
SEC RELEASE No. 34-34961 (November 10, 1994): Final Rule 15c2-12

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

Release No. 34-34961; File No. S7-5-94

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Municipal Securities Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Final Rule.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is adopting amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 ("Exchange Act") to deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of securities for which adequate information is not available. The amendments prohibit a broker, dealer, or municipal securities dealer ("Participating Underwriter") from purchasing or selling municipal securities unless the Participating Underwriter has reasonably determined that an issuer of municipal securities or an obligated person has undertaken in a written agreement or contract for the benefit of holders of such securities to provide certain annual financial information and event notices to various information repositories; and prohibit a broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipal security unless it has procedures in place that provide reasonable assurance that it will receive promptly any event notices with respect to that security.

DATES: *Effective Date:* This rule is effective on July 3, 1995 except for 240.15c2-12(c) which is effective on January 1, 1996.

Compliance Date: 240.15c2-12(b)(5)(i)(A) and 240.15c2-12(b)(5)(i)(B) shall not apply with respect to fiscal years ending prior to January 1, 1996; and 240.15c2-12(d)(2)(ii) and 240.15c2-12(d)(2)(iii) shall not apply to an Offering of municipal securities commencing prior to January 1, 1996.

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1875, Division of Corporation Finance, Mail Stop 7-6 Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction and Summary

The Commission has long been concerned with disclosure in both the primary and secondary markets for municipal securities.¹ As part of the Securities Acts Amendments of 1975, Congress established a limited regulatory scheme for the municipal securities market. This limited regulatory scheme included mandatory registration of municipal securities brokers and dealers, and the creation of the Municipal Securities Rulemaking Board ("MSRB"). In 1989, acting in response to consistently slow dissemination of information in connection with primary offerings of municipal securities, the Commission, pursuant to its authority under Exchange Act Section 15(c)(2),² adopted Rule 15c2-12³ and an accompanying interpretation concerning the due diligence

1 Both the Securities Act and the Exchange Act were enacted with broad exemptions for municipal securities from all of their provisions except the antifraud provisions of the Securities Act Section 17(a) and Exchange Act Section 10(b). Municipal securities received special exemptions not only based on considerations of federal-state comity, but also due to the lack of perceived abuses, at the time of enactment, in the municipal securities market as compared with the corporate market. Furthermore, until recently, the typical purchasers of municipal securities were institutional investors with financial expertise.

2 Section 15(c)(2) of the Exchange Act prohibits municipal securities dealers from effecting any transaction in, or inducing or attempting to induce the purchase or sale of, any municipal security by means of a "fraudulent, deceptive, or manipulative act or practice," and authorizes the Commission, by rules and regulations, to define and prescribe means reasonably designed to prevent such acts and practices. Exchange Act Section 15(c)(2), 15 U.S.C. 78o(c)(2). Rule 15c2-12 also was adopted pursuant to the Commission's authority under Exchange Act Section 2, 3, 10, 15, 15B, and 23; 15 U.S.C. 78b, 78c, 78j, 78o, 78o-4, 78q, and 78w.

3 17 CFR 240.15c2-12. Rule 15c2-12 was proposed for adoption in 1988, and adopted in 1989. See Securities Exchange Act Release No. 26100 (Sept. 22, 1988), 53 FR 37778 ("1988 Release"); Securities Exchange Act Release No. 26985 (June 28, 1989), 54 FR 28799 ("1989 Release"). Rule 15c2-12 requires an underwriter of municipal securities (1) to obtain and review an issuer's official statement that, except for certain information, is "deemed final" by an issuer prior to making a purchase, offer, or sale of municipal securities; (2) in negotiated sales, to provide the issuer's most recent preliminary official statement (if one exists) to potential customers; (3) to deliver to customers, upon request, copies of the final official statement for a specified period of time; and (4) to contract to receive, within a specified time, sufficient copies of the issuer's final official statement to comply with the rule's delivery requirement, and the requirements of the rules of the MSRB.

obligations of underwriters of municipal securities.⁴ In 1993, the Commission's Division of Market Regulation conducted a comprehensive review of many aspects of the municipal securities market, including secondary market disclosure.⁵ Findings in the September, 1993 *Staff Report on the Municipal Securities Market* ("*Staff Report*") regarding the growing participation of individual investors, who may not be sophisticated in financial matters, as well as the proliferation of complex derivative municipal securities, underscored the need for improved disclosure practices in both the primary and secondary municipal securities markets.⁶ Information about the issuer and other obligated persons is as critical to the secondary market,⁷ where little information about municipal issuers and obligated persons is regularly disseminated, as it is in primary offerings, where, as a general matter, good disclosure practices exist. As one industry group testified, today "secondary market information is difficult to come by even for

4 The 1989 Release also stated that issuers are primarily responsible for the content of their disclosure documents, and may be held primarily liable under the federal securities laws for misleading disclosure. See 1989 Release at n. 84.

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

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

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

professional municipal analysts, to say nothing of retail investors."⁸

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

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

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

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

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

about which little or no current information exists. Brokers, dealers, and municipal securities dealers serve as the link between the issuers whose securities they sell and the investors to whom they recommend securities. Investors, especially individual investors, place their reliance on these securities professionals for their recommendations of municipal securities.

The amendments to Rule 15c2-12 ensure that brokers, dealers, and municipal securities dealers will review the secondary market disclosure practices of issuers and other obligated persons at the time of an offering of municipal securities.¹¹ This scrutiny at the time of initial issuance of municipal securities will result in the dissemination of important information by issuers and other obligated persons throughout the term of the municipal securities. As a result of the amendments, brokers, dealers, and municipal securities dealers will be better able to satisfy their obligation under the federal securities laws to have a reasonable basis on which to recommend municipal securities, as well as their obligations under the rules of the MSRB.

The availability of secondary market disclosure to all municipal securities market participants will enable investors to better protect themselves from misrepresentation or other fraudulent activities by brokers, dealers, and municipal securities dealers. A lack of consistent secondary market disclosure impairs investors' ability to acquire information necessary to make intelligent, informed investment decisions, and thus, to protect themselves from fraud.

In the Proposing Release, comment was requested on each aspect of the Proposed Amendments, as well as on standards for recognition of nationally recognized municipal securities information repositories ("NRMSIRs"). In response to the request for comments, the Commission received over 390 comment letters representing over 475 groups and individuals. The commenters represented all types of participants in the municipal securities market, including issuers, underwriters, investors, counsel, analysts, financial advisers, banks, insurance providers, disclosure services, and the MSRB.¹² The comment letters presented a variety of thoughtful views on

the issues raised by the Proposing Release.¹³ The Commission has determined to adopt amendments to Rule 15c2-12, with certain modifications that are designed to address concerns expressed by commenters.¹⁴ In addition, the suggestions of a group of industry participants that cooperated to assist the Commission in its efforts to improve disclosure in the municipal securities market have been valuable.¹⁵

Commenters across a broad range of market participants supported the goal of improved secondary market disclosure for the municipal securities market, but emphasized that flexibility is necessary, given the diversity that exists in the municipal securities market.¹⁶ As adopted, the amendments to Rule 15c2-12 will further that goal by prohibiting underwritings unless there are commitments to provide ongoing disclosure, while, at the same time, providing issuers with significant flexibility to determine the appropriate nature of that disclosure. The amendments retain the requirement that a Participating Underwriter ascertain that an issuer or obligated person has undertaken to provide secondary market disclosure, including notices of material events, to information repositories, but rely on the parties to the transaction to establish who will provide secondary market disclosure, and what information is material to an understanding of the security being offered.

The amendments build upon and reinforce current market practices that have provided, as a general matter, good quality disclosure in official statements, and extend those practices to the secondary market. As is currently the practice, under the amendments, the participants in an underwriting would continue to determine which persons are material to an

11 Participating Underwriters generally maintain a market in an issue of municipal securities in the period following an offering. Failure by a Participating Underwriter to receive assurances with respect to undertakings to provide secondary market disclosure will increase the difficulty of its formulation of a reasonable basis on which to recommend a municipal security during this period of secondary market trading.

12 Among others, the Commission received 232 letters representing the views of 242 issuers and issuer associations; 52 letters representing the views of 57 brokers, dealers, and municipal securities dealers; and 8 letters representing the views of 8 investors and investor associations.

13 The Commission has given consideration to the views of some commenters who questioned the Commission's authority to adopt the amendments to Rule 15c2-12. See, e.g., Letter of ABA Business Law Section; Letter of Hawkins Delafield & Wood, Letter of NABL. The Commission believes that it has ample authority to adopt the amendments.

14 The comment letters and a summary of the comment letters prepared by Commission staff are contained in Public File No. S7-5-94. See also Public File No. S7-4-94.

15 See Joint Response to the Securities Exchange Commission on Releases Concerning Municipal Securities Market Disclosure prepared by American Bankers Association's Corporate Trust Committee, American Public Power Association, Association of Local Housing Finance Agencies, Council of Infrastructure Financing Authorities, Government Finance Officers Association, National Association of Counties, National Association of State Auditors, Comptrollers and Treasurers, National Council of State Housing Agencies, National Federation of Municipal Analysts, Public Securities Association ("Joint Response").

16 See, e.g., Joint Response; Letter of Chapman and Cutler; Letter of Florida Division of Bond Finance of the State Board of Administration; Letter of J.P. Morgan Securities, Inc.; Letter of National Association of Bond Lawyers ("NABL"); Letter of Orrick, Herrington & Sutcliffe ("Orrick Herrington"); Letter of Public Securities Association ("PSA").

understanding of the Offering. Information concerning those persons would be included in the final official statement. Financial information and operating data that is material to an offering at the outset generally remains material throughout the life of the securities. Under the amendments, that information would be provided on an annual basis. Put simply, the amendments reflect the belief that purchasers in the secondary market need the same level of financial information and operating data in making investment decisions as purchasers in the underwritten offering.

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

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

II. Description of Amendments to Rule

15c2-12

A. Amendments with Respect to the Underwriting of Municipal Securities

Under the amendments to Rule 15c2-12, a broker, dealer, or municipal securities dealer (“Participating Underwriter”)¹⁷ will be prohibited, subject to certain

¹⁷ See Rule 15c2-12(a).

exemptions, from purchasing or selling municipal securities in connection with a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more (“Offering”),¹⁸ unless the Participating Underwriter has made certain determinations.¹⁹ Specifically, the Participating Underwriter must reasonably determine that an issuer of municipal securities or an obligated person, either individually or in combination with other issuers of such municipal securities or other obligated persons,²⁰ has undertaken in a written agreement or contract for the benefit of holders of such securities, to provide, either directly or indirectly through an indenture trustee or a designated agent, certain annual financial information and event notices to various information repositories.²¹

The “reasonable determination” required by the amendments to Rule 15c2-12 must be made by the Participating Underwriter prior to its purchasing or selling municipal securities in connection with an Offering. A Participating Underwriter would, therefore, need to receive assurances from the issuer or obligated persons that such undertakings would be made before agreeing to act as an underwriter. A dealer could look to provisions in the underwriting agreement or bond purchase agreement that describe the undertakings for the benefit of bondholders made elsewhere, such as in a trust indenture, bond resolution, or separate written agreement.²² In a competitively bid offering, such assurances also might be found in a notice of sale. Of course, representations concerning commitments to provide secondary market disclosure, like any other key representations by an issuer, are subject to specific verification, such that a Participating Underwriter has a reasonable basis to believe that such representations are true and accurate. Thus, investigation of an issuer's or obligated person's undertakings to provide secondary market disclosure would be an element of the Participating Underwriter's professional review of offering documents.²³

¹⁸ The amendments also include an exemption for small and infrequent issuers. See Section II.D.1., *infra*.

¹⁹ Rule 15c2-12(b)(5)(i).

²⁰ These concepts are discussed in Section II.A.1.b., *infra*.

²¹ Information repositories are discussed in Section II.C., *infra*.

²² See Letter of Merrill Lynch, Pierce, Fenner & Smith (“Merrill Lynch”).

²³ As noted in the 1988 Release, the obligations of managing underwriters and underwriters participating in an offering differ. An underwriter participating in an offering need not duplicate the efforts of the managing underwriter, but must satisfy itself that the managing underwriter reviewed the accuracy of the information in the official statement in a professional manner and therefore had a reasonable basis for its recommendation. Underwriters participating in offerings, however, have

Because the amendments prohibit Participating Underwriters from purchasing or selling securities in the absence of undertakings in a written agreement or contract, such agreement or contract would have to be in place at the time the issuer delivers the securities to the Participating Underwriter.²⁴ As discussed below, in conditioning the closing of an Offering on the existence of an agreement or contract, this provision of the amendments permits flexibility as to where undertakings for continuing disclosure are memorialized.²⁵

The amendments to the definition of final official statement will affect the obligations of Participating Underwriters under Rule 15c2-12. Rule 15c2-12(b)(1) requires that a Participating Underwriter, prior to bidding for, purchasing, offering, or selling municipal securities, obtain and review a DFOS.²⁶ The Commission expects that Participating Underwriters will review the DFOS with a view to ascertaining that it contains information satisfying the definition of final official statement in Rule 15c2-12.²⁷ The Commission further

a duty to notify the managing underwriter of any factors that suggest inaccuracies in disclosure, or signal the need for additional investigation. See 1988 Release at n. 87.

24 See Letter of Kutak Rock; Letter of Section of Urban, State and Local Government Law, American Bar Association ("ABA Urban Law Section"); Letter of Colorado Municipal Bond Supervisory Board.

