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**SEC RESPONDS TO REQUEST FOR GUIDANCE ON RULE  
15c2-12 AMENDMENTS FROM ASSOCIATION'S COMMITTEE  
ON SECURITIES LAW AND DISCLOSURE**

*Editor's Note: The following letters dated June 23, 1995, were received in response to a request for guidance submitted to the Office of the Chief Counsel of the SEC's Division of Market Regulation by the Association's Committee on Securities Law and Disclosure, chaired by John S. Overdorff and vice-chaired by Gerald J. Laporte.*

June 23, 1995

Andrew Kintzinger, Esq., President  
Amy Dunbar, Esq., Director of Governmental Affairs  
National Association of Bond Lawyers  
2000 Pennsylvania Avenue, N.W.  
Suite 9000  
Washington, D.C. 20006

Dear Drew and Amy:

Attached is the staff's response to the June 23, 1995 [sic] letter of the Securities Law and Disclosure Committee of the National Association of Bond Lawyers, providing answers to questions raised by that committee regarding Rule 15c2-12. I want to take this opportunity to thank you and the membership of the National Association of Bond Lawyers for your valuable assistance in educating the municipal securities market regarding the amendments to Rule 15c2-12. Your request for clarification of certain issues will facilitate the smooth implementation of the amendments to the rule.

The response to your letter resulted from the efforts of many members of the staff, including staff of the Divisions of Market Regulation and Corporation Finance, and the Office of Municipal Securities. On behalf of this group, we look forward to working with NABL in future educational efforts.

Sincerely,

Robert L. D. Colby  
Deputy Director

June 23, 1995

John S. Overdorff, Chair  
Gerald J. Laporte, Vice-Chair  
Securities Law and Disclosure Committee

National Association of Bond Lawyers  
2000 Pennsylvania Avenue, N.W  
Suite 9000  
Washington, D.C. 20006

Re: Rule 15c2-12.

Dear Messrs. Overdorff and Laporte:

The Securities Law and Disclosure Committee of the National Association of Bond Lawyers, in its letter of June 23, 1995 [*sic*], requested staff interpretive guidance regarding the recent amendments to Securities Exchange Act of 1934 ("Exchange Act") Rule 15c2-12, as adopted in Exchange Act Release No. 34961 (Nov. 10, 1995) ("Adopting Release"). For ease of reference, the questions in the attached letter have been restated with the responses.

Question 1:

Paragraph (b)(5)(i) requires that the undertaking be "for the benefit of the holders of such securities." The Release acknowledges that the Rule does not specify the consequences of an issuer's breach and that remedies for breach are a subject of negotiation between the parties. Typically, indentures permit only the trustee or the holders of a minimum percentage of the bonds (e.g., a majority or 25%) to exercise remedies other than with respect to the right to receive payment. Would it be permissible to apply the remedial provisions of the indenture or other governing instrument applicable to non-performance of covenants generally to non-performance of the undertaking?

Response:

In the staff's view, a Participating Underwriter would be unable to determine that an undertaking meets the requirements of Rule 15c2-12(b)(5)(i) if the undertaking restricts the ability of beneficial owners of municipal securities to seek compliance by an issuer or obligated person with the undertaking. Requiring beneficial owners to act in concert with other holders or beneficial owners in order to take remedial action to require the provision of information and notices is an example of such a restriction. In contrast, the staff would not object if the rights of holders or beneficial owners to challenge the adequacy of the information provided in accordance with the undertaking are conditioned upon the same type of enforcement restrictions as those applicable to other information undertakings in the governing documents. Of course, nothing in the undertaking can limit a holder's or beneficial owner's rights under other provisions of the federal securities laws.

The amendments to Rule 15c2-12 were intended to make remedies available directly to beneficial owners of municipal securities who need information in order to make investment decisions, by looking past nominees such as the Depository Trust Company or a broker-dealer to holders in street name. For guidance in analyzing whether a particular holder is a beneficial owner, analogous provisions of the federal securities laws, such as the definition of beneficial owner in Exchange Act Rule 13d-3, may be helpful.

