled draws on debt service reserves reflecting financial difficulties; (3) unscheduled draws on credit enhancements reflecting financial difficulties; (4) substitution of credit or liquidity providers, or their failure to perform; (5) defeasances; and (6) rating changes.<sup>293</sup> The Commission preliminarily believes that these events are of such a high level of importance to investors that notice of their occurrence should always be included in a continuing disclosure agreement. Furthermore, the Commission preliminarily believes that eliminating the necessity to make a materiality decision upon the occurrence of these events would simplify issuer compliance with the terms of continuing disclosure agreements to which they are a party and would help to make such filings available more quickly.

The proposal also would add the following events, for which disclosure notices would be provided pursuant to a continuing disclosure agreement: (i) Tender offers (paragraph (b)(5)(i)(C)(8) of the Rule);<sup>294</sup> (ii) bankruptcy, insolvency, receivership or similar event of the issuer or obligated person (paragraph (b)(5)(i)(C)(12) of the Rule);<sup>295</sup> (iii) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake

<sup>286</sup> See Securities Exchange Act Release No. 34961 (November 10, 1994), 59 FR 59590, 59601 (November 17, 1994) ("1994 Amendments").

<sup>287</sup> *Id.*

<sup>288</sup> See *supra* Section II.B.

<sup>289</sup> *Id.*

<sup>290</sup> See *supra* Section II.D.

<sup>291</sup> *Id.*

<sup>292</sup> *Id.*

<sup>293</sup> *Id.*

<sup>294</sup> See *supra* Section II.E.1.

<sup>295</sup> See *supra* Section II.E.2.

such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material (paragraph (b)(5)(i)(C)(13) of the Rule);<sup>296</sup> and (iv) appointment of a successor or additional trustee, or the change of name of a trustee (paragraph (b)(5)(i)(C)(14) of the Rule), if material.<sup>297</sup> The Commission believes that there is a need to make available to all investors such important information affecting their decisions and the value of their securities. The Commission believes that the proposed addition of these four events disclosure items would substantially improve the availability of important information in the municipal securities market.

Finally, the proposal would modify the Rule's exemption for demand securities by eliminating paragraph (d)(1)(iii) to Rule 15c2-12, and adding new paragraph (d)(5) to the Rule. The Commission's experience with the operation of the Rule and changes in the municipal securities market over the last fourteen years suggests a need to increase the availability of information to investors regarding demand securities.<sup>298</sup> Furthermore, the recent period of turmoil in the markets for municipal auction rate securities and variable rate demand obligations ("VRDOs") and the comments of numerous primary purchasers of demand securities also suggest that a full exemption for demand securities is no longer appropriate and that the exemption should be modified to provide that paragraphs (b)(5) and (c) of the Rule relating to the disclosure of continuing disclosure documents and recommendations by broker-dealers also would apply to the offerings of demand securities.<sup>299</sup>

#### B. Objectives

The purpose of the proposal is to achieve more efficient, effective, and wider availability of municipal securities information to broker-dealers, mutual funds, analysts and other market professionals, institutional and retail investors, and the public generally, and to help prevent fraudulent, deceptive, or manipulative acts or practices in the municipal securities market.

#### C. Legal Basis

Pursuant to the Exchange Act, and particularly Sections 2, 3(b), 10, 15(c), 15B, 17 and 23(a)(1) thereof, 15 U.S.C. 78b, 78c(b), 78j, 78o(c), 78o-4, 78q and

78w(a)(1), the Commission is proposing amendments to § 240.15c2-12 of Title 17 of the *Code of Federal Regulations*.

#### D. Small Entities Subject to the Rule

The proposal would apply to any broker, dealer, or municipal securities dealer that acts as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more and issuers of such securities.

The RFA defines "small entity" to mean "small business," "small organization," or "small government jurisdiction."<sup>300</sup> The Commission's rules define "small business" and "small organization" for purposes of the RFA for each of the types of entities regulated by the Commission.