25 In contrast to the requirement in Rule 15c2-12(b)(5) that Participating Underwriters reasonably determine that issuers or obligated persons have undertaken to provide secondary market disclosure prior to the time they "purchase or sell" municipal securities, Rule 15c2-12(b)(1) requires Participating Underwriters to obtain and review an official statement deemed final by the issuer ("DFOS") prior to the time they "bid for, purchase, offer, or sell" securities. Thus, under Rule 15c2-12(b)(1), in a competitive underwriting, a Participating Underwriter must obtain and review the DFOS prior to placing a bid on an issue of municipal securities. Because the term "offer" encompasses the distribution of a preliminary official statement, as well as oral solicitations of indications of interest, in a negotiated underwriting, a Participating Underwriter is required to obtain and review the DFOS prior to the time it distributes the preliminary official statement to potential investors. If no offers are made, the Participating Underwriter is required to obtain and review the DFOS by the earlier of the time it agrees (whether in principle or by signing the bond purchase agreement) to purchase the bonds, or the first sale of bonds. See Mudge Rose Guthrie Alexander & Ferdon (April 4, 1990); Interpretive Release at Section III.C.6.

26 Information regarding the offering price, interest rate, selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, any other terms or provisions required by an issuer of such securities to be specified in a competitive bid, ratings, other terms of the securities depending on such matters, and the identity of the underwriters, may be omitted from the official statement reviewed by the Participating Underwriter for purposes of Rule 15c2-12(b)(1).

27 Whether information is in fact known or not reasonably ascertainable at the time the Participating Underwriter must obtain and review the DFOS

expects that the quality of disclosure in the DFOS will improve in a manner that is commensurate with the changes in final official statement disclosure.²⁸

Rule 15c2-12(b)(2) requires, for all except competitively bid offerings, from the time a Participating Underwriter has reached an understanding with an issuer of municipal securities that it will act as a Participating Underwriter, until the final official statement is available, that the Participating Underwriter send, to any potential customer, no later than the next business day, a copy of the most recent POS, if any. The Commission expects that the Participating Underwriters' obligations with respect to dissemination of the POS will not change.

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

Under the amendments as adopted, the financial information and operational data to be provided on an annual basis pursuant to the undertaking will mirror the financial information and operating data contained in the final official statement with respect to both the issuers and obligated persons that will be the subject of the ongoing disclosure, and the type of information provided. The amendments govern the core financial and operational data to be provided. It does not address the textual disclosure typically provided in annual reports, leaving the scope of that disclosure to market practice.²⁹ To clarify the intended quantitative focus of the rule, as adopted, the rule uses the term "financial information and operating data."

a. *The Starting Point -- Definition of Final Official Statement (1) Information Concerning Persons Material to an Evaluation of the Offering.* The Proposed Amendments would have revised the definition of final official statement to require that financial and operating information, including audited annual financial statements, regarding the

pursuant to the rule is best determined in the context of each offering by the issuer, the Participating Underwriter, and their respective counsel. See Public Securities Association (May 29, 1992)

28 As a practical matter, the DFOS and the preliminary official statement ("POS") are often the same document. See Mudge Rose Guthrie Alexander & Ferdon (April 4, 1990).

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

issuer and any significant obligor be included in order to provide a fair presentation of the issuer's and significant obligor's financial condition, results of operations, and cash flow.

Commenters objected to various aspects of the proposed definition, including the general requirement that financial and operating information be presented in the final official statement.³⁰ Commenters also objected that the use of the term "the issuer," in specifying whose financial information should be included in the final official statement, failed to take into account a variety of situations in which the governmental issuer does not have any repayment obligations on the municipal securities (as with conduit issuers), as well as other situations (such as revenue bonds) in which the payments will be derived from entities, enterprises, funds and accounts that do not prepare separate financial statements. Some commenters took the position that in certain instances, inclusion of the financial statements of the general municipal issuer of which the enterprise is a part may be misleading.³¹

In view of these comments, the definition of final official statement has been revised to require that financial information and operating data be provided for those persons, entities, enterprises, funds, and accounts that are material to an evaluation of the offering.³² Thus, the definition eliminates the reference to "the" issuer. In addition, the definition no longer requires that the official statement provide information about specific "significant obligors." It leaves to the parties (including the issuer and Participating Underwriters) the determination of whose financial information is material to the offering (including, without limitation, the credit supporting the securities being offered).

The definition does not set its own form and content requirements on the financial information and operating data to be included; in particular, the proposed requirement for audited financial statements has not been adopted. Instead, it provides the flexibility that many commenters asserted is necessary in determining the content and scope of the disclosed financial information and operating data, given the diversity among types of issuers, types of issues, and sources of repayment.³³

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

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

32 See Rule 15c2-12(f)(3).

33 See, e.g., Letter of Association of Local Housing Financing Agencies ("ALHFA"); Letter of Treasurer, State of Connecticut Office of the Treasurer ("Treasurer of the State of Connecticut"); Letter of Council of

The fact that the amendments rely on the final official statement to set the standard for ongoing disclosure should not serve as an incentive for issuers to reduce existing disclosure practices in the preparation of the final official statement. Market discipline and regulatory requirements should ensure that those practices continue at current or improved levels. While issuers remain primarily responsible for the content and accuracy of their disclosures,³⁴ as noted, Participating Underwriters must review the DFOS in a manner consistent with their obligations.

As the Commission recognized in the Interpretive Release,³⁵ the extensive voluntary guidelines issued by the Government Finance Officers' Association, and the industry specific guidelines published by industry groups such as the National Federation of Municipal Analysts, are followed widely in the preparation of official statements.³⁶ The Commission anticipates that such sound practices will continue and develop beyond that mandated by the amendments. Although those guidelines are not mandatory, the Commission encourages market participants to continue to refer to those voluntary guidelines and the Commission's Interpretive Release in preparing disclosure documents. In addition, as noted in the Interpretive Release,³⁷ final official statements are subject to the prohibition against false or misleading statements of material facts, including the omission of material facts necessary to make the statements made, in light of the circumstances in which they are made, not misleading.

2. *Use of Cross References to Publicly Available Information.* The Proposing Release requested comment on the appropriateness of satisfying disclosure needs through a reference to other externally prepared and located documents. In response, a number of commenters stated that the concept of incorporation of information should be explicitly included in the rule,³⁸ and that the ability to incorporate information should not be conditioned on a minimum dollar amount of securities in the hands of the public -- commonly known as

Development Finance Agencies ("CDFA"); Joint Response; Letter of Securities Industry Association ("SIA"); Letter of Morgan Stanley & Co., Inc. ("Morgan Stanley").

34 See 1989 Release.

35 Interpretive Release at Section III.B. The Interpretive Release is cited in the Preliminary Note to Rule 15c2-12 as a source of guidance as to the disclosure obligations of issuers of municipal securities, as well as the role of brokers, dealers, and municipal securities dealers.

36 See note 31, *supra*.

37 See Interpretive Release at Section III.A.

38 See Joint Response.

“public float.”³⁹ Some commenters also suggested that any limitation of this practice to “seasoned issuers” should include all investment grade issuers.⁴⁰ Some commenters further noted that the final official statement should not have to set forth information that has been filed with the Commission in accordance with its periodic reporting requirements.⁴¹ The commenters suggested one significant prerequisite for permitting cross referencing -- the availability of the information in some public repository.⁴²

The definition of final official statement has been revised to make explicit⁴³ that a final official statement may include financial information and operating data either by setting forth the information in the document or set of documents composing the final official statement, or by including a specific reference to documents already prepared and previously made publicly available.⁴⁴ For purposes of the amendments, documents will be considered to be publicly available if they have been submitted to each NRMSIR and to the appropriate state information depository or, if the information concerns a reporting company, filed with the Commission. If the document is a final official statement, it must be available from the MSRB.

If cross referencing is used, for purposes of determining the appropriate scope of the ongoing information undertaking, the final official statement will be deemed to include all information and documents that have been cross

referenced.⁴⁵ The amendment does not place limitations on the type of issuer that may use cross referencing. This approach is consistent with the goal of making the repositories the principal source of information concerning municipal securities. Once received by a repository, the referenced information should be readily available regardless of the nature of the issuer.

As commenters noted, permitting cross referencing to other externally prepared and available information should result in official statements that are clear and concise, yet provide information material to the Offering.⁴⁶ Moreover, the use of cross referencing also should ease some expressed apprehension about the ability of some issuers to obtain information about parties not within their control, to the extent that information about these parties is made available to the repositories or, if a reporting company, filed with the Commission.⁴⁷

3. *Description of Information Undertakings.* The definition of final official statement also has been changed from the Proposed Amendments to include a requirement that the undertakings provided pursuant to the rule be described in the final official statement.⁴⁸ As the Commission recognized in the Interpretive Release⁴⁹ and a number of commenters echoed,⁵⁰ it is important for investors and the market to know the scope of any ongoing disclosure. By including a description of the undertaking in the final official statement, market participants will know the identity of the entities about which information will be provided, and the type of information to be provided. By reviewing the final official statement, investors in the secondary market will be able to ascertain the scope of that undertaking and whether it has been satisfied.

39 See Letter of ABA Urban Law Section; Letter of Bose McKinney & Evans; Joint Response; Letter of Mudge Rose Guthrie Alexander & Ferdon (“Mudge Rose”); Letter of Dormitory Authority of the State of New York (“New York Dormitory Authority”).

40 See Letter of Mudge Rose; Letter of New York Dormitory Authority.

41 See Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of Texas Public Finance Authority.

42 See, e.g., Letter of Bose McKinney & Evans; Joint Response. One commenter also stated that if cross referencing was permitted, there should be a delay between the distribution of the official statement and the offering. The delay would enable potential purchasers and others to obtain any materials that were referenced in the official statement and make an informed investment decision. See Letter of Prudential Investment Corp.

43 See 1989 Release (discussing the definition of “final official statement” in Rule 15c2-12 as originally adopted, and stating that the definition recognizes that the issuer’s final official statement may be composed of one or more documents).

44 Rule 15c2-12(f)(3). To avoid confusion with the technical aspects of incorporation by reference for registrants under the Commission’s registration rules, the amended rule does not use that term.

At least two states, New York and Texas, have prepared a standard disclosure document for state information.

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

46 See, e.g., Letter of New York Dormitory Authority; Letter of the Treasurer of the State of Connecticut.

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

48 Rule 15c2-12(f)(3).

49 See Interpretive Release at Section III.C.4.

50 See, e.g., Letter of Chemical Securities, Inc. (“Chemical Securities”); Letter of Ferris Baker Watts; Letter of National Federation of Municipal Analysts (“NFMA”).

Critical to any evaluation of a covenant is the likelihood that the issuer or obligated person will abide by the undertaking. The definition of final official statement thus has been modified to require disclosure of all instances in the previous five years in which any person providing an undertaking failed to comply in all material respects with any previous informational undertakings called for by the amendments.⁵¹ This information is important to the market, and should, therefore, be disclosed in the final official statement. The requirement should provide an additional incentive for issuers and obligated persons to comply with their undertakings to provide secondary market disclosure, and will ensure that Participating Underwriters and others are able to assess the reliability of disclosure representations.⁵²

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

b. *Entities About Which Information Must be Provided to the Secondary Market.* It is critical that current financial information and operating data is provided to the secondary market about the persons that would be important to investors in evaluating the security. The Proposed Amendments would have required the Participating Underwriter to determine that the issuer had committed to provide, at least annually, current financial information concerning the issuer of the municipal securities and any significant obligor.⁵³ The identity of persons about which information should be provided to the secondary market was the subject of a substantial number of comment letters.⁵⁴ As with the proposed definition of final official statement, a large number of commenters expressed particular concern about the provision of information on a continuing basis for conduit issuers who have no ongoing

liability for repayment of municipal securities.⁵⁵ There also were a significant number of comments received critiquing the concept of significant obligor.⁵⁶

Under the amendments as revised, the identity of the persons for which information must be provided on an annual basis is determined by the information included in the final official statement. If the final official statement includes financial information or operating data on a person, information about that person must continue to be provided to the secondary market if the person is committed by contract or other arrangement to support payment of the obligations on the municipal securities.⁵⁷ Thus, the obligation to provide ongoing information relates to those persons for which financial information or operating data is included in the final official statement and that have a contractual or other connection to repayment of the municipal obligations.

(1) *The Obligated Person Concept.* The Proposed Amendments defined a significant obligor as “any person who, directly or indirectly, is the source of 20 percent or more of the cash flow servicing the obligations on the municipal security.” The proposed definition generated a significant amount of comment, including concerns that it could be interpreted to include significant taxpayers and customers,⁵⁸ credit enhancers (including banks that are letter of credit providers and insurers providing bond insurance),⁵⁹ providers of guaranteed investment contracts,⁶⁰ as well as state and federal governments that provide revenue sharing, grant, state

51 See Rule 15c2-12(f)(3).

52 See Letter of PSA.

53 Paragraph (b)(5)(i)(A) of the Proposed Amendments.

54 See, e.g., Letter of Fidelity Management and Research Company; Letter of First Albany Corporation; Letter of Maine Municipal Bond Bank; Letter of NABL; Letter of National Council of Health Facilities Finance Authorities (“NCHFFA”); Letter of Realvest Capital Corporation; Letter of South Carolina Economic Developers Association, Inc.