## Question 2:

Under what circumstances can an undertaking be amended?

## Response:

The staff anticipates that, in meeting the requirement that annual financial information be specified in reasonable detail, the undertakings will set forth a general description of the type of financial information and operating data that will be provided. These descriptions need not state more than a general category of financial information and operating data. For example, categories of operating data provided for a college or university facility bond offering might include, among others, information regarding attendance, applications, and tuition and room and board rates charged to students. In a water or sewer financing, categories of information provided might include, among others, customers, rates, use, capacity, and demand. Moreover, where an undertaking calls for information that no longer can be generated because the operations to which it related have been materially changed or discontinued, a statement to that effect would satisfy the undertaking. In such an instance, it may be good practice to provide similar operating data with respect to any substitute or replacement operation. In addition, issuers and obligated persons may provide additional information that is not required by the terms of the undertaking. Accordingly, the staff does not anticipate that it often will be necessary to amend informational undertakings.

As noted in the Adopting Release, the undertakings may not be amended based on a unilateral decision by either the issuer, an obligated person, or by any other party. An undertaking that includes an amendment provision nevertheless may satisfy the requirements of Rule 15c2-12, if the following conditions are included:

- (a) The amendment may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the obligated person, or type of business conducted;
- (b) The undertaking, as amended, would have complied with the requirements of the rule at the time of the primary offering, after taking into account any amendments or interpretations of the rule, as well as any change in circumstances; and
- (c) The amendment does not materially impair the interests of holders, as determined either by parties unaffiliated with the issuer or obligated person (such as the trustee or bond counsel), or by approving vote of bondholders pursuant to the terms of the governing instrument at the time of the amendment.

The undertaking also should provide that the annual financial information containing the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to an undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made should present a comparison between the financial

statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

The comparison should include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the issuer or obligated person to meet its obligations. To the extent reasonably feasible, the comparison also should be quantitative. A notice of the change in the accounting principles should be sent to the NRMSIRs or the MSRB, and the appropriate SID, if any.

Question 3:

Can a written undertaking to file information with a state information depository ("SID") be limited to a SID in the state in which the governmental entity constituting an "issuer" is located?

Response:

For purposes of compliance with Rule 15c2-12, a written undertaking to provide the required information to a SID may be limited to the SID of the state in which a governmental entity constituting an "issuer" is located. While the rule does not prohibit an issuer or obligated person from also sending information to the SID of any other state, an undertaking to provide this information only to a SID in another state will not satisfy the rule.

Question 4:

The "small issuer" exemption in the Rule (paragraph (d)(2)) allows certain issuers and obligated persons the option of filing annual financial information or operating data with a SID as opposed to filing such information and data with each nationally recognized municipal securities information repository ("NRMSIR"). In many states, however, there may not be an entity that qualifies as a SID. To provide its small issuers the opportunity to use the exemption, can such a state designate a single NRMSIR as its SID?

Response:

The staff would consider particular situations on an individual basis. The staff is concerned that it may be inconsistent with the functioning of the NRMSIR system contemplated by the rule for an issuer to provide information required to be made available under the rule to one NRMSIR, without providing it to other NRMSIRs on a contemporaneous basis.

Question 5:

We interpret the Rule to require that the annual financial information and operating data to be provided on an annual basis is that which pertains particularly to the issuer or obligated person's "operations", i.e., the information which the issuer or obligated person generates as

to itself. Under this approach, are forecasts and demographic information considered to be financial information or operating data required to be updated under the Rule?

Response:

Operating data is quantitative information that relates to an obligated person's own operations. It is unlikely, therefore, that demographic information would constitute operating data of a particular obligated person.

Forecasts regarding the obligated person's operations contained in a final official statement do not need to be updated because the forecasts themselves are not operating data. The components of these forecasts (i.e., sources of revenue or expenses), however, would identify the type of actual operating data to be provided as part of annual financial information. Similarly, if a feasibility study or other type of expertised report included in the final official statement contains components of operating data, only the results of these actual operations need be provided on an annual basis pursuant to the undertaking.

