

SEC RELEASE No. 34-26985 (June 28, 1989): Adoption of Rule 15c2-12**SECURITIES AND EXCHANGE COMMISSION****17 CFR Parts 240 and 241****RIN 3235-AD58****[Rel. No. 34-26985, File No. S7-20-88]****Municipal Securities Disclosure****AGENCY: Securities and Exchange Commission****ACTION: Final rule.**

SUMMARY: The Securities and Exchange Commission today announced the adoption of Rule 15c2-12, which requires underwriters participating in primary offerings of municipal securities of \$1,000,000 or more to obtain, review, and distribute to investors copies of the issuer's disclosure documents. Under the rule, in a primary offering of municipal securities the underwriter will be required: (1) to obtain and review a copy of an official statement deemed final by an issuer of the securities, except for the omission of specified information; (2) in non-competitively bid offerings, to make available, upon request, the most recent preliminary official statement, if any; (3) to contract with an issuer of the securities, or its agent, to receive, within specified time periods, sufficient copies of the issuer's final official statement, both to comply with this rule and any rules of the Municipal Securities Rulemaking Board; and (4) to provide, for a specified period of time, copies of final official statements to any potential customer upon request. The rule contains exemptions for underwriters participating in certain offerings of municipal securities issued in large denominations that are sold to no more than 35 sophisticated investors, have short-term maturities, or have short-term tender or put features. The release also modifies, in limited respects, a previously published interpretation of the legal obligations of municipal securities underwriters.

EFFECTIVE DATE: Rule 15c2-12 is effective on January 1, 1990. The modification of the interpretation of the legal obligations of municipal underwriters is effective June 28, 1989.

FOR FURTHER INFORMATION CONTACT: Catherine McGuire, Special Assistant to the Director (202) 272-2790 (prior to the effective date); Robert L.D. Colby, Chief Counsel, or Edward L. Pittman, Assistant Chief Counsel, (202) 272-2848 (concerning the rule and release generally); or Christine A. Sakach, Branch Chief--Market Structure (202) 272-2857 (concerning interpretation of the term "nationally

recognized municipal securities information repository"), Division of Market Regulation, Mail Stop 5-1, Securities and Exchange Commission, Washington, DC 20549.

I. Introduction

On September 22, 1988, the Commission released to Congress the results of an extensive investigation into the default of the Washington Public Power Supply System ("Supply System").¹ At the same time, it published Securities Exchange Act Release No. 26100 ("Release"),² which requested comment on several initiatives that were designed to improve the quality, timing, and dissemination of disclosure in the Municipal securities markets. The Release proposed for adoption Rule 15c2-12 ("Proposed Rule") under the Securities Exchange Act of 1934³ [FN3] ("Exchange Act"), provided an interpretation of underwriter's responsibilities in municipal offerings ("Interpretation"), and solicited comment on proposals advanced by the Municipal Securities Rulemaking Board ("MSRB") and other members of the industry to create a repository for municipal disclosure documents.

Comment was requested on each aspect of the Proposed Rule, Interpretation, and the creation of a central repository for municipal disclosure documents. In response to the request for comments, the Commission received over sixty letters from all segments of the industry, including issuers, underwriters, institutional investors, bond counsel, analysts, financial advisers, insurance providers, disclosure services, the MSRB, and state securities regulators. The comment letters presented a variety of thoughtful views on the major issues raised by the Release, as well as the commentators' assessment of the general adequacy of disclosure in the municipal markets and current letters, the Commission has determined to adopt Rule 15c2-12 ("Rule"), with certain modifications that are designed to address the concerns expressed by commentators.⁴ The Commission also is amending portions of its Interpretation in light of the comments.

II. Rule 15c2-12

¹ Securities and Exchange Commission Staff Report on the Investigation in the Matter of Transactions in Washington Public Power Supply System Securities (1988) ("Supply System Report"). The Commission's investigation of the Supply System default revealed serious problems in the disclosure practices observed by securities professionals participating in the Supply System's bond offerings.

² Securities Exchange Act Release No. 26100 (Sept. 22, 1988), 53 FR 37778.

³ 15 U.S.C. 78a et. seq.

⁴ FN4 The comment letters and a summary of the comment letters prepared by the staff of the Division of Market Regulation are contained in Public File No. S7-20-88.

The Commission proposed Rule 15c2-12, in part, under its authority in section 15(c) of the Exchange Act to adopt rules and regulations “reasonably designed to prevent [] such acts and practices as are fraudulent, deceptive, or manipulative”.⁵ [FN5] As indicated in the Release, the Proposed Rule was designed to establish standards for the procurement and dissemination by underwriters of disclosure documents as a means of enhancing the accuracy and timeliness of disclosure to investors in municipal securities. Specific provisions of the Proposed Rule also were intended to assist underwriters in meeting their responsibilities under the general antifraud provisions of the federal securities laws, by providing them with a mandatory opportunity to review the issuer's disclosure documents before commencing sales to investors.