55 See, e.g., Letter of ABA Urban Law Section; Letter of Gilmore & Bell, P.C. (“Gilmore & Bell”); Letter of New York State Housing Finance Agency, State of New York Mortgage Agency, New York State Medical Care Facilities Finance Agency (“New York State Housing Finance Agency”); Letter of Orrick Herrington.

56 See, e.g., Letter of Section of Business Law, American Bar Association (“ABA Business Law Section”); Letter of Treasurer of the State of California (“Treasurer of the State of California”); Letter of Goldman Sachs; Letter of IDS Financial Corporation; Joint Response; Letter of Kutak Rock; Letter of Morgan Stanley; Letter of National Association of State Treasurers (“NAST”).

57 Providers of bond insurance, letters of credit, and liquidity facilities have been excepted from the definition of obligated person to eliminate the need to separately obtain and disseminate annual information about such providers. See Section II.A.1.b.(1). *infra*.

58 See, e.g., Letter of American Municipal Power -- Ohio, Inc. (“AMP -- Ohio”); Letter of Gilmore & Bell; Letter of Treasurer of the State of California.

59 See, e.g., Letter of Financial Guaranty Insurance Company (“FGIC”); Letter of Goldman Sachs; Letter of Hawkins Delafield & Wood; Letter of Thacher Proffitt & Wood.

60 See, e.g., Letter of Kutak Rock.

and local aid and other cofinancing arrangements.⁶¹ Commenters raised technical concerns as to the appropriate percentage of repayment obligation necessary to trigger inclusion in the definition of significant obligor,⁶² and when the percentages were to be measured.⁶³ Some commenters also expressed concern that, in the bond pool context, the definition of significant obligor may not have permitted sufficient flexibility in determining which obligors in a pool would be the subject of the requirement to provide information on an ongoing basis.⁶⁴

Commenters suggested a number of modifications to the significant obligor concept. First, a number of commenters indicated that the definition of significant obligor should include a requirement that a contractual relationship exist between the obligor and the repayment of the obligation before a continuing information obligation is imposed.⁶⁵ Second, commenters recommended modifying the definition to include different percentages of cash flow, ranging from a low of no threshold to a high of 50% of cash flow.⁶⁶ Third, some commenters suggested replacing the entire definition of significant obligor with the concept of materiality, in which the issuer and the other offering participants would determine, on a continuing basis, whose information would be provided.⁶⁷

As suggested by a number of commenters, the amendments eliminate the reference to significant obligor.⁶⁸ Instead, the amendments include a definition of “obligated person,” which means a person (including an issuer of separate securities) that is committed by contract or other arrangement structured to support payment of all or part of the obligations on the municipal securities.⁶⁹ By including a nexus to the financing through a commitment that is structured to support the payment obligations, the amendments address concerns raised by many commenters that the term “source of cash flow” in the definition of significant obligor was overbroad and could encompass persons with no relationship to the financing.⁷⁰ The requirement for a contractual or other arrangement will assist Participating Underwriters in identifying the persons for which information should be provided pursuant to an undertaking.

Some commenters recommended that the commitment with respect to payment of the obligation on the securities consist of a contractual obligation to and enforceable by bondholders.⁷¹ Instead, the definition includes a broader notion of a contract or arrangement that is structured to “support payment,” without specifying that it run to bondholders. The definition is intended to include contracts or arrangements where payments are made either to bondholders, to issuers to be used to pay obligations on municipal securities, or through conduit structures.⁷² Similarly, the reference to

61 See, e.g., Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of State of Washington, Office of the Treasurer.

62 See, e.g., Letter of APPA; Letter of George K. Baum & Co.; Letter of CDFIA; Letter of Eaton Vance Management; Letter of NCHFFA.

63 See, e.g., Letter of ABA Business Law Section; Letter of Electricities, Inc.; Letter of Hawkins Delafield & Wood; Letter of Kutak Rock; Letter of Mudge Rose; Letter of San Francisco International Airport.

64 See, e.g., Letter of ABA Urban Law Section; Letter of A.G. Edwards & Sons, Inc.; Letter of Council of Infrastructure Financing Authorities (“CIFA”); Letter of Hawkins Delafield & Wood; Letter of Program Administration Services, Inc.

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

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

67 See, e.g., Letter of ABA Business Law Section; Letter of ALHFA; Letter of PSA.

68 See, e.g., Letter of FGIC; Joint Response; Letter of NABL; Letter of PSA.

69 See Rule 15c2-12(f)(10).

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

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

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

“obligations on municipal securities” is intended to be broad enough to cover debt obligations, lease payments and any other repayment obligation on or resulting from the municipal securities.

As was the case with the proposed significant obligor concept, the term “obligated persons” includes, but is broader than, the concept of issuers of separate securities under Rule 131 pursuant to the Securities Act of 1933 (“Securities Act”)⁷³ and Exchange Act Rule 3b-5.⁷⁴ Also, in response to comments raised that the terms “issuer” or “significant obligor” do not sufficiently address financings in which the source of repayment is not a separate person or entity, but a dedicated revenue stream from a specified project, segregated tax revenues or other enterprise, fund or account,⁷⁵ the definition includes persons which are obligated generally, such as with full recourse to the person, or, in a more limited manner, such as through an enterprise, fund or account of such person, including a dedicated revenue stream. As noted above, the obligation to provide information must cover all such enterprises, funds or accounts, whether or not there is a separate entity. In such a case, the information undertaking could be provided by the governmental unit or financing authority of which the enterprise, fund or account is a part.⁷⁶ For example, a Participating Underwriter could accept an information undertaking from a state issuing bonds secured solely by funds collected under a special tax, to report financial information relating to the special tax; for issues supported both by contracts of assistance of separate authorities or funds in addition to the issuer's own revenues, undertakings from the separate authorities, as well as the issuer could be provided. Accordingly, although the definition of significant obligor has been eliminated, that modification does not reflect a change in the Commission's assessment of the importance of ongoing information concerning the ultimate sources of payment on the securities.

Unlike the significant obligor concept in the Proposed Amendments, there is no need to include a specified percentage of payment in the definition of obligated person, because the issuer and other participants will determine at the time of preparation of the final official statement which obligated

service the borrowing is dependent upon the developer as part of the structure of the financing may be appropriate.

73 17 CFR 239.131.

74 17 CFR 240.3b-5

75 See, e.g., Letter of Fidelity Management and Research Company; Letter of Mudge Rose; Letter of NABL; Letter of Texas Public Finance Authority.

76 See Rule 15c2-12(b)(5)(i).

persons are material to an Offering.⁷⁷ In making that materiality determination, the parties to a financing will evaluate the facts of the Offering.⁷⁸

Determining the obligated persons in pooled financings requires more flexibility, because the composition of the pool may vary over time. Rather than identifying the specific persons for which information will be provided on a continuing basis, under the amendments, bond pools must describe in their official statements, and the undertaking, the objective criteria (presumably including percentage of payment support) they will apply consistently, both in the final official statement and on a continuing basis, in determining whether information concerning an obligated person will be provided.⁷⁹ The amendments permit, but do not require this approach for non-pooled issuers. The objective criteria approach ensures that financial information and operating data will be provided about those persons that, at the time of disclosure, meet the objective standards described in the undertakings. Obligated persons could commit to the issuer, at the time of initial participation in a pooled financing, through an undertaking to provide information when and if they satisfy that criteria. Obligated persons that no longer meet the objective criteria will no longer need to provide ongoing information. In order to ensure that the selection method is incorporated into the undertaking, the amendments require that Participating Underwriters reasonably determine that the undertakings identify those persons for which the information will be provided, either by name or by the objective criteria to be used to select such persons.⁸⁰

77 Under the revised amendments, the concerns of some commenters that the definition of significant obligor failed to take into account short term arrangements (i.e. the arrangements with persons providing cash flow were shorter than the term of the securities) is also alleviated in two ways. First, the issuer determines at the outset if an obligated person is material to the offering. Second, assuming an obligated person is included in the final official statement, the undertaking to continue to provide information on such obligated person may be terminated once it no longer has liability for any obligation on or relating to repayment of the municipal securities. See Rule 15c2-12(b)(5)(iii); Letter of APPA; Letter of Hawkins Delafield & Wood.

78 Guidelines and practices that have developed in other contexts may be useful in analyzing both the materiality of an obligated person to the municipal financing and the appropriate level of disclosure relating to such obligated person. For example, in connection with securitization of non-recourse commercial mortgage loans, the 10 percent and 20 percent property assets concentration tests described in Staff Accounting Bulletins 71 and 71A are applied. These percentages are applied by analogy in other asset-backed financings.

79 Although the amendments do not specify the scope of the objective criteria, the criteria description should be clear as to when and how they are applied.

80 See Rule 15c2-12(b)(5)(ii).

Commenters were divided on whether providers of bond insurance, letters of credit, and other liquidity facilities, should be excluded from the definition of significant obligor.⁸¹ The concept of “obligated person” encompasses these entities because they are committed, at least conditionally, to support payment of principal and interest obligations. Moreover, these persons normally are material to an understanding of the security, and, therefore, official statements should contain financial information concerning such persons either directly or by reference to publicly available materials. A number of commenters stated, however, that it would be inappropriate to put the onus on the issuer to provide information on such providers on an annual basis, particularly where that information is otherwise available to investors either upon request or in public reports that have been submitted to appropriate regulatory authorities.⁸²

Commenters indicated a willingness by providers of bond insurance, letters of credit, and other liquidity facilities to deposit publicly available reports in a repository, or otherwise note where such reports may be easily obtained.⁸³ The issuer

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

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

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

or other obligated person providing the undertaking may then refer to such reports in their annual financial information and indicate the location where any such current annual reports can be obtained. Based upon such representations, providers of bond insurance, letters of credit, and liquidity facilities have been excepted from the definition of obligated person to eliminate the need to separately obtain and disseminate annual information about such providers.

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

(2) *Who Must Undertake.*

A related question to whose information must be given is who must provide the information undertaking; the person providing the undertaking may not necessarily be the person about which the information relates. The Proposed Amendments would have required that the continuing information undertaking be provided by the issuer. A significant number of commenters raised concerns about which of potentially several persons that could be considered an issuer of municipal securities⁸⁴ would be expected to provide the undertaking and who would make that determination.⁸⁵ This was a particular concern in light of the potential liability of the issuer providing the undertaking for the provision and the content of information regarding other issuers and significant obligors -- persons not necessarily under their control. Commenters made a number of suggestions to address these perceived ambiguities, including requiring that each issuer of a municipal security and each significant obligor undertake to provide the information only with respect to itself.⁸⁶

In response to these concerns, and consistent with the general approach to affording underwriting participants significant flexibility, the undertaking provision has been revised to provide that the undertaking may be made by any issuer of the municipal securities being offered, or by any

84 The term “issuer of municipal securities,” as defined in Rule 15c2-12, includes issuers of separate securities as well.

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

86 See, e.g., Letter of ABA Urban Law Section; Letter of ALHFA; Letter of Kutak Rock; Letter of NABL.

obligated person for which information is provided in the final official statement. An issuer of a municipal security may provide the undertaking, regardless of whether it is obligated on the municipal security. In addition, obligated persons may provide the undertaking regardless of whether they are deemed an issuer of municipal securities. These obligated persons may be the main, if not the only, credit source for repayment of the obligations on the municipal securities. This approach should allow the governmental issuer to shift to the obligated person the responsibility to provide information on a continuing basis.

Thus, a Participating Underwriter need only reasonably determine that an issuer of municipal securities or an obligated person for which financial information or operating data is presented in the final official statement has agreed to provide the information called for by the rule; it will not be necessary to obtain an undertaking from all possible issuers and obligated persons. Moreover, to respond to the expressed concern that separate undertakings should be permitted, the amendments have been revised to recognize that undertakings may be provided in combination with other issuers and other obligated persons. In all cases, however, the undertakings, either individually or collectively, must constitute a commitment to provide information with respect to all the persons about which information must be provided on an annual basis.

The amendments have been revised to clarify that dissemination responsibilities may be delegated to designated agents or to indenture trustees. As commenters pointed out, there are circumstances in which third parties may be effective in assisting issuers and obligated persons in disseminating the information.⁸⁷ Moreover, indenture trustees have expressed concerns about being considered “designated agents” in performing any dissemination role, based on the scope of, and standards affecting, their responsibilities as indenture trustees.⁸⁸ The language has been revised in response to clarify that, in addition to designated agents, issuers or obligated persons may contractually empower indenture trustees to disseminate information that an issuer or obligated person has agreed to provide. The parties may authorize an indenture trustee to provide certain information through specific instruction or on its own initiative upon becoming aware of particular facts.

c. *Scope of Financial Information and Operating Data to be Provided on an Annual Basis (1) Definition of Annual Financial Information.* The amendments provide a definition of

⁸⁷ See, e.g., Letter of Bond Investors Association; Letter of PSA; Letter of Texas Public Finance Authority.

⁸⁸ See, e.g., Letter of Bank One Corporation; Letter of Reliance Trust Company; Letter of State Street Bank and Trust Company.

the term “annual financial information,”⁸⁹ a concept that was used, without definition, in the Proposed Amendments. The definition of annual financial information specifies both the timing of the information -- that is, once a year -- and, by referring to the final official statement, the type of financial information and operating data that is to be provided to the repositories. If financial information or operating data concerning an obligated person (or category of obligated persons in the case of financings using the objective criteria approach) is included in the final official statement, then annual financial information would consist of the same type of financial information or operating data. For example, if anticipated cash flow information is provided in the final official statement for a revenue bond financing, cash flow data reflecting actual operations must continue to be provided on an annual basis. Only the annual financial information called for by the undertakings need be sent to the repositories; other types of financial information and reports that may be prepared by the issuer or obligated persons are not subject to the rule’s dissemination provisions.