Question 6:

When an obligated person provides audited financial statements in the final official statement, does the annual information requirement of Rule 15c2-12 require the obligated person to provide audited financial statements as part of its annual financial information, or should the obligated person provide unaudited financial statements as part of annual financial information, and subsequently, if and when available, provide audited financial statements?

Response:

As emphasized in the Adopting Release, the type of financial information that should be contained in the final official statement and as part of annual financial information will depend on the type of issuing entity, obligated person, and type of financing. If an obligated person has ongoing revenues and expenses, it is anticipated that full financial statements would be provided in the final official statement and as part of the annual financial information. For other types of issues and obligated persons, including those involving dedicated revenue streams and certain types of structured financings, other types of special purpose financial statements, project operating statements or reports may be used to reflect the financial position of the credit source for the financing (and also be provided as part of annual financial information).

The same financial statements that are included in the final official statement must be provided as part of the annual financial information. If audited financial statements are not available by the time the annual financial information must be provided, unaudited financial statements must be provided as part of the annual financial information, and, as required by the rule, audited financial statements, when and if available, must be provided to each NRMSIR and to the appropriate SID, if any.

## Question 7:

Reporting companies are required to file various materials with the Securities and Exchange Commission under the Exchange Act. Such materials include financial information and operating data. Assuming a reporting company was an obligated person under the Rule, could its written undertaking for purposes of paragraph (b)(5) be one to continue such filings with the Commission, without identifying the specific information to be provided?

## Response:

An obligated person that also is a company required to file reports under the Exchange Act may provide the annual financial information through a cross-reference to the filed reports. The undertaking need not specify the type of information required by Commission rules, but by referencing those rules, the issuer or obligated person would commit itself to provide that type of information, whether or not it continues to file reports with the Commission. A Participating Underwriter also should ascertain that the obligated person has agreed to send a notice to each NRMSIR and to the appropriate SID, if any, on an annual basis indicating that reports filed in accordance with the Exchange Act constitute the annual financial information of the obligated person for that year.

## Question 8:

Neither Release No. 33742 (in which the Rule was proposed) nor the Release elaborates on the term "bond calls," as such term is used in the context of paragraph (b)(5)(i)(C) of the Rule. In addition, bond calls were not one of the events enumerated in the American Bankers Association Corporate Trust Committee's 1990 proposal. We interpret the Rule such that, generally, notice of scheduled bond calls (e.g., maturities and sinking fund redemptions) would not be required, and that, generally, notice of redemptions at the option of the obligor after a period where the call could not be exercised (e.g., after 10 years from the date of issuance) or upon a so-called "calamity call" (e.g., destruction or condemnation) would be required. We would appreciate the Staff's understanding as to whether redemptions in the ordinary course of a financing that are expected, but the timing and amount of which are uncertain (e.g., prepayments and excess revenue in mortgage revenue bonds or excess tax receipts in a tax increment financing) are generally events for which notice should be given pursuant to the Rule.

## Response:

A notice of the occurrence of a mandatory, scheduled redemption, not otherwise contingent upon the occurrence of an event, is not required under the rule if the terms under which the redemption is to occur are set forth in detail in the final official statement, and the only open issue is which bonds will be redeemed in the case of a partial redemption. So called "calamity calls," optional calls, and other calls in which the timing or amount are uncertain would be contingent on the occurrence of another event, and thus would be subject to a notice, if they were material. This

position is conditioned on the provision of notice of the redemption to the bondholders as required under the terms of the governing instrument, and on the provision of public notice of the redemption. See Exchange Act Release No. 23856 (Dec. 3, 1986).

Question 9:

The Rule appears to require notice of rating changes with respect to the municipal securities being offered. Providers of guaranteed investment contracts, reserve fund surety bonds and credit enhancers receive ratings (individually, a "rated entity"). The rating on an issue of municipal securities with such features may not be affected if there is a rating change with respect to a rated entity. Must a material events notice be filed if the rating changes on the rated entity but not on the municipal securities?