In proposing Rule 15c2-12, the Commission recognized that, as a result of efforts by the industry to improve disclosure, most issuers in offerings above \$1 million prepare offering documents that are available to investors. The Government Finance Officers Association (“GFOA”) Disclosure Guidelines⁶ state, however, that “[i]ssuers of municipal securities should, in addition to preparing official statements, take appropriate steps to further the availability to the public of the information therein.” Among other things, the GFOA's Disclosure Guidelines encourage the dissemination of official statements to investors “as early as possible.”⁷

In responding to the Commission's request for comments, numerous issuers confirmed that it was their practice to produce preliminary and final official statements in connection with an offering of bonds. Moreover, among frequent issuers, the quality of disclosure was reported to be quite good. The Public Securities Association (“PSA”) noted, for example, that most of those responding to its survey of current disclosure practices in the municipal markets⁸ had rated disclosure in new issues as “satisfactory” and “very good”.⁹ It pointed out that 94% of those responding to the survey rated “content and completeness” of disclosure documents in new issues as “satisfactory” to “excellent”. Nevertheless, the PSA reported that this very positive assessment of disclosure practices

⁵ Rule 15c2-12, although denominated under Section 15(c) of the Exchange Act (15 U.S.C. 78o), also was proposed, and is herein adopted, under the Commission's authority in Sections 2, 3, 10, 15B, 17, and 23 of the Exchange Act, 15 U.S.C. 78b, 78c, 78j, 78o-4, 78q, and 78w.

⁶ GFOA, *Disclosure Guidelines for State and Local Government Securities* (January 1988) (hereinafter “GFOA Disclosure Guidelines”).

⁷ See Procedural Statement No. 3, “Availability of Official Statements to the Public and Delivery of Official Statements to Underwriters,” *Id.* at 83.

⁸ Public Securities Association, *Municipal Disclosure Task Force Report: Initial Analysis of Current Disclosure Practices in the Municipal Securities Market*, (June 1988) (hereinafter “PSA Task Force Report”).

⁹ Letter from Austin V. Koenen, Chairman, Municipal Securities Division, PSA, to Jonathan G. Katz, Secretary, SEC (Dec. 23, 1988).

dropped sharply when the availability of disclosure was considered. Forty-five percent of those responding to its survey rated “availability of documents (preliminary and final) in a timely fashion” as less than “satisfactory”.

The views of the PSA generally correspond to the comments received from issuers, underwriters, and investors. While most issuers are conscientious about providing adequate quantities of official statements in a timely fashion, commentators indicated that there was a range of practices. Investors, in particular, have complained about the ability to obtain disclosure documents prepared by issuers at a time that would permit review prior to making an investment decision.¹⁰

In addition, there is concern among underwriters that, in light of their responsibilities under the general antifraud provisions of the federal securities laws, greater opportunity should be afforded to review the disclosure of infrequent issuers, so that any problems in the disclosure documents may be detected before recommendations are made to investors. One association, representing bank municipal securities dealers, commented, for example, that in some geographic areas underwriters are able to examine official statements a week prior to the bid date for competitive offerings, while in other geographic areas the preliminary official statements are not available, if at all, until after the bids are due.¹¹

The Commission believes that Rule 15c2-12 will promote greater industry professionalism and confidence in the integrity of the municipal markets without unnecessarily burdening issuers. As suggested in the Release, and reflected in the comment letters, it has generally been the view of state and local governments that regulation intended to enhance disclosure in the municipal markets is beneficial, so long as it does not adversely affect the capital-raising function of responsible issuers. In determining to adopt the Rule, the Commission is sensitive to the impact that the Rule may have on efficient financing practices developed in the municipal market. In this regard, the Commission has attempted to take into account commentators' concerns that the use of certain

¹⁰ See e.g., Letter from Peter J.D. Gordon, Vice President and Director, Municipal Bond Division, T. Rowe Price, to Jonathan G. Katz, Secretary, SEC (Dec. 27, 1988). The PSA's survey also indicates that when disclosure documents are prepared, they are furnished to dealers prior to settlement of the transaction only 41% of the time. Respondents to the PSA's survey reported that official statements are furnished to underwriters and dealers after settlement of the transaction approximately 30% of the time. PSA Task Force Report, *supra* note 8 at III-14, 15.

¹¹ Letter from Richard L. DeCair, Executive Director, Bank Capital Markets Association, to Jonathan G. Katz, Secretary, SEC (Jan. 12, 1989). Similar comments were received from individual underwriters who stated that even when preliminary official statements are distributed to potential bidders in competitive offerings, they may not arrive in sufficient time to permit an appropriate review. See, e.g. Letter from Susan V. Dushock, First Vice President, Municipal Bond Department, and Walter J. Peters, Vice President and Associate General Counsel, Shearson Lehman Hutton, to Jonathan G. Katz, Secretary, SEC (Dec. 27, 1988).

financing techniques, including tax-exempt commercial paper, variable rate offerings, and multi-mode issues,¹² as well as limited placements to sophisticated investors, might be unduly restricted if the Rule is adopted as proposed. Accordingly, the Commission has provided exemptions in the Rule to facilitate such offerings, which generally do not raise the concerns sought to be addressed by the Rule. Although the Commission has chosen to adopt Rule 15c2-12 at this time, it encourages a continuing dialogue with members of all segments of the municipal industry. The Commission has specifically provided in paragraph (d) of the Rule, discussed later, that exemptions from any of the provisions of the Rule may be granted, upon written request, where the exemption is consistent with the public interest and the protection of investors. The exemptive provisions in paragraph (d) are designed to afford immediate flexibility to correct unforeseen burdens.