Many commenters addressed the issue of whether the rule should specify form and content of the information that should be provided on an annual basis, as well as for event specific information.⁹⁰ Some commenters argued that the rule should include specified formats for information to be provided, including financial statements and certain industry reporting formats,⁹¹ while other commenters contended that no form or content should be specified and that the parties should be permitted to make determinations based on materiality alone.⁹² As discussed below, the flexibility afforded by the concept of annual financial information addresses these concerns by providing a minimum standard for ongoing disclosure, but allowing the parties to define that standard with respect to each Offering of municipal securities.

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

⁸⁹ Rule 15c2-12(f)(9).

⁹⁰ See, e.g., Letter of Dean Witter Reynolds, Inc. (“Dean Witter”); Letter of National League of Cities; Letter of NFMA; Joint Response; Letter of PSA; Letter of Tillinghast, Collins & Graham; Letter of the Treasurer of the State of Connecticut.

⁹¹ See, e.g., Letter of Dain Bosworth, Inc.; Letter of First Albany Corporation; Letter of MSRB; Letter of NFMA; Letter of Standish, Ayer & Wood, Inc.

⁹² See, e.g., Letter of CDFA; Letter of Chapman and Cutler; Letter of CIFA; Joint Response; Letter of H.M. Quackenbush; Letter of NABL.

Some commenters indicated that some municipalities were not required by law to have independently audited financial statements, and any such requirement would impose a significant new expense.⁹³ A number of commenters also expressed doubt as to whether audited financial information could be delivered on an annual basis, because audits may not be completed for a number of years following the close of the fiscal year.⁹⁴ Commenters noted that in some cases, financial statements for certain types of entities were audited every year, and in other cases every 2-3 years.⁹⁵ Therefore, some of these commenters argued that the requirement for annual audited financial statements would have an adverse impact on an issuer's ability to access the public securities markets or increase its costs of financing.⁹⁶

A number of commenters also raised concerns regarding the availability of full financial statements for certain issuers, whether or not audited.⁹⁷ As examples, commenters noted that some issuing entities do not have their own financial statements and may be included in the financial statements of a larger issuer or entity.⁹⁸ Commenters from two states indicated that governmental units of the states may be encompassed in the state's comprehensive annual financial report and that there may be only supplemental schedules that described the governmental units.⁹⁹

Some commenters raised the point that financial statements of a general governmental unit may not necessarily be relevant in certain project and structured financings.¹⁰⁰ As

an example, one commenter noted that in some asset backed financings, information about the governmental issuer may be relevant only with respect to its experience in managing programs of loan pools.¹⁰¹

Commenters proposed a number of alternatives to the requirement to provide annual audited financial statements. Among the alternatives was a suggestion that financial statements be required in the form customarily prepared by the issuer promptly upon becoming available and that audited financial statements be provided to the extent available.¹⁰² Other suggestions included limiting the requirement to those entities required by state or federal law to have audited financial statements.¹⁰³

In view of the comments received, the amendments do not adopt the proposal to mandate audited financial statements on an annual basis with respect to each issuer and significant obligor. Instead, the amendments continue to require annual financial information, which may be unaudited, and may, where appropriate and consistent with the presentation in the final official statement, be other than full financial statements. While it is anticipated that full financial statements will be provided for entities with ongoing revenues and operating expenses, it is possible that in the case of 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. However, if audited financial statements are prepared, then when and if available, such audited financial statements will be subject to the undertaking and must be submitted to the repositories.¹⁰⁴ Thus, as suggested by a number of commenters, the undertaking must include audited financial statements only in those cases where they otherwise are prepared.

The amendments adopt the proposed requirement that the undertaking specify the accounting principles pursuant to which the financial information provided as part of the annual financial information will be prepared.¹⁰⁵ As discussed in the Proposing Release, it is important that financial information be prepared on a consistent basis to enable market participants to

93 See, e.g., Letter of Texas Water Development Board; Letter of State of Washington, Office of the Treasurer.

94 See, e.g., Letter of City of Barling; Letter of Dain Bosworth, Inc.; Letter of Friday, Eldridge & Clark.

95 See, e.g., Letter of AMP -- Ohio; Letter of State of Indiana, State Board of Accounts; Letter of State of Montana, Department of Natural Resources and Conservation; Letter of Washington Finance Officers Association.

96 See, e.g., Letter of AMP -- Ohio; Letter of Washington Finance Officers Association.

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

98 See, e.g., Letter of Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

99 See, e.g., Letter of the Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

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

101 See Letter of ABA Urban Law Section.

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

103 See, e.g., Letter of the Treasurer of the State of North Carolina; Letter of Washington Finance Officers Association.

104 See Rule 15c2-12(b)(5)(i)(B).

105 See Rule 15c2-12(b)(5)(ii)(B).

evaluate results and perform year to year comparisons.¹⁰⁶ The undertaking also must specify whether audited financial statements will be provided as part of the annual financial information.¹⁰⁷

The amendments do not establish a standardized format for presentation of financial information, or any specification of the content of the information, other than by reference to the final official statement. The annual financial information may be presented through any disclosure document or set of documents, whatever their form or principal purpose, that include the necessary information. The amendments, as adopted, contemplate that sequential final official statements prepared by frequent issuers may meet the standards of the rule. As in the case of final official statements, annual financial information submitted to a repository also may reference other information already submitted to repositories or the MSRB, or filed with the Commission.¹⁰⁸

(3) *Operating Data.* The Proposed Amendments¹⁰⁹ would have required that the undertaking call for pertinent operating information, and that the parties specify the pertinent operating information to be provided on an annual basis. The basic concern of commenters regarding this provision, in addition to issues of specification of form and content discussed above, was that the use of the term "pertinent" did not provide sufficient guidance as to who would determine what was pertinent and what independent obligations Participating Underwriters would have with respect to such evaluation.¹¹⁰

The amendments have been modified to respond to these comments. The phrase "pertinent" has been deleted from the reference to operating information and the word "data" is used to emphasize the intended quantitative nature of the information. Operating data is included as a subset of annual financial information, and the operating data to be provided annually also is determined by reference to the type of

¹⁰⁶ See Proposing Release. A number of commenters responded to the request for comment on specification of the use of generally accepted accounting principles ("GAAP") and generally accepted auditing standards ("GAAS"). See, e.g., Letter of Comptroller of the State of California; Letter of Government Accounting Standards Board ("GASB"); Letter of NAST; Letter of National State Auditors Association; Letter of Prudential Investment Corp. The amendments as adopted do not mandate the use of either GAAP or GAAS.

¹⁰⁷ See Rule 15c2-12(b)(5)(ii)(B).

¹⁰⁸ Of course, any required information must be the subject of an undertaking, and if the information cross referenced has not been submitted to a repository or the MSRB, or filed with the Commission, the undertaking will not have been complied with.

¹⁰⁹ Paragraph (b)(5)(i)(A) of the Proposed Amendments.

¹¹⁰ See, e.g., Letter of APPA; Letter of Fidelity Management and Research Company; Letter of Hawkins Delafield & Wood.

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

Some commenters expressed concern that the Proposed Amendments were not sufficiently flexible to permit parties to address changing conditions because the undertaking would have to describe the financial and pertinent operating information to be provided in the future.¹¹¹ Nonetheless, the requirement that the undertaking specify in reasonable detail the type of data that will be provided on an ongoing basis, including the identity of the persons (or category of persons) about which the information will relate has been retained. As is the case with financial information, the intent of the amendments is to give investors and market participants the ability to evaluate the security through comparisons of the quantitative operating data provided. Contrary to the suggestion of some commenters, the undertaking would be meaningless if issuers and obligated persons could unilaterally determine that certain types of information were no longer necessary or meaningful to investors.

Because the amendments require that the undertaking specify only the general type of information to be supplied, there should be sufficient flexibility to accommodate subsequent developments that may require adjustments in the financial information and operating data that should be provided annually. Of course, nothing in the undertaking will prevent a party from providing additional information, particularly where such disclosure may be necessary to avoid liability under the antifraud provisions of the federal securities laws. Similarly, the amendments make specific provision for adjusting the persons about which information is provided. As required in the case of pooled financings, parties may identify the persons covered by reference to objective selection criteria that will be applied on a consistent basis between the offering statements and with regard to annual financial information. Moreover, the party providing the undertaking need not

¹¹¹ See, e.g., Letter of Chapman and Cutler; Joint Response; Letter of Kutak Rock.

continue to provide information concerning persons that are no longer obligated persons with respect to the municipal securities.

A new provision has been added to the amendments which permits the written agreement or contract to have a termination provision with respect to any obligated person that is no longer directly or indirectly liable for repayment of any of the obligations on the municipal securities.¹¹² Once an obligated person no longer has any liability for repayment of the municipal securities, whether through termination or expiration of its commitment to support payment, or as a result of a defeasance of the municipal securities with no remaining liability, then the obligation to provide annual financial information and notices of events may terminate.

2. Notice of Material Events

Commenters generally agreed that issuers and obligors should be subject to an undertaking to provide event information to the market.¹¹³ Brokers, dealers and municipal securities dealers supported these provisions of the Proposed Amendments, because the use of a list provides guidance as to what events should be covered.¹¹⁴ Other commenters, however, felt that the list should be deleted from the rule and that the concept of materiality should be relied upon to determine what events should be the subject of notices.¹¹⁵ Some commenters believed that the list of eleven events should be expanded to include a provision that would cover any other event that might reasonably be expected to have a material adverse effect on the holders of the bonds.¹¹⁶

The list of eleven events has been retained in the amendments.¹¹⁷ As indicated in the Proposing Release, the list of eleven events was proposed in response to requests for guidance to issuers and other participants in the municipal

securities markets as to those events that normally would reflect on the credit supporting the municipal securities, as well as on the terms of the securities that they issue, and thus normally would be considered material. Under the amendments, only the occurrence of one of the specified events will, if material, create an obligation to send a notice to the repository.

The determination of whether other events also should be the subject of notification pursuant to the information undertaking is left to the parties. For example, some commenters requested that the list of events be expanded to address circumstances when the notified events have been cured or rectified, as well as other favorable developments.¹¹⁸ The parties would be free to add such matters to the undertaking. Issuers also may wish to send information regarding material developments to the repositories, to ensure equal access to that information by all investors and participants in the market, regardless of whether the particular development is subject to the undertaking.¹¹⁹

Some commenters were concerned that permitting issuers and obligors to send any notices or information they wished would flood the repositories. Given the fact that event notices generally are short, it appears that the repositories would be able to handle the flow of notices. The Commission will, however, monitor developments in this area.

Some commenters expressed concern that the event described as "matters affecting collateral" was too broad.¹²⁰ In response to such observations, that reference has been revised to reflect more clearly the types of events relating to collateral that could affect the creditworthiness of the security being offered. For instance, the item was not intended to require

¹¹² See Rule 15c2-12(b)(5)(iii).

¹¹³ See paragraph (b)(5)(i)(B) of the Proposed Amendments. See also, Letter of A.G. Edwards; Letter of Chemical Securities; Letter of J.J. Kenny Co., Inc. ("J.J. Kenny Co."); Letter of MSRB.

¹¹⁴ See, e.g., Letter of Chemical Securities; Letter of Goldman Sachs; Letter of George K. Baum; Letter of PSA.

¹¹⁵ See, e.g., Letter of CDFa; Letter of Gust & Rosenfeld; Joint Response; Letter of Municipal Treasurers Association; Letter of Rauscher Pierce Refsnes, Inc.; Letter of Standish Ayer & Wood, Inc.

¹¹⁶ -[118]- See, e.g., Letter of Chemical Securities; Letter of Edward D. Jones & Co.; Letter of Finance Authority of Maine; Letter of Ferris Baker Watts; Letter of Norwest Investment Services, Inc.; Letter of Prudential Investment Corp.

¹¹⁷ The introduction to the list also has been clarified to indicate that the events relate specifically to the securities being offered. See Rule 15c2-12(b)(5)(i)(C).

¹¹⁸ See, e.g., Letter of NAST; Letter of the Treasurer of State of California.

¹¹⁹ Several commenters have expressed concern that statements by various elected officials made in a political context relating to an issuer must now be included in information provided to a repository. The amendments contain no such requirement. Moreover, these concerns appear to be based upon a misunderstanding of the reminder to issuers in the Interpretive Release that investors may rely on a variety of formal and informal sources for continuing information on municipal issuers, including public statements and press releases concerning an entity's fiscal affairs made by municipal officials, particularly in the absence of a more standardized mechanism for disseminating information about the municipal issuer to the market as a whole. The caution contained in the Interpretive Release that the antifraud provisions may apply to releases of information to the public reasonably expected to reach investors and the trading market does not mean, as some commenters inferred, that such statements are per se material; nor do the amendments require that such statements, even where material, be provided to the repositories.