Response:

Given the diversity of possible structures of offerings in the municipal securities market, any rating change that relates to the issue, an issuer, an obligated person, credit enhancer, or liquidity provider for the issue that could affect the value of a municipal security could be the subject of a notice, if such rating change is material. For example, whether or not the municipal securities themselves were rated, there may be circumstances in which a rating change for an entity that has provided a guarantee or insurance to support repayment of the securities could affect the securities. In such a situation, in assessing the materiality of a rating change of such an entity, the degree to which the rating change has been widely reported and has widespread impact may be taken into account. In certain circumstances, it may not be clear, absent individual disclosure, which classes of outstanding securities are affected by rating changes with respect to such an entity.

Question 10:

Many municipal issuers account pursuant to the generally accepted accounting principles ("GAAP") promulgated by the Financial Accounting Standards Board ("FASB"), as such principles are modified by the governmental accounting standards promulgated by the Government Accounting Standards Board ("GASB"). Further, state laws may require other modifications of GAAP. Rather than summarizing their accounting procedures in the written undertaking, can issuers and obligated persons merely refer to the statutes or manuals in which their method of accounting is specified?

Response:

The undertaking must specify in reasonable detail what accounting principles are followed. An undertaking that contains a reference to GAAP or mandated state statutory principles, as in effect from time to time, would satisfy this provision of the rule. The accounting principles that will be followed also should be discussed in the final official statement, either as part of the financial statements or independently. As noted in Exchange Act Release No. 33741 (March 9, 1994) ("Interpretive

Release"), that discussion should provide a quantified reconciliation to GAAP, if possible, when non-GAAP principles are followed.

Question 11:

Over the term of a municipal security, the accounting principles pursuant to which an issuer or obligated person prepares its financial statements may change as a result of future promulgations by FASB and GASB, as well as changes in state law. May a written undertaking provide that such changes will be deemed to be included by reference in the undertaking when they are adopted and disclosed in the issuer's annual filings under the undertaking?

Response:

As indicated in our response to Question 10, the undertaking may specify the accounting principles being followed by reference to GAAP or mandated state statutory principles, as in effect from time to time. This provision anticipates changes in GAAP or state law requirements. If such changes occur and are material, obligated persons should consider including a narrative explanation in the annual financial information describing the impact of the changes. See also response to Question 2 above.

Question 12:

May obligated persons that are reporting companies under Section 12 or Section 15(d) of the Exchange Act specify in their written undertakings that their financial statements will be prepared in accordance with those accounting principles applicable to their periodic reports filed with the Commission, and that, if they go private, their financial statements will be prepared in accordance with GAAP?

Response:

The undertaking of an obligated person that is a reporting company under the Exchange Act containing such a description of its accounting principles would satisfy the requirements of the rule.

Question 13:

Rather than the "date on which" annual financial information for the preceding fiscal year will be provided, may the written undertaking specify the "time within which" such information will be available?

Response:

The requirement in Rule 15c2-12(b)(5)(ii)(C) that the written agreement or contract specify the date on which the annual financial information for the preceding fiscal year will be provided would be satisfied if such written agreement or contract stated that the annual financial information would be provided within a specified number of days after the fiscal year end of the person covered by the agreement. If the fiscal

year-end of the person covered by the agreement were changed after the execution of the agreement, notification of such fact should be made to the NRMSIRs or the Municipal Securities Rulemaking Board ("MSRB"), and the appropriate SID, if any. See Letter re: R.V. Norene & Associates, Inc. (May 4, 1995).

Question 14:

The Release suggests that an issuer's undertaking to provide continuing information about "obligated persons" may terminate once the person no longer has liability relating to the payment of the municipal securities. If the written undertaking provides for such termination, will termination occur automatically or is notice thereof required to be given?