A. Scope of the Rule

As indicated above, Rule 15c2-12 is being promulgated under the Commission's authority in section 15(c) of the Exchange Act as a means reasonably designed to prevent fraud. The Rule applies only to underwriters participating in "a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more". In addition, the Rule contains exemptions for underwriters participating in offerings of municipal securities in large denominations that are sold to no more than 35 sophisticated investors, or have short-term maturities, or have short-term tender or put features.

1. Thresholds

Proposed Rule 15c2-12 would have applied to underwriters participating in an offering of municipal securities with an aggregate offering price in excess of \$10 million. The Commission proposed an initial threshold of \$10 million in an effort to assure that any costs that the Rule might impose would be offset by the potential protection to the largest number of investors. Data supplied by the PSA indicated that if the proposed threshold were implemented, 25% of long-term bond offerings, accounting for 86% of the total dollar volume of such offerings, would be subject to the Proposed Rule. The Commission also requested comment on whether some alternative level was more appropriate, including \$1 million, \$5 million, \$20 million, or \$50 million.¹³

¹² See discussion *infra* at note 81 concerning variable rate demand notes and multi-mode offerings. See generally, Amdrusky, *Creative State and Local Financing Techniques*, in *State and Local Government Financing* (Gelfand ed. 1987).

¹³ The Commission inquired about the costs that issuers and underwriters would experience if the threshold were set at alternative offering amounts, and invited comment about the quality and timeliness of disclosure provided at the alternative offering amounts. In addition, the Commission requested comment on whether the threshold should be based upon the type of issuer, maturity, or complexity of the bonds being offered.

Thirty-nine commentators expressed a view on the appropriate threshold for the Rule. The alternative suggestions ranged from no threshold to \$50 million. Eight commentators generally favored a higher threshold, while 29 suggested lower thresholds, usually at the \$1 million level.¹⁴ In particular, the PSA and the MSRB strongly recommended that the Commission move the Rule's threshold to \$1 million dollars.

The comment letters expressed a strong sentiment that a substantial portion of both defaults and disclosure dissemination problems in the municipal securities markets occurred in offerings below the proposed threshold. The Bond Investors Association, for example, noted that of the defaults occurring in bonds issued between 1981 and 1985, 79% of issues and 40% of the dollar amount of defaults were in issues below \$10 million.¹⁵ While there is not a direct correlation between economic defaults and the adequacy of disclosure, many of the offerings below the proposed \$10 million threshold are in types of securities that present higher risks to investors that should be highlighted in a complete disclosure document. In addition, a greater portion of offerings below \$10 million are by infrequent issuers, with whom the market is unfamiliar. The PSA, along with other commentators, noted that the quality of disclosure correlates directly with the size of the bond issue. Generally, the larger the bond issue, the better the disclosure.¹⁶ Thus, the Commission is persuaded that the structural safeguards contained in Rule 15c2-12 will have added significance in offerings below \$10 million.

Apart from the actual quality of disclosure in offerings below \$10 million, there was also concern about the perception that a high threshold would create among investors.

Specifically, some commentators conjectured that if a \$10 million threshold were utilized, it would result in a "tiering" of the

¹⁴ Many of the commentators conditioned their support for lower thresholds on appropriate exemptions for certain types of offerings. Some commentators, including the GFOA, that supported higher thresholds for governmental issuers, also indicated that lower, or no thresholds, would be appropriate for conduit offerings, which they reported have shown the greatest degree of disclosure problems. Two commentators supported the proposed threshold.

¹⁵ Letter from C. Richard Lehman, President, Bond Investors Association, to Jonathan G. Katz, Secretary, SEC (Nov. 22, 1988). The Bond Investors Association indicated that it selected the five year period from 1981 to 1985 to avoid most of the distortion created by the Supply System default in pre-1981 statistics. The period chosen also ignores the last three years in which the Association indicated that defaults are a future event for the most part.

¹⁶ The PSA's Task Force Report on municipal securities stated that only 5% of the 264 dealers responding to its survey found that the adequacy of disclosure was below satisfactory in negotiated offerings above \$50 million. In contrast, 20% of the respondents found disclosure to be less than satisfactory in negotiated offerings of \$10 million or less. PSA Task Force Report, *supra* note 8, Table 11A. See also, Forbes & McGrath, *Disclosure Practices in Tax-Exempt General Obligation Bonds: An Update*, 7 *Mun. Fin. J.* 207 (1986).

municipal markets.¹⁷ They indicated that investors might view all offerings below the \$10 million threshold as lacking the same quality of disclosure as those subject to the Rule, and may have discriminated against such offerings. Accordingly, issuers offering securities in amounts below