¹²⁰ See, e.g., Letter of ABA Business Law Section; Letter of ABA Urban Law Section; Letter of NABL; Letter of NCHFFA; Letter of New York State Housing Finance Agency; Letter of Orrick Herrington.

disclosure in the event of a drop in revenues or receipts securing payment. Rather, as more clearly indicated in the revised amendments, it is intended to encompass the release, substitution, or sale of property securing repayment of the securities being offered.¹²¹

Commenters also questioned whether the event relating to adverse tax opinions or events affecting the tax-exempt status of the security would include events not specific to an issuer, such as tax law changes which may affect a multitude of issuances and which are broadly reported.¹²² They argued that there is no need for each issuer to make that disclosure, which may overwhelm the repositories. The amendments do not include a uniform requirement for notification of events having widespread impact that are widely reported. Frequently, individual issuer disclosure may not affect the total "mix" of information available to investors, for example where Congress amends tax rates or alternative minimum tax rules that could affect an investor's yield. On the other hand, it may not be clear, absent individual disclosure, which classes of outstanding securities are affected by the general events, for example, where the tax law change affects a particular type of municipal security or financing structure.

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

Commenters expressed concern that the party providing the undertaking may not have knowledge of the occurrence of events affecting other parties that might be called for by the provisions of the rule.¹²³ This concern should be addressed by the revised approach of enabling the parties to the transaction to determine who will provide the undertakings. For example, in the conduit context, the covenant could be provided by the person that is committed by contract or other arrangement to support payment of debt service, rather than the conduit issuer.

The timing for providing the notification has not been changed from the Proposed Amendments, which required that the notice be provided on a "timely" basis. The amendments do not establish a specific time frame as "timely," because of the

wide variety of events and issuer circumstances. In general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice.

A new paragraph has been added to the amendments¹²⁴ that would require a Participating Underwriter to reasonably determine that the undertaking includes an agreement to notify the appropriate repository if the annual financial information is not provided in the stated time frame. Given the expressed concerns of some commenters regarding the difficulty that they would face in determining whether an issuer or other person was in compliance with any of its undertakings,¹²⁵ this provision will help inform market participants if annual financial information for such persons has not been made available in the agreed upon time frame.

3. Location of Undertaking in a Written Agreement or Contract

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

As discussed in the Proposing Release, many offerings of municipal securities are issued pursuant to a trust indenture setting out the covenants of the issuer for the benefit of the holders of the municipal securities. If there is no trust indenture as part of an offering, as is the case with general obligation and certain other types of bonds, there may be a bond resolution, ordinance, or other legislation. Most commenters addressing this issue considered the trust indenture, bond resolution, ordinance, or other legislation to be appropriate for undertakings to provide secondary market disclosure, because they would create a direct obligation by issuers to bondholders.¹²⁶ Commenters also suggested the use of a separate written agreement between the issuer and the

¹²¹ See Rule 15c2-12(b)(5)(i)(C)(10).

¹²² See, e.g., Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of Orrick Herrington.

¹²³ See, e.g., Letter of First Southwest Company; Letter of New York Dormitory Authority; Letter of the Treasurer of the State of North Carolina; Letter of City of Pullman, Washington.

¹²⁴ See Rule 15c2-12(b)(5)(i)(D).

¹²⁵ See, e.g., Letter of Gust & Rosenfeld.

¹²⁶ See, e.g., Letter of Merrill Lynch. Certain commenters considered that undertakings in a trust indenture could prove inflexible, as well as difficult to modify if they became inappropriate in the future. Letter of ABA Business Law Section. Other commenters considered that the issue of flexibility could be addressed through careful drafting. Letter of Morgan Stanley; Letter of Rauscher, Pierce, Refsnes, Inc.

trustee as an appropriate method of memorializing undertakings.¹²⁷

Several commenters suggested that the inclusion of the undertakings in an underwriting agreement or bond purchase agreement would be sufficient for purposes of Rule 15c2-12,¹²⁸ though another commenter suggested that a promise running to the benefit of the underwriter, whether in a bond purchase agreement or in a separate agreement, would be enforceable by existing and future bondholders only on the basis of a third party beneficiary theory, the availability of which may vary from state to state.¹²⁹

Because commenters were supportive of leaving the determination of the location of the undertaking to the parties, the relevant language of the Proposed Amendments, requiring a Participating Underwriter to look to "undertakings in a written agreement or contract for the benefit of holders of such securities" has been adopted as proposed. Therefore, undertakings may be included in a trust indenture, bond resolution or other legislation, or a separate written agreement. Undertakings also may be included in the bond form itself. This general requirement will create a direct obligation to bondholders, yet will be flexible to address variations in state law, as well as the wide variety of types and structures of offerings in the municipal securities market.

The Commission also recognizes that an issuer's ability to contract may be limited under state law. To the extent that issuers are restricted by statute from entering into long-term contractual arrangements, the undertaking may include a qualifier to its obligation, such as that it is subject to appropriation.¹³⁰

¹²⁷ See Letter of Chapman and Cutler (suggesting that an agreement could be made between an issuer and a trustee or between the issuer and a NRMSIR); Letter of Rauscher, Pierce, Refsnes, Inc. These commenters noted that such agreements provide flexibility for the future modification of the type, timing, or presentation of secondary market disclosure, as well as remedies in the event of a breach of the agreement.

¹²⁸ See e.g., Letter of Mudge Rose.

¹²⁹ See Letter of Morgan Stanley. Morgan Stanley also suggested that an underwriting agreement was an unsatisfactory vehicle for undertakings to provide secondary market disclosure because an underwriter of a specific bond issue should not be the recipient of a long-term contract of this type. See Letter of Morgan Stanley. Other commenters agreed that undertakings should be for the benefit of holders of municipal securities, and that there should be no requirement that undertakings be made for the benefit of Participating Underwriters. See, e.g., Letter of Merrill Lynch (noting that "the holders of the securities have the greatest interest in enforcing the covenant to provide information and are in the best position to evaluate whether affirmative efforts to enforce the covenant should be undertaken").

¹³⁰ Some commenters were concerned that in some jurisdictions, an issuer's ability to agree to provide information beyond a one year period might be restricted by state law. To address such concerns, inclusion of a

Commenters generally took the view that, while a statement in the final official statement describing any undertakings to provide secondary market disclosure would be an important addition to undertakings in a written agreement or contract, in order to make clear that the undertaking is an obligation of the issuer or obligated person that is enforceable on behalf of bondholders, the undertaking should be in a writing signed by the issuer or obligated person.¹³¹ Statements regarding an issuer's or obligated person's provision of secondary market disclosure made exclusively in an official statement would not satisfy the terms of Rule 15c2-12(b)(5) because they would not create a contract enforceable on behalf of bondholders.

Commenters addressing the inclusion of undertakings in various documents were concerned that the failure to provide continuing disclosure pursuant to the undertakings could be deemed a potential event of default on the securities.¹³² Though a failure to comply with the undertaking would be a breach of contract, the rule does not specify the consequences of an issuer's breach of its undertakings to provide secondary market disclosure. As called for by the Joint Response, as well as other commenters, remedies for breach of any undertaking under applicable state law are a subject for negotiation between the parties to the Offering. To avoid uncertainties of enforcement, the parties to a transaction are encouraged to enumerate the consequences in the undertaking, including the available remedies, for breach of the information undertaking.

B. Recommendation of Transactions in Municipal Securities

The Proposed Amendments would have prohibited any broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipal security unless it had specifically reviewed the information the issuer of such municipal security had undertaken to provide.¹³³ The purpose of this provision of the Proposed Amendments was to assist dealers in satisfying their obligation to have a reasonable basis to recommend municipal securities by requiring them to

condition subsequent in the covenant, such as subject to appropriation, might be appropriate. It is anticipated, however, that should funds that would enable the issuer to provide the agreed upon information not be appropriated, disclosure of such fact would be made by notice to the repositories pursuant to Rule 15c2-12(b)(5)(i)(D).

¹³¹ See, e.g., Letter of Chemical Securities; Letter of Dain Bosworth, Inc.; Letter of Dillon, Read & Co., Inc.

¹³² Commenters argued that an issuer's failure to comply with undertakings to provide secondary market disclosure should not result in an event of default. See, e.g., Letter of ABA Urban Law Section; Letter of State of Washington, Office of the Treasurer; Letter of Colorado Municipal Bond Supervision Advisory Board.

¹³³ See paragraph (c) of the Proposed Amendments.

consider the most current information before making a recommendation.

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

Many commenters strongly criticized this provision of the Proposed Amendments. The majority of commenters responded that requiring the review of information prior to making a recommendation on the purchase or sale of a municipal security would create substantial compliance burdens for dealers.¹³⁴ Commenters also noted that the specific requirement to review information either would impel dealers to hire larger research and analysis staffs,¹³⁵ or, more likely, would cause dealers to restrict the issuers whose municipal securities they would trade to a smaller number of large and frequent issuers.¹³⁶ Commenters predicted that, as a result, liquidity for all but the largest and most frequent issuers would be reduced.¹³⁷

Commenters proposed alternatives to the recommendation prohibition, including basing the type of review of a municipal security, and disclosure about such review, on whether the investor was an institutional or retail investor,¹³⁸ or on the type of municipal security recommended.¹³⁹ Other commenters suggested the continued

reliance on the reasonable basis standard inherent in the MSRB's suitability rule, G-19, and the antifraud provisions, as discussed by the Commission in the 1988 and 1989 Releases proposing and adopting Rule 15c2-12, as well as the Interpretive Release.¹⁴⁰

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

In the Commission's view, the recommendation provision, as modified, should substantially reduce the concerns of commenters with respect to compliance burdens and effects on liquidity. It also will help ensure that dealers will consider the material event notices that issuers produce, thus enabling them to have an adequate basis on which to recommend¹⁴¹ municipal securities.

Moreover, even though the amendments do not require that dealers directly review an issuer's ongoing disclosure before making each recommendation, the Commission agrees with those commenters that said that additional information made available by issuers will be taken into account by dealers making recommendations regarding that security, under the MSRB's fair dealing and suitability rules, and the antifraud provisions.¹⁴² In addition to the Commission's past interpretations of the responsibilities of

¹³⁴ See Letter of PSA (noting that paragraph (c) would require dealers to create records showing that they had reviewed municipal securities).

¹³⁵ See, e.g., Letter of Chapman and Cutler (brokers with fewer analysts will be at a competitive disadvantage); Letter of Morgan Stanley (noting that in order to comply with paragraph (c) as proposed, reliance on third-party service providers for information analysis would be required).

¹³⁶ See, e.g., Joint Response; Letter of PSA; Letter of Gabriel, Hueglin & Cashman.

¹³⁷ See, e.g., Joint Response; Letter of PSA.

¹³⁸ Letter of Investment Company Institute ("ICI"). See also Letter of MSRB; Letter of NABL. NABL suggested disclosure by dealers as to whether a party has committed to provide secondary market disclosure, and if not, the consequences of investing in the securities.

¹³⁹ See, e.g., Letter of Edward D. Jones & Co. (suggesting application of the Proposed Amendments only to non-rated or special assessment bonds); Letter of NABL (suggesting exemptions from the amendments to Rule 15c2-12 for issuers that obtain and maintain an investment grade rating, and for general obligation bonds and revenue bonds issued to finance essential government purposes).

¹⁴⁰ See, e.g., Letter of PSA; Letter of A.G. Edwards & Sons, Inc. (reviewing issuer's disclosure is not the only way to form the basis for a recommendation).

¹⁴¹ As noted in the Proposing Release, most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer.

¹⁴² See, e.g., Letter of MSRB (emphasizing that, in the Board's view, dealers would be responsible for continuing disclosure information available in NRMSIRs even without the specific "review" requirement); Letter of Paine Webber.

dealers to have a reasonable basis for their recommendations, the MSRB repeatedly has emphasized that secondary market disclosure information publicized by issuers must be taken into account by dealers to meet the investor protection standards imposed by its investor protection rules. Specifically, MSRB rule G-17 requires dealers to disclose material facts of a transaction to the customer; MSRB rule G-19 requires dealers to ensure that any transaction recommended to the customer is suitable for that customer; and MSRB rule G-30 requires dealers to ensure that the prices set for customer transactions are fair and reasonable. In its comment letter, the MSRB noted that "[i]f a dealer is not aware of major financial and other material developments affecting an issuer's securities, it is difficult or impossible for the dealer to comply with these requirements."¹⁴³

For example, if a dealer reviews an electronic reporting system for material events relating to a security, and finds that an issuer has submitted a notice that it has failed to provide annual financial information on or before the date specified in the written agreement or contract,¹⁴⁴ that fact would be a significant factor to be taken into account when the dealer formulates the basis for a recommendation of such securities. While the dealer would not be prohibited per se from recommending such municipal securities, notice that the issuer has failed to provide annual financial information would be the type of material information required to be disclosed to the customer pursuant to MSRB rule G-17.¹⁴⁵ Such a notice also would trigger a further inquiry by the dealer to assure itself that it is cognizant of the condition of the issuer or obligated persons, despite the absence of promised information. This also would be true if a dealer attempts to obtain an issuer's annual financial information, finds that it has not been submitted to any repository, and the dealer had no record of the issuer submitting a notice to this effect. In such cases, further research may be necessary or advisable prior to making a recommendation in the issuer's securities.