Response:

Whether termination occurs automatically or whether the obligated person is required to give notice in order to terminate its obligation is a matter of contract, and is subject to negotiation by the parties. It would be good practice, however, to provide notice to the NRMSIRs or the MSRB, and the appropriate SID, if any, in the event of a termination of an obligation to provide annual financial information.

Question 15:

If the written undertaking does not specify the criteria pursuant to which obligated persons are selected, will an issuer's obligation to provide continuing information about an obligated person described in the official statement terminate when the obligated person's commitment regarding the municipal securities is no longer material to the repayment of the securities or when the obligated person is no longer liable for any obligation relating to the securities?

Response:

In the absence of the use of objective criteria to determine who are obligated persons for purposes of the rule, the obligation of an issuer or obligated person to provide annual financial information and notices of material events terminates only when the person no longer has any liability for repayment of the municipal securities (for example, through termination or expiration of its commitment to support payment, or as a result of a defeasance of the municipal securities with no remaining liability). In this context, materiality would not govern an obligated person's continuing obligation to comply with an undertaking.

Question 16:

FASB's Statement of Financial Accounting Standards No. 76 ("Extinguishment of Debt") requires that a debtor consider debt to be extinguished under three circumstances: (i) payment of the debt, (ii) legal release as a primary obligor, and (iii) defeasance by irrevocably depositing eligible assets in a trust to be used solely to satisfy scheduled payments on the debt (an "economic defeasance").

If the written undertaking does not specify the criteria pursuant to which obligated persons are selected, will an issuer's obligation to provide continuing information about an obligated person described in the official statement terminate when there has been an economic defeasance of the obligated person's commitment regarding the municipal securities?

Response:

For purposes of the rule, an obligated person's liability with respect to the municipal securities will be considered to be terminated under the following circumstances:

(a) Redemption in full of the municipal securities; or

(b) The occurrence of a legal defeasance in accordance with the terms of the governing instrument and, for the purposes of such governing instrument, the lien securing the municipal securities, if any, is released. Economic defeasance (*i.e.*, an irrevocable deposit of monies or U.S. Treasury securities into an escrow account with a bona fide third party to be used solely to satisfy scheduled payments on the municipal securities, where the amount deposited into the escrow account is sufficient to pay the principal and interest on the municipal securities in full) will terminate a person's status as an obligated person only where the escrow arrangement results in legal defeasance under the terms of the governing instrument.

In the case of a defeasance, there also should be explicit disclosure to the NRMSIRs or the MSRB, and the appropriate SID, if any, and in the refunding documents, if any, that the bonds have been escrowed to maturity or escrowed to call, as well as appropriate disclosure of the timing of maturity or call. Cf. Letter from Richard Ketchum, Director, Division of Market Regulation, SEC, to H. Keith Brunnemer, Chairman, MSRB (June 24, 1988).

Question 17:

Can an issuer opt out of the small issuer "exception" and otherwise comply with Rule 15c2-12(b)(5)?

Response:

In an offering of municipal securities that otherwise satisfies the small issuer exception of Rule 15c2-12(d)(2)(ii)(A), the rule would be satisfied if an issuer or obligated person undertakes to provide annual financial information and notices of material events as described in Rule 15c2-12(b)(5), in lieu of complying with the provisions of the small issuer exception. If an issuer or obligated person opts out of the small issuer exception, the entire offering would be subject to Rule 15c2-12(b)(5).

Question 18:

The Rule seems to imply that the final official statements prepared by "small issuers" must "include, at a minimum, that financial information

and operating data which is customarily prepared by such obligated person and is publicly available." Municipalities customarily prepare many documents that contain financial information and operating data, most of which are publicly available due to "sunshine" laws. Is an issuer required to provide more information under a paragraph (d)(2) undertaking than it would otherwise be required to provide under a paragraph (b)(5) undertaking?

Response:

The undertaking provided in accordance with Rule 15c2-12(d)(2)(ii)(A) must specify the particular information that an issuer or obligated person will make available. If an issuer or obligated person customarily prepares and makes publicly available information that is more extensive than that provided in the final official statement, the undertaking may be limited to providing the information that would comprise annual financial information for non-exempt offerings.