A broker-dealer is a small business if its total capital (net worth plus subordinated liabilities) on the last day of its most recent fiscal year was \$500,000 or less, and is not affiliated with any entity that is not a "small business."<sup>301</sup>

A municipal securities dealer that is a bank (including a separately identifiable department or division of a bank) is a small business if it has total assets of less than \$10 million at all times during the preceding fiscal year; had an average monthly volume of municipal securities transactions in the preceding fiscal year of less than \$100,000; and is not affiliated with any entity that is not a "small business."<sup>302</sup>

For purposes of Commission rulemaking, an issuer or person, other than an investment company, is a "small business" or "small organization" if its "total assets on the last day of its most recent fiscal year were \$5 million or less."<sup>303</sup>

Based on information obtained by the Commission's staff in connection with the 2008 Adopted Amendments, the Commission estimates that 250 broker-dealers, including municipal securities dealers, would be Participating Underwriters within the meaning of Rule 15c2-12. Based on a recent review of industry sources, the Commission does not believe that any Participating Underwriters would be small broker-dealers or municipal securities dealers.

A "small governmental jurisdiction" is defined by the RFA to include "governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand."<sup>304</sup> Currently,

there are more than 50,000 state and local issuers of municipal securities<sup>305</sup> that would be subject to the proposal. The Commission estimates that approximately 40,000 state and local issuers would be "small" entities for purposes of the RFA. However, the Commission believes that most issuers of municipal securities would qualify for the limited exemption in paragraph (d)(2) of the Rule.<sup>306</sup> The Commission has estimated that currently 10,000 issuers have entered into continuing disclosure agreements that provide for their submitting continuing disclosure documents to the MSRB and that, under the proposed amendment to narrow the Rule's exemption for demand securities, the number of affected issuers would increase to 12,000 issuers. It is possible that some of these issuers may be small issuers.

The proposed amendments would apply to all small entities that are currently subject to Rule 15c2-12. Because small entities already may submit event notices for the current disclosure items, these entities are able to prepare event notices that are proposed to be incorporated into the Rule. The Commission expects that providing the additional event disclosure items would increase costs incurred by small entities, to the extent that their primary offerings of municipal securities are covered by the Rule, because they potentially would have to provide a greater number of event notices than they do currently. However, the Commission notes this increased cost would be approximately \$8 per entity annually. The Commission's staff has estimated that for purposes of the Paperwork Reduction Act each issuer, including small entities, would be subject to an annual reporting burden of approximately 4.5 hours and an estimated annual cost ranging from \$600 to \$760.<sup>307</sup> In addition, some issuers could have one-time costs ranging from \$50 to \$4,300.<sup>308</sup>

#### E. Reporting, Recordkeeping and Other Compliance Requirements

Rule 15c2-12 currently sets forth eleven disclosure items that the

<sup>305</sup> See Securities Exchange Act Release No. 33741 (March 9, 1994), 59 FR 12748 (March 17, 1994).

<sup>306</sup> Specifically, Rule 15c2-12(d)(2) provides an exemption from the application of paragraph (b)(5) (Rule's provisions regarding continuing disclosure agreements) of the Rule with respect to primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation, including sending certain material event notices to the MSRB. See 17 CFR 240.15c2-12(d)(2).

<sup>307</sup> See *supra* Section V.E.2.

<sup>308</sup> *Id.*

<sup>296</sup> See *supra* Section II.E.3.

<sup>297</sup> See *supra* Section II.E.4.

<sup>298</sup> See *supra* Section II.A.

<sup>299</sup> *Id.*

<sup>300</sup> 5 U.S.C. 601(6).

<sup>301</sup> 17 CFR 240.0-10(c).

<sup>302</sup> 17 CFR 240.0-10(f).

<sup>303</sup> 17 CFR 230.157. See also 17 CFR 240.0-10(a).

<sup>304</sup> 5 U.S.C. 601(5).