C. *Information Repositories*

1. Background

Under Rule 15c2-12, as adopted in 1989, NRMSIRs essentially serve the function of disseminators of official

statements on behalf of Participating Underwriters.¹⁴⁶ The option of Participating Underwriters to transfer their final official statement delivery obligations to NRMSIRs has encouraged the development of NRMSIRs.¹⁴⁷ The three existing NRMSIRs are private vendors that gather and disseminate final official statements pursuant to Rule 15c2-12. In addition, although not required under existing provisions of the rule, they provide other current information about municipal issuers to the primary and secondary municipal securities markets.¹⁴⁸

As a result of the amendments, NRMSIRs will play an expanded role in the collection and dissemination of secondary market information. In addition to the collection and dissemination of final official statements, they will collect and disseminate annual financial information, as well as notices of material events. The Commission is sensitive to the need of NRMSIRs for flexibility, especially with respect to the timing requirements for the dissemination of notices of material events. The Commission will monitor developments in the municipal securities market as participants adapt to the changes in Rule 15c2-12, and fully expects that the current and potential NRMSIRs are capable of adjusting to their expanded

146 Under Rule 15c2-12(b)(4), underwriters must deliver final official statements to potential customers for a 90 day period after the close of the underwriting period. The underwriters' 90 day delivery obligation is shortened to 25 days if the final official statement can be obtained from a NRMSIR.

147 Since the Commission adopted Rule 15c2-12, the Division of Market Regulation issued three no-action letters recognizing national information vendors as NRMSIRs, based on the standards set out in the July 1989 Release. See Letters from Richard G. Ketchum, Director, Division of Market Regulation to: Joseph V. Riccobono, Executive Vice-President, American Banker- Bond Buyer (Jan. 4, 1990); J. Kevin Kenny, President, Chief Executive Officer, J.J. Kenny Co. (Jan. 4, 1990); and Michael R. Bloomberg, President, Bloomberg, L.P. (Jan. 11, 1990). Recently, the Commission has received inquiries from additional information vendors desiring to be recognized as NRMSIRs.

148 NRMSIRs are not the only source of information in the municipal market. The MSRB has developed its Municipal Securities Information Library ("MSIL") system, which presently collects information and disseminates it to market participants and information vendors. The Official Statement and Advance Refunding Document- Paper Submission System ("OS/ARD") of the MSIL collects and makes available on magnetic tape and on paper official statements and advance refunding notices. Securities Exchange Act Release No. 29298 (June 13, 1991), 56 FR 28194. As a part of the MSIL system, the MSRB commenced operation of its Continuing Disclosure Information ("CDI") pilot system in January, 1993. The CDI system is a central repository for voluntarily submitted official continuing disclosure documents relating to outstanding municipal securities issues. Securities Exchange Act Release No. 30556 (April 6, 1992) 57 FR 12534. Neither the MSIL OS/ARD system nor the CDI system is a NRMSIR; the Commission has previously indicated that it would consider the competitive implications of a MSRB request for NRMSIR status. See Securities Exchange Act Release No. 28081 (June 1, 1990), 55 FR 23333, 23337 n.26.

143 Letter of MSRB (noting the requirements of the MSRB's rules in commenting that the Proposed Amendment's requirement to review periodic information is not a practical option for dealers).

144 See Rule 15C2-12 (B) (5) (i) (D).

145 See MSRB Manual (CCH) 3581.30 (interpreting MSRB rule G-17 to require that a dealer disclose, at or prior to a sale, all material facts concerning the transaction, including a complete description of the security). See also 1988 Release at n. 50 and accompanying text.

role. The Commission is of the view that NRMSIRs, as private information vendors, will have sufficient economic incentives to serve their expanded functions resulting from the amendments to Rule 15c2-12, even in the absence of the more specific review requirement of the recommendation prohibition of the Proposed Amendments.¹⁴⁹

2. Definition of Nationally Recognized Municipal Securities Information Repository

The Commission requested comment on whether the term "NRMSIR" should be defined in Rule 15c2-12, and whether specific standards should be established for NRMSIRs. If standards were to be established in the rule, the Commission requested comment on whether proposed standards set forth in the release were adequate.¹⁵⁰ The majority of state-based information gatherers and disseminators, and other NRMSIRs that addressed the issue of defining the term "NRMSIR" supported maintaining the guidelines already established by the Commission in the 1989 Release.¹⁵¹ After reviewing the comment letters, the Commission has determined that the guidance established in the 1989 Release for NRMSIRs should be modified only as necessary to reflect the amendments to Rule 15c2-12. In determining whether a particular entity is a NRMSIR the Commission will now consider, among other things, whether the repository:

(1) is national in scope;

¹⁴⁹ See, e.g., Letter of PSA (noting that the suggestion made by some market participants that municipal securities dealers will not utilize information they have long sought is implausible), Letter of Ferris Baker Watts (information will be used if it is available).

¹⁵⁰ The Commission suggested that NRMSIRs (a) maintain current, accurate information about municipal securities, including final official statements, the issuer's annual final information, and issuer's notices of material events; (b) have effective systems for the timely collection, indexing, storage and retrieval of these documents; and (c) be capable of national dissemination of final official statements, annual financial information, and notices of material events through electronic dissemination systems, in response to telephone inquiries, and hard copy delivery via facsimile, by mail and by messenger service. The Commission also stressed the importance of timely public availability upon receipt of information by a NRMSIR.

¹⁵¹ See, e.g., Letter of Bloomberg L.P.; Letter of Cypress Capital Corp. (a dealer chosen by the Louisiana Municipal Association to assist it in developing a repository to collect and disseminate information on Louisiana issuers of municipal securities). In discussing NRMSIRs in the 1989 Release, the Commission noted that in determining whether a particular entity is a NRMSIR, it would look, among other things, at whether the repository: (1) is national in scope; (2) maintains current, accurate information about municipal offerings in the form of official statements; (3) has effective retrieval and dissemination systems; (4) places no limit on the issuers from which it will accept official statements or related information; (5) provides access to the documents deposited with it to anyone willing and able to pay the applicable fees; and (6) charges reasonable fees. See 1989 Release at n. 65.

(2) maintains¹⁵² current, accurate¹⁵³ information about municipal offerings in the form of official statements, and annual financial information, notices of material events, and notices of a failure to provide annual financial information undertaken to be provided in accordance with Rule 15c2-12;

(3) has effective retrieval and dissemination systems;

(4) places no limits on the persons from which it will accept official statements, and annual financial information, notices of material events, and notices of a failure to provide annual financial information undertaken to be provided in accordance with Rule 15c2-12;

(5) provides access to the documents deposited with it to anyone willing and able to pay the applicable fees; and

(6) charges reasonable fees.

While NRMSIRs may charge reasonable fees¹⁵⁴ for the dissemination of information, they may not charge issuers for accepting information provided by issuers in accordance with Rule 15c2-12.¹⁵⁵ In response to concerns raised by commenters, the Commission also notes that giving preferential treatment to certain brokers, dealers, and municipal securities dealers by giving them market information before it is made available to all customers would be wholly inconsistent with recognition as a NRMSIR.¹⁵⁶

Comment also was requested on the ability and willingness of both potential NRMSIRs, and those presently operating under no- action letters, to meet the dissemination standards discussed in the Proposing Release. NRMSIRs

¹⁵² In the past, the Division of Market Regulation has required that each NRMSIR maintain copies of all disclosure documents. In view of recent requests from information collectors and disseminators, the Division of Market Regulation will review, on a case by case basis, NRMSIR proposals to satisfy the requirement to maintain copies of disclosure documents through a contract with another entity (including the MSRB) that will maintain copies. See Letters from Laurence M. Landau, Vice President, Dow Jones Telerate, to Elizabeth MacGregor, Division of Market Regulation, SEC, (July 18, 1994) and to Gautam S. Gujral, Division of Market Regulation, SEC (August 4, 1994). See also Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial). This flexible approach, requested by industry participants, may allow NRMSIRs to reduce the cost at which they can collect and disseminate disclosure information to broker-dealers and investors.

¹⁵³ It should be noted that NRMSIRs are not being required to verify the accuracy of the information provided them. NRMSIRs are required to accurately convey the information provided to them.

¹⁵⁴ See 1989 Release.

¹⁵⁵ See, e.g., Letter of Maine Municipal Bond Bank; Letter of National Association of Independent Public Financial Advisers (NRMSIR users, not issuers, should pay the NRMSIR costs).

¹⁵⁶ See, e.g., Letter of Colonial Management Associates, Inc.

responded that they can meet these standards.¹⁵⁷ In order to implement these standards, the Commission has determined that existing NRMSIRs should reapply for recognition from the Commission under the revised criteria to continue to function as NRMSIRs.

3. State Information Depositories

The Commission also requested comment on whether a state-based depository could serve as an effective means to disseminate information to the market for a nationally traded security, thus enabling the appropriate parties to fulfill their disclosure obligations using a state-based depository. Commenters expressed divergent views on this issue.¹⁵⁸ No state responded directly in response to the Commission's request for comment on whether states are willing to make the necessary financial commitment to create a state-based system. The Comptroller of the State of New York pointed out, however, that his office already collects financial data from local governments, and that there "is an appropriate and important function which the states may perform in the secondary market disclosure process."¹⁵⁹ A number of third party state-based information collectors also stated that they were in the process of creating state-based repositories.¹⁶⁰ Other such third party state-based information collectors pointed out that they already had working depositories in place.¹⁶¹

¹⁵⁷ Letter of Bloomberg L.P.; Letter of J.J. Kenny Co.; Letter of The Bond Buyer.

¹⁵⁸ With one notable exception, national information vendors generally did not see a need for state-based repositories and argued that state-based repositories would indeed add to the complexity of collecting and disseminating information. See, e.g., Letter of J.J. Kenny Co. Some state-based information gatherers and disseminators, however, argued that they already had created mechanisms for the collection and dissemination of information, and their systems are working well. The National Association of State Auditors, Comptrollers and Treasurers ("NASACT") pointed out that issuers and other obligors will probably file with state-based repositories, with whom they are accustomed to working and with whom they typically must file in any event for regulatory purposes unrelated to secondary market disclosure. NASACT argued that while the state repositories do not wish to compete with NRMSIRs, state-based repositories can serve an important role in enhancing the accessibility of disclosure information for repackaging by the NRMSIRs. See Letter of NASACT.

¹⁵⁹ See Letter of the Office of the State Comptroller, State of New York.

¹⁶⁰ See, e.g., Letter of Cypress Capital Corporation (Louisiana Municipal Security Disclosure Board "intends to be in a position to comply with the standards developed by the Commission for NRMSIRs").

¹⁶¹ See Letter of Municipal Advisory Council of Texas; Letter of Ohio Municipal Advisory Council.

Based on these comments, and in light of existing disclosure mechanisms and recent legislation in several states designed to enhance secondary market disclosure,¹⁶² it appears that states can play a beneficial role in enhancing disclosure in the municipal securities market.¹⁶³ State-based depositories will be in a special relationship with filers of disclosure information to provide for convenient and efficient dissemination. The Commission therefore encourages states to develop state-based depositories.

To encourage the development of state-based depositories, the Commission has amended Rule 15c2-12 to require that Participating Underwriters reasonably determine that the information undertaken to be provided, in addition to being submitted to the NRMSIRs, or, in some cases, to the MSRB, will be submitted to a state information depository ("SID"), if an appropriate SID has been established in that state. Further, as discussed below,¹⁶⁴ an exemption conditioned on making annual financial information available upon request or to a SID, and providing notices of material events to each NRMSIR or the MSRB, and to a SID, has been adopted. An appropriate SID would be a depository operated or designated¹⁶⁵ by the state that receives information from all issuers within the state, and makes this information available promptly to the public on a contemporaneous basis.¹⁶⁶ The Commission staff is prepared to provide guidance in particular instances regarding a SID's qualification for purposes of the rule.

4. Information Delivery Requirements

¹⁶² South Carolina recently enacted legislation requiring issuers to agree in a bond indenture to file an annual independent audit within a specified number of days of the issuer's receipt thereof and certain event information with a central repository. South Carolina Senate Bill 1182, (effective September 1, 1994) to be codified in S.C. Code Ann. Chapter 1, Title 11, Section 11-1-85 (1976). Similarly, Tennessee recently adopted legislation authorizing the adoption of rules to facilitate secondary market disclosure by any public entity, including the form and content of that disclosure. Tenn. Code Ann. Sec. 9-21-151 (a) and (b)(2).

¹⁶³ See, e.g., Letter of the Office of the State Comptroller, State of New York.

¹⁶⁴ See Section II.D.1. *infra*.

¹⁶⁵ There is no requirement that SIDs be instrumentalities of a state. A number of private organizations already function as state-based repositories, at times at no cost to the taxpayer. The Commission defers to each state's determination whether to have a private or public entity be its SID.

¹⁶⁶ As with NRMSIRs, for a SID to give preferential treatment to a NRMSIR by giving it market information before it is made available to other NRMSIRs would be wholly inconsistent with functioning as a SID.

The Proposing Release asked to whom the required information should be delivered. It also requested comment on the feasibility of requiring NRMSIRs to inform the MSRB when they receive disclosure information from issuers, and whether such information also should be required to be placed with the MSRB, in addition to or in lieu of a NRMSIR. The NRMSIRs did not address the issue of requiring them to inform the MSRB whenever they received disclosure information from an issuer, although one commenter argued that designating the MSRB as a repository only would add an unnecessary layer to the dissemination process.¹⁶⁷ Other commenters suggested designating a single central repository.¹⁶⁸ Similarly, some commenters suggested imposing a requirement that disclosure information be delivered to all NRMSIRs,¹⁶⁹ while others suggested that NRMSIRs be required to share the information received with other NRMSIRs,¹⁷⁰ and a third group preferred the establishment of a central index.¹⁷¹ State-based information gatherers and disseminators had diverging views on this issue.¹⁷²

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

¹⁶⁷ Letter of Bloomberg L.P.