Question 19:

Pursuant to a paragraph (b)(5) undertaking, an issuer or obligated person may prepare an annual filing that is current as of its date, and supplement such information by filing notices of material events during the intervening period. In complying with its promise to provide certain information to any person "upon request" under a paragraph (d)(2) undertaking, can an issuer disseminate financial information and operating data that was prepared as of a certain date (and properly disclosed as such), together with any material event notices that may have been disseminated since such date, or would the issuer be required to update the information as of the date of each request?

Response:

Under the provisions of Rule 15c2-12(d)(2)(ii)(A), information provided by small issuers pursuant to a limited information undertaking would not be required to contain information more current than that which customarily has been prepared annually, together with any subsequent material event notices. The information provided should indicate that it was prepared as of a specified date.

Question 20:

For purposes of many securities, there will be no disclosure in the final official statement regarding obligated persons who, at the time the securities are sold, are unknown. Under paragraph (b)(5)(i)(A), issuers may agree to objective criteria for determining whether a person is an "obligated person" for whom continuing disclosure is required. Can small issuers also agree to "objective criteria" for determining whether a person is an "obligated person" for whom continuing disclosure is required? Can small issuers limit their undertaking regarding "obligated persons" to only those described in the final official statement?

Response:

Rule 15c2-12(d)(2)(ii)(A) requires that the limited undertaking cover each obligated person for which financial information or operating data is presented in the final official statement. The undertakings may be limited to such persons. Small issuers also may use objective criteria to describe the persons covered by the undertaking. If objective criteria are used, the same objective criteria used in presenting the information in the final official statement must be applied in determining the entities for which financial information and operating data will be provided annually.

Question 21:

Can a small issuer list the appropriate office or officer from which information may be obtained, as opposed to such person's "name"?

Response:

A small issuer may list the appropriate office or officer from which information may be obtained, rather than naming a particular person.

Question 22:

Providers of municipal bond insurance, letters of credit, or other liquidity facilities are not considered to be "obligated persons" for purposes of the Rule. Credit enhancement for municipal securities is not necessarily limited to those categories. Many municipal securities may be credit enhanced indirectly. For example, entities such as the Government National Mortgage Association, the Federal National Mortgage Association and the Federal Housing Administration may provide credit enhancement with respect to municipal securities by guaranteeing, or entering into other contractual arrangements to enhance, all or part of the obligations underlying the municipal securities (e.g., mortgage loans). Are such types of entities, to the extent they may provide credit enhancement as described above, either (a) not considered within the definition of an "obligated person" or (b) considered to be providing "other liquidity facilities" and therefore specifically excluded from the definition of "obligated person"?

Response:

Under the rule, obligated persons are those persons committed by contract or other arrangement that is structured to support payment of all, or part, of the obligations on the municipal securities. As the Adopting Release notes, providers of bond insurance, letters of credit, and liquidity facilities were excluded from the definition of "obligated person" because of the availability of public information concerning these providers, and their expressed willingness to deposit publicly available reports in repositories, or otherwise to note where such reports may be obtained easily.

In light of the fact that the Government National Mortgage Association, the Federal National Mortgage Association, and the Federal Housing Administration and similar

entities are United States government sponsored enterprises or government agencies, and public information regarding such entities is readily available, the staff would not object if such entities were not covered by an undertaking.

\* \* \* \*

The foregoing responses address only the questions raised in your letter relating to Rule 15c2-12, as amended. The responses do not address the staff's or the Commission's position regarding the obligations of municipal market participants, and in particular, issuers, brokers, dealers, and municipal securities dealers, under the antifraud provisions of the federal securities laws. In that regard, please refer to the Interpretive Release for further guidance. Should you have questions regarding the responses, please contact the Office of Chief Counsel, Division of Market Regulation, at (202) 942-0073.

Sincerely,

Robert L. D. Colby