Participating Underwriter must reasonably determine would be provided, in accordance with the continuing disclosure agreement, to the MSRB. The proposed amendments to Rule 15c2–12 would amend an existing event disclosure item and add four new event disclosure items. The proposed amendments would clarify the current disclosure item regarding adverse tax opinions, add tender offers to the current disclosure item regarding bond calls contained in paragraph (b)(5)(C)(8), and add three new disclosure items: bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and the appointment of a successor or additional trustee or the change of name of a trustee, if material. In addition, the proposal would modify the condition that event notices be submitted to the MSRB, “if material,” for some, but not all, of the Rule’s specified events. The proposal also would delete the current exemption for demand securities in paragraph (d)(1)(iii) and add language in new paragraph (d)(5) so that paragraphs (b)(5)<sup>309</sup> and (c)<sup>310</sup> of the Rule also would apply to a primary offering of demand securities. Lastly, the proposed amendments would modify paragraphs (b)(5)(i)(C) and (d)(2)(ii)(B) of the Rule to require a Participating Underwriter to reasonably determine that the issuer or obligated person has agreed in its continuing disclosure agreement to submit event notices to the MSRB, “in a timely manner not in excess of ten business days after the occurrence of the event,” instead of “in a timely manner” as the Rule currently provides.

<sup>309</sup> Rule 15c2–12(b)(5) requires a Participating Underwriter, before purchasing or selling municipal securities in connection with an offering of municipal securities, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of the holders of the municipal securities, to provide annual filings, material event notices, and failure to file notices (*i.e.*, continuing disclosure documents) to the MSRB. See 17 CFR 240.15c2–12(b)(5).

<sup>310</sup> Rule 15c2–12(c) requires a broker, dealer, or municipal securities dealer that recommends the purchase or sale of a municipal security to have procedures in place that provide reasonable assurance that it will receive prompt notice of any material event and any failure to file annual financial information regarding the municipal security. See 17 CFR 240.15c2–12(c).

#### *F. Duplicative, Overlapping, or Conflicting Federal Rules*

The Commission believes that there are no rules that duplicate, overlap, or conflict with the proposed amendments to Rule 15c2–12.

#### *G. Significant Alternatives*

The RFA directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed revisions to the Rule, the Commission considered the following alternatives:

- (1) Establishing differing compliance or reporting requirements or timetables which take into account the resources available to smaller entities;
- (2) Exempting smaller entities from coverage of the disclosure requirements, or any part thereof;
- (3) The clarification, consolidation, or simplification of disclosure for small entities; and
- (4) Use of performance standards rather than design standards.

The Commission believes that separate compliance or reporting requirements or timetables for smaller entities that would differ from the proposed requirements, or exempting broker-dealers from the obligations in paragraph (b)(5) and (c) of the Rule with respect to small issuers, would not achieve the Commission’s objectives. At the outset, the Commission notes that most small issuers of municipal securities are eligible for the limited exemption currently contained in paragraph (d)(2) of the Rule. The exemption in Rule 15c2–12(d)(2) provides that paragraph (b)(5) of the Rule, which relates to the submission of continuing disclosure agreements, does not apply to a primary offering if the conditions contained therein are met.<sup>311</sup> This limited exemption from the Rule is intended to assist small governmental jurisdictions that issue municipal securities. In the case of primary offerings by small governmental jurisdictions that are not covered by the exemption, the Commission notes that the proposal balances the informational needs of investors and others with regard to municipal securities issued by small governmental jurisdictions with the effects of the proposed rule change. The adoption of separate rules for

<sup>311</sup> Specifically, Rule 15c2–12(d)(2) provides an exemption from the application of paragraph (b)(5) (Rule’s provisions regarding continuing disclosure agreements) of the Rule with respect to primary offerings if, among other things, the issuer or obligated person has agreed to a limited disclosure obligation, including sending certain material event notices to the MSRB. See 17 CFR 240.15c2–12(d)(2).

broker-dealers with respect to continuing disclosure agreements entered into by smaller entities would not be consistent with the Commission’s intent to improve the greater availability and timeliness of disclosures in the municipal securities market. Furthermore, the municipal securities market could be disadvantaged by disparate disclosures by small and large entities pursuant to their continuing disclosure agreements. Broker-dealers and other market participants would be better able to satisfy their legal obligations under the federal securities laws to have a reasonable basis on which to recommend municipal securities. In addition, the proposal would impose performance standards rather than design standards.