¹⁶⁸ See, e.g., Artemis Capital Group, Ltd. (proposing that the Commission designate the MSRB's MSIL system as the single central repository); Letter of Chapman and Cutler (there should be one central source of information).

¹⁶⁹ See, e.g., Letter of J.J. Kenny Co.; Letter of National Association of Independent Public Financial Advisers.

¹⁷⁰ See, e.g., Letter of MSRB; Letter of Richard A. Ciccarone.

¹⁷¹ Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial); Letter of The Bond Buyer.

¹⁷² The Ohio Municipal Advisory Council stated that it is feasible to require repositories to inform the MSRB as to which issuers have released information to it. Under Cypress Capital Corporation's proposal, the indexing party would receive descriptions of all materials received by the Louisiana Repository. But see, Letter of NASACT (requirement that a repository be required to notify a central index each time an item of information is received by the repository is unduly burdensome and unnecessary).

information sharing among NRMSIRs.¹⁷³ The requirement to send information to all NRMSIRs rather than a single NRMSIR of the issuer's or obligated person's choice, should not impose significant burdens or costs, other than duplication and mailing costs. Furthermore, this requirement to deliver disclosure to the NRMSIRs and the appropriate SID also allays the anti-competitive concerns raised by the creation of a single NRMSIR.

In contrast to annual financial information, under the amendments, notices of material events, as well as notices of a failure by an issuer or other obligated person to provide annual financial information must be delivered to each NRMSIR or the MSRB, and the appropriate SID. The Commission is of the view that permitting issuers and obligated persons to file such notices either with each NRMSIR or with the MSRB (as well as the appropriate SID) will facilitate prompt and wide disclosure. The amendments reflect the preference of some commenters for filing such notices in one central place, such as the MSRB, rather than having to file with multiple NRMSIRs. The Commission expects that if notices are filed with the MSRB, the MSRB will make these notices available to all NRMSIRs on a prompt and contemporaneous basis.

5. Timing of Dissemination

Due to the time sensitive nature of notices of material event and failures to provide annual financial statements, it is important that such notices are disseminated quickly. These market requirements will dictate that disseminators have a system in place by which information vendors can make such notices available to broker-dealers and investors quickly and contemporaneously.

NRMSIRs and other information vendors have indicated in their comment letters that under certain circumstances a 15 minute turnaround¹⁷⁴ time for notices of material events, and a 24 hour turnaround period for annual financial information may be feasible, and, in some instances,

¹⁷³ Some commenters expressed an interest in creating a central index and an information sharing system. Letter of Storch & Brenner (on behalf of R.R. Donnelly Financial); Letter of Dow Jones Telerate, Inc. The Commission is prepared to review such mechanisms for centralized collection and dissemination if requested to do so.

¹⁷⁴ The Commission considers "turnaround time" or "turnaround period" to mean the time between which a NRMSIR initially receives information, and the time when such information is made available to the public. NRMSIRs will be required to make available the full text of notices of material events, and post the receipt and availability of other documents within the designated turnaround time period.

already is in place.¹⁷⁵ Nonetheless, because the ultimate scope of the information undertakings was not known to the existing and potential NRMSIRs at the time they submitted their comments, the Commission intends to discuss with the NRMSIRs during the recognition process appropriate and practicable turnaround standards for information re-dissemination. Because SIDs are alternative sources of information for every type of disclosure, the Commission does not intend to impose strict turnaround times for SIDs. Instead, SIDs should provide the Commission and users with a clear statement of turnaround times that they will meet consistently.

6. Technological Considerations

The Commission also received many suggestions from information gatherers and vendors on streamlining the filing of disclosure information. These suggestions included requiring electronic filing of disclosure information, providing filings on computer disks and providing information to NRMSIRs as images of original source documents rather than exclusively as coded text.¹⁷⁶ Rather than dictate standards, the Commission encourages municipal securities market participants to coordinate their requirements and preferences on an industry-wide basis.

D. Exemptions

The Proposed Amendments contained two new exemptions, which are being adopted with certain

¹⁷⁵ The Bond Buyer stated that it broadcasts, through its Munifacts News product, material events and time critical announcements within 15 minutes of their receipt to municipal market participants throughout the country. It stated that it also posts documents within 24 hours of a document's receipt to the Bond Buyer's On-line Index which is updated throughout the day. Letter of The Bond Buyer. Similarly, Dow Jones Telerate stated that electronic dissemination will allow the turnaround time of 24 hours for an official statement and 15 minutes for secondary disclosure documents on material events to be feasible. Letter of Dow Jones Telerate. Material information is electronically disseminated on a "real time" basis by Bloomberg L.P. Letter of Bloomberg L.P.

¹⁷⁶ J.J. Kenny Co. requested that documents be required to be filed as images of original source documents rather than exclusively as coded text. Dow Jones Telerate requested that Official statements be filed along with one electronic disk copy of the original Word Processing/Desktop publishing file with the label marked as to which software and version was used. For secondary market disclosure documents, Telerate advises using the NFMA proposed worksheets. The Bond Buyer stated that "collection would be most efficient if documents were in ASCII and a common word processing or publishing format".

modifications. A third new exemption from the annual financial information requirement, for short-term securities, also is being adopted. In addition, Rule 15c2-12's limitation to primary offerings of municipal securities with an aggregate principal amount of \$1,000,000 or more, and its existing exemptions, also apply to the amendments.¹⁷⁷

1. Small Issuer Exemption

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

A number of commenters discussed the appropriateness of the proposed dollar exemption, with comments ranging from a call for increased thresholds to no thresholds at all.¹⁷⁸ Some commenters believed that the thresholds should be increased, because many small municipalities would exceed these thresholds if they delay their financings in order to issue a greater amount of bonds at one time. The commenters argued that these are small, infrequent issuers with limited trading in the secondary market and the cost of compliance would outweigh the benefits received from improved secondary market disclosure.¹⁷⁹

Other commenters took exception to the proposed thresholds because they were too high. These commenters argued that the exemption as proposed would exclude from coverage of the rule the types of issuers who have historically had deficient disclosure practices and disproportionate numbers of defaults.¹⁸⁰ A number of commenters also argued that the

¹⁷⁷ Former paragraph (c) of Rule 15c2-12 was proposed to be, and has been redesignated as paragraph (d)(1). This paragraph exempts primary offerings of municipal securities in authorized denominations of \$100,000 or more, if such securities: (1) are sold to no more than 35 investors, each of whom the underwriter reasonably believes is capable of evaluating the investment and who is not purchasing with a view to distribution; (2) have a maturity of nine months or less or; (3) at the option of the holder may be tendered to an issuer at least as frequently as every nine months.

¹⁷⁸ See, e.g. Letter of ALHFA; Letter of CDFA; Letter of NFMA; Letter of National Association of Independent Public Finance Advisors; Letter of Prudential Investment Corp.; Letter of PSA; Letter of Washington State Auditor.

¹⁷⁹ See, e.g., Letter of NAST; Letter of SIA.

¹⁸⁰ See, e.g. Letter of Chemical Securities; Letter of Eaton Vance Management; Letter of Edward D. Jones & Co.; Letter of Morgan Stanley;

\$3 million/48 month component of the threshold was too complex.¹⁸¹

As adopted,¹⁸² the exemption retains the aggregate \$10,000,000 limitation, but eliminates the \$3,000,000 threshold. Instead, in addition to falling under the \$10,000,000 in outstanding securities threshold, the exemption is conditioned upon an issuer or obligated person providing a limited disclosure undertaking. Under this undertaking, financial information and operating data concerning each obligor for which financial information or operating data is presented in the final official statement, must be provided upon request to any person, or be provided at least annually to the appropriate SID. The undertaking would specify the type of financial information and operating data that will be made available annually, which must include financial information and operating data that is customarily prepared by the obligated person and is publicly available. The final official statement must describe where and how the financial information and operating data can be obtained.

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

In addition to providing financial information and operating data annually, notices of material events must be sent to each NRMSIR or to the MSRB, and the appropriate SID. This public information condition has been adopted in response

Letter of National Association of Independent Public Finance Advisors; Letter of Norwest Investment Services.

¹⁸¹ See, e.g., Letter of APPA; Letter of The Bank of New York; Joint Response.

¹⁸² See Rule 15c2-12(d)(2).

to comments highlighting the need for information regarding small issuers accessing the public debt market.¹⁸³

The threshold of \$10,000,000 has been retained, notwithstanding comments that it was too high or too low. According to statistics provided by one commenter,¹⁸⁴ in 1993, 71% of the approximately 52,000 municipal issuers had under \$10,000,000 in outstanding municipal securities. Accordingly, the amendments as proposed already provided significant exemptive relief for small issuers. Indeed, the fact that a majority of issuers fall below that threshold supports conditioning the exemption on a commitment to provide a limited amount of secondary market information from exempt issuers. Even with that condition, a significant percentage of offerings would remain totally exempt from the amendments as adopted, because over 20% of the total issuances in 1993 were under \$1,000,000.¹⁸⁵ As these statistics demonstrate, the exemption should exclude a large percentage of small infrequent issuers.

Commenters also questioned how the aggregate thresholds were measured, including whose securities would be included and whether the exemption applied only to outstanding securities that were sold in Offerings subject to the rule.¹⁸⁶ Many commenters indicated that the thresholds should be separately applied to each issuer of municipal securities and each underlying obligor.¹⁸⁷ Thus, in the case of conduit issuers that have no liability on the municipal securities, commenters argued that the thresholds should be determined by reference to the persons who are the beneficiaries of the financing.¹⁸⁸ Some commenters argued that those issuers that had different types of financings that relied on separate revenue streams for repayment, such as dedicated tax revenues, should not be

¹⁸³ See Joint Response. A number of other commenters expressed concern about the lack of information on issuers in market segments in which the higher proportion of defaults have occurred. See note 182, *supra* and accompanying text. The effective date for this information undertaking condition on the small issuer exemption will be delayed until January 1, 1996. See Section II.E., *infra*.

¹⁸⁴ See Letter of The Bond Buyer.

¹⁸⁵ See Letter of The Bond Buyer. The requirements of Rule 15c2-12, as amended, may not be avoided by breaking up an offering into several offerings of less than \$1,000,000, where the offerings are of the same class of securities and are for the same purpose.

¹⁸⁶ See, e.g., Letter of ABA Urban Law Section; Letter of CIFA; Letter of Colorado Municipal Bond Supervision Advisory Board.

¹⁸⁷ See, e.g., Letter of ALHFA; Letter of CDFA; Letter of Hawkins Delafield & Wood.

¹⁸⁸ See, e.g., Letter of Alaska Municipal Bond Bank; Letter of Bose, McKinney & Evans; Letter of CDFA; Letter of Oregon Economic Development Department.

foreclosed from relying on the small issuer exemption for each financing.¹⁸⁹

To address the first of these concerns, the amendments have been revised to clarify that the availability of the exemption turns on the amount of outstanding municipal securities for which an issuer or obligated person also is an obligated person. An issuer of municipal securities would need to satisfy the threshold only if it were an obligated person with respect to the security being offered. Under this approach, if a financing agency that is offering obligations that have some recourse to the agency, only those outstanding securities of the agency that likewise are recourse would count toward the threshold. If the financing agency does not issue recourse securities, the exemption will be unavailable only if a conduit borrower obligated on the municipal securities being offered is an obligated person with respect to more than \$10,000,000 in outstanding municipal securities. If any one obligated person in an Offering exceeds the threshold, then the entire Offering, including all obligated persons, will be subject to the rule. Subsequent non-recourse offerings by the financing agency would not be affected, but would be subject to a similar test.

With respect to the second concern, however, the amendments require that an obligated person aggregate all its outstanding obligations, even if some are payable from separate dedicated revenue sources. For example, a city or county that issues securities for a number of different purposes could not qualify as a small and infrequent issuer merely because its outstanding securities are payable from separate revenue streams. Thus, while a governmental issuer's outstanding obligations need not be aggregated with that of non-governmental obligated persons, a governmental issuer could not avoid aggregation of its securities by restricting repayment to separate revenue streams.¹⁹⁰

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

¹⁸⁹ See, e.g., Letter of ABA Business Law Section; Letter of Chapman and Cutler; Letter of NABL.

¹⁹⁰ Significant indicia of whether an issuer in a revenue-type financing is in fact a part of a larger municipality would be whether the issuer's accounts are reflected in the municipality's financial statements and whether the municipality's officials or personnel manage the separate financing programs.

should be measured only against publicly offered, long-term bonds.¹⁹¹

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

A number of commenters indicated that an exemption should be available based on the number of holders of the municipal securities.¹⁹² However, in accordance with concerns voiced by other commenters regarding the difficulty in ascertaining the number of holders due to the fact that most municipal securities are held in street name through a very limited number of depositories,¹⁹³ the amendments do not adopt any exemption based on the number of holders of the municipal securities.

A variety of other comments were raised relating to exemptions, and a number of alternative exemptions were proposed, including exemptions based on the type of issuer or the existence of an investment grade rating.¹⁹⁴ Commenters also believed that an exemption should be available for securities covered by bond insurance or other credit enhancement, such as bank letters of credit.¹⁹⁵ Except as described above, the exemptions have not been revised to adopt these suggestions. Commenters, including some bond insurance providers,¹⁹⁶ expressed the view that the existence of credit

¹⁹¹ See, e.g., Letter of ABA Business Law Section; Letter of Day Berry & Howard; Joint Response; Letter of Kutak Rock; Letter of the Treasurer of the State of North Carolina.

¹⁹² See, e.g., Letter of ABA Business Law Section; Letter of Kutak Rock; Letter of Mudge Rose; Letter of National League of Cities.

¹⁹³ See, e.g., Letter of Bank One Corporation; Letter of Reliance Trust Company.

¹⁹⁴ See, e.g., Letter of ICI; Letter of McDonald & Company Securities; Letter of NABL; Letter of National League of Cities; Letter of NFMA; Letter of New York Dormitory Authority; Letter of Putnam Investment Management; Letter of State of Utah, Office of the State Treasurer; Letter of State of Washington, Office of the State Treasurer.

¹⁹⁵ See, e.g., Letter of Delaware County Industrial Development Authority; Letter of Financial Security Assurance; Letter of McNair & Sanford; Letter of Smith, Gambrell & Russell.

¹⁹⁶ As some commenters indicated, the existence of credit enhancement or other programmatic enhancement features does not eliminate the need for information on underlying obligated persons, particularly where there is a long term guarantee, because of the potential impact of a default on the pricing of the securities. See Letter of Kutak Rock on behalf of Financial

enhancement does not necessarily eliminate the need for information regarding the underlying credit.

A number of commenters also argued that new exemptions should be added that would mirror exemptions under the Securities Act.¹⁹⁷ Some commenters argued that exemptions should be included for non-profit entities that would have their own exemption from registration under the Securities Act.¹⁹⁸ The Commission is not including any exclusion in the amendments for any such issuers. Issuers accessing the tax-exempt public securities markets have obligations to promote the integrity and efficiency of those markets. As the Commission noted in the Interpretive Release, the high level of defaults in sectors such as healthcare, lifecare, retirement homes and multifamily housing, relative to other market sectors,¹⁹⁹ and the past problems with the sufficiency of information in many of these sectors, weighs heavily against adopting such exclusions.

2. Exemption from the Annual Financial Information Requirement for Short-term Securities

A new exemption has been added to exempt from the requirement for an undertaking calling for annual financial information, Offerings of securities with an 18 month or shorter maturity.²⁰⁰ The new exemption is in response to comments suggesting that the rule not require annual financial information in situations where the securities would mature shortly after, or possibly even before, the annual financial information would be due.²⁰¹ The provisions of the amended rule relating to notices of material events, however, would

apply to these Offerings absent some other Rule 15c2-12 exemption.

3. Exemptions from the Recommendation Prohibition

The Proposed Amendments also included a new exemption,²⁰² which would have permitted the recommendation in the secondary market of securities that were not subject to the underwriting prohibition, either because they were sold in a primary offering²⁰³ of municipal securities with an aggregate principal amount of less than \$1,000,000, or came within the existing exemptions for limited placements, short-term securities, and securities with demand features,²⁰⁴ or within the new exemption for small, infrequent issuers.²⁰⁵ This exemption has been adopted as proposed,²⁰⁶ with the exception that securities sold in an exempt Offering that is subject to the limited undertaking condition,²⁰⁷ are not exempt from the application of the recommendation prohibition. Pursuant to this element of the small issuer exemption, dealers must have in place procedures to receive notices of material events.²⁰⁸

4. Transactional Exemption

The existing Rule 15c2-12 transactional exemption²⁰⁹ permits the Commission to exempt any Participating Underwriter from any requirement of the rule. Because Rule 15c2-12, as amended, places requirements on brokers, dealers, and municipal securities dealers in the secondary market, the transactional exemption has been amended to clarify that the Commission has exemptive authority with respect to both Participating Underwriters, in connection with Offerings, and with respect to brokers, dealers,

Guaranty Insurers; Letter of FGIC; Letter of Prudential Investment Corp. See also Securities and Exchange Commission, Report by the Securities and Exchange Commission on the Financial Guaranty Market: The Use of the Exemption In Section 3(a)(2) of the Securities Act for Securities Guaranteed by Banks and the Use of Insurance Policies to Guarantee Debt Securities (August 28, 1987).

¹⁹⁷ See, e.g., Letter of ABA Business Law Section; Letter of Goldman Sachs; Letter of Morgan Stanley; Letter of Mudge Rose; Letter of Thacher Proffitt & Wood.

¹⁹⁸ See, e.g., Letter of Morgan Stanley; Letter of Mudge Rose; Letter of New York Dormitory Authority.

¹⁹⁹ Interpretive Release at Section III.D. See also Letter of The Bond Buyer.

²⁰⁰ Rule 15c2-12(d)(3).

²⁰¹ See, e.g., Letter of ABA Urban Law Section; Letter of Chemical Securities; Letter of Day, Berry & Howard; Letter of Kutak Rock; Letter of Maryland Department of Economic and Employment Development.

²⁰² See paragraph (d)(3) of the Proposed Amendments.

²⁰³ This exemption has been modified to clarify that the recommendation prohibition will not apply to primary or secondary market trading where municipal securities are exempt at the time of their original issuance. Several commenters noted that the inclusion of the term "a primary offering of" created confusion, based on the stated purpose of the exemption in the Proposing Release. See, e.g., Letter of Kutak Rock; Letter of ABA Urban Law Section; Letter of Colorado Municipal Bond Supervision Advisory Board; Letter of Day, Berry & Howard. The exemption has been modified to delete that term, thus giving the exemption its intended meaning.

²⁰⁴ See paragraph (d)(1) of the Proposed Amendments.

²⁰⁵ See paragraph (d)(2) of the Proposed Amendments.

²⁰⁶ Rule 15c2-12(d)(4).

²⁰⁷ See Rule 15c2-12(d)(2)(ii).

²⁰⁸ See Rule 15c2-12(b)(5)(i)(C).

²⁰⁹ Former paragraph (d) of Rule 15c2-12.

and municipal securities dealers recommending transactions in the secondary market. 210

E. Transitional Provision

The rule as amended contains a transitional provision for the amendments to Rule 15c2-12. 211 The underwriting prohibition applies to a Participating Underwriter that has contractually committed to act as an underwriter in an Offering on or after the effective date of the rule, July 3, 1995; provided that issuers need not undertake to provide annual financial information for fiscal years ending prior to January 1, 1996. The recommendation prohibition will become effective on January 1, 1996. The Commission is of the view that this delay of six months beyond the effective date of the amendment relating to the underwriting of municipal securities is sufficient to permit participants in the municipal securities market to design procedures for compliance with the provisions of Rule 15c2-12. Brokers, dealers and municipal securities dealers must, therefore, have procedures in place to comply with the recommendation prohibition on or before January 1, 1996. Finally, the limited undertaking condition to the small issuer exemption need not be satisfied for offerings commencing prior to January 1, 1996.

III. Effects on Competition and Regulatory Flexibility Act Considerations

Section 23(a)(2)²¹² of the Exchange Act requires the Commission, in adopting rules under the Act, to consider the anticompetitive effects of those rules, if any, and to balance that impact against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission has considered the amendments to Rule 15c2-12 in light of the standard cited in Section 23(a)(2) and believes the adoption of the amendments will not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

In addition, the Commission has prepared a final regulatory flexibility analysis ("FRFA"), pursuant to the requirements of the Regulatory Flexibility Act²¹³ regarding the proposed amendments to Rule 15c2-12. The Commission requested comment on the extent to which current practice deviates from the requirements of the proposed amendments,

210 The transactional exemption also has been redesignated as paragraph (e) of Rule 15c2-12.

211 See Rule 15c2-12(g). -[214]- 15 U.S.C. 78w(a)(2).

212 15 U.S.C. 78w(a) (2).

213 5 U.S.C. 604.

and the extent to which additional costs may be imposed on small issuers, brokers, dealers, and municipal securities dealers if the amendments are adopted as proposed. The FRFA indicates that the amendments to the rule could impose some additional costs on small broker-dealers and municipal issuers. Nonetheless, the Commission is of the view that many of the substantive requirements of the amendments already are observed, absent access to the continuing information provided by the amendments, by issuers, brokers, dealers, and municipal securities dealers as a matter of business practice, or to fulfill their existing obligations under the antifraud provisions of the federal securities laws. To the extent that the Proposed Amendments would have imposed additional costs on small issuers, brokers, dealers, and municipal securities dealers, in response to commenters' concerns, the Commission has modified the amendments as described.

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

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, securities.

Text of Amendments to Rule 15c2-12

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

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

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

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

* * * * *

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

§ 240.15c2-12 Municipal securities disclosure.

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

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

* * * * *

(b) *Requirements.* * * *

(5)(i) A Participating Underwriter shall not purchase or sell municipal securities in connection with an Offering unless the Participating Underwriter has reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement has undertaken, either individually or in combination with other issuers of such municipal securities or obligated persons, in a written agreement or contract for the benefit of holders of such securities, to provide, either directly or indirectly through an indenture trustee or a designated agent:

(A) To each nationally recognized municipal securities information repository and to the appropriate state information

depository, if any, annual financial information for each obligated person for whom financial information or operating data is presented in the final official statement, or, for each obligated person meeting the objective criteria specified in the undertaking and used to select the obligated persons for whom financial information or operating data is presented in the final official statement, except that, in the case of pooled obligations, the undertaking shall specify such objective criteria;

(B) If not submitted as part of the annual financial information, then when and if available, to each nationally recognized municipal securities information repository and to the appropriate state information depository, audited financial statements for each obligated person covered by paragraph (b)(5)(i)(A) of this section;

(C) In a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any, notice of any of the following events with respect to the securities being offered in the Offering, 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 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, substitution, or sale of property securing repayment of the securities;
- (11) Rating changes; and

(D) In a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any, notice of a failure of any person specified in paragraph (b)(5)(i)(A) of this section to provide required annual financial information, on or before the date specified in the written agreement or contract.

(ii) The written agreement or contract for the benefit of holders of such securities also shall identify each person for whom

annual financial information and notices of material events will be provided, either by name or by the objective criteria used to select such persons, and, for each such person shall:

(A) Specify, in reasonable detail, the type of financial information and operating data to be provided as part of annual financial information;

(B) Specify, in reasonable detail, the accounting principles pursuant to which financial statements will be prepared, and whether the financial statements will be audited; and

(C) Specify the date on which the annual financial information for the preceding fiscal year will be provided, and to whom it will be provided.

(iii) Such written agreement or contract for the benefit of holders of such securities also may provide that the continuing obligation to provide annual financial information and notices of events may be terminated with respect to any obligated person, if and when such obligated person no longer remains an obligated person with respect to such municipal securities.

(c) *Recommendations.* As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices, it shall be unlawful for any broker, dealer, or municipal securities dealer to recommend the purchase or sale of a municipal security unless such broker, dealer, or municipal securities dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to paragraph (b)(5)(i)(C), paragraph (b)(5)(i)(D), and paragraph (d)(2)(ii)(B) of this section with respect to that security.

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

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

(A) Has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment; and

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

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

(iii) At the option of the holder thereof may be tendered to an issuer of such securities or its designated agent for redemption or purchase at par value or more at least as frequently as every nine months until maturity, earlier redemption, or purchase by an issuer or its designated agent.

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

such municipal securities delivers the securities to the Participating Underwriters:

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

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

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

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

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

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

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

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

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

(e) *Exemptive Authority.* The Commission, upon written request, or upon its own motion, may exempt any broker, dealer, or municipal securities dealer, whether acting in the capacity of a Participating Underwriter or otherwise, that is a participant in a transaction or class of transactions from any requirement of this section, either unconditionally or on

specified terms and conditions, if the Commission determines that such an exemption is consistent with the public interest and the protection of investors.

(f) *Definitions.* * * *

(3) The term *final official statement* means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering; and a description of the undertakings to be provided pursuant to paragraph (b)(5)(i), paragraph (d)(2)(ii), and paragraph (d)(2)(iii) of this section, if applicable, and of any instances in the previous five years in which each person specified pursuant to paragraph (b)(5)(ii) of this section failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of this section. Financial information or operating data may be set forth in the document or set of documents, or may be included by specific reference to documents previously provided to each nationally recognized municipal securities information repository, and to a state information depository, if any, or filed with the Commission. If the document is a final official statement, it must be available from the Municipal Securities Rulemaking Board.

* * * *

(9) The term *annual financial information* means financial information or operating data, provided at least annually, of the type included in the final official statement with respect to an obligated person, or in the case where no financial information or operating data was provided in the final official statement with respect to such obligated person, of the type included in the final official statement with respect to those obligated persons that meet the objective criteria applied to select the persons for which financial information or operating data will be provided on an annual basis. Financial information or operating data may be set forth in the document or set of documents, or may be included by specific reference to documents previously provided to each nationally recognized municipal securities information repository, and to a state information depository, if any, or filed with the Commission. If the document is a final official statement, it must be available from the Municipal Securities Rulemaking Board.

(10) The term *obligated person* means any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to

be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities).

* * * *

(g) *Transitional Provision.* * * *

Paragraph (b)(5) of this section shall not apply to a Participating Underwriter that has contractually committed to act as an underwriter in an Offering of municipal securities before July 3, 1995; except that paragraph (b)(5)(i)(A) and paragraph (b)(5)(i)(B) shall not apply with respect to fiscal years ending prior to January 1, 1996. Paragraph (c) shall become effective on January 1, 1996. Paragraph (d)(2)(ii) and paragraph (d)(2)(iii) of this section shall not apply to an Offering of municipal securities commencing prior to January 1, 1996.

By the Commission.

Jonathan G. Katz,

Secretary,

Dated: November 10, 1994