#### *H. Request for Comments*

The Commission encourages written comments on matters discussed in the IRFA. In particular, the Commission requests comments on: (a) The number of small entities that would be affected by the proposed amendments; (b) the nature of any impact the proposed amendments would have on small entities and empirical data supporting the extent of the impact; (c) how to quantify the number of small entities that would be affected by and/or how to quantify the impact of the proposed amendments; and (d) potential costs to small entities, if any, including costs associated with providing event notices. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rule is adopted, and will be placed in the same public file as comments on the proposed rule itself. Persons wishing to submit written comments should refer to the instructions for submitting comments in the front of this release.

#### **X. Statutory Authority**

Pursuant to the Exchange Act, and particularly Sections 2, 3(b), 10, 15(c), 15B, 17 and 23(a)(1) thereof, 15 U.S.C. 78b, 78c(b), 78j, 78o(c), 78o–4, 78q and 78w(a)(1), the Commission is proposing amendments to § 240.15c2–12 of Title 17 of the *Code of Federal Regulations* in the manner set forth below.

#### **Text of Proposed Rule Amendments**

##### **List of Subjects in 17 CFR Part 240**

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is proposed to be 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, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78l, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

2. Section 240.15c2-12 is amended by the following:

A. Revise the introductory text of paragraph (b)(5)(i)(C), and paragraphs (b)(5)(i)(C)(2), (6), (7), (8), (10), and (11);

B. Add new paragraphs (b)(5)(i)(C)(12), (13), and (14);

C. Revise paragraph (d)(1)(ii);

D. Remove paragraph (d)(1)(iii); and

E. Revise the paragraph (d)(2)(ii)(B); and

F. Add new paragraph (d)(5).

The additions and revisions read as follows.

**§ 240.15c2-12 Municipal securities disclosure.**

\* \* \* \* \*

(b) \* \* \*

(5)(i) \* \* \*

(C) In a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events with respect to the securities being offered in the Offering:

\* \* \* \* \*

(2) Non-payment related defaults, if material;

\* \* \* \* \*

(6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax-exempt status of the

securities, or other events affecting the tax-exempt status of the security;

(7) Modifications to rights of security holders, if material;

(8) Bond calls, if material, and tender offers;

\* \* \* \* \*

(10) Release, substitution, or sale of property securing repayment of the securities, if material;

(11) Rating changes;

(12) Bankruptcy, insolvency, receivership or similar event of the obligated person;

**Note to paragraph (b)(5)(i)(C)(12):** For the purposes of the event identified in paragraph (b)(5)(i)(C)(12), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan or reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person;

(13) The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material;

(14) Appointment of a successor or additional trustee or the change of name of a trustee, if material; and

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

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

\* \* \* \* \*

(2) \* \* \*

(ii) \* \* \*

\* \* \* \* \*

(B) In a timely manner not in excess of ten business days after the occurrence of the event, 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; and

\* \* \* \* \*

(5) With the exception of paragraphs (b)(5) and (c) of this section, this section shall not apply to a primary offering of municipal securities in authorized denominations of \$100,000 or more if such securities may, at the option of the holder thereof, 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.

\* \* \* \* \*

**PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER**

\* \* \* \* \*

3. Part 241 is amended by adding Release No. 34-XXXXX and the release date of X to the list of interpretative releases.

Dated: July 17, 2009.

By the Commission.

**Elizabeth M. Murphy,**  
*Secretary.*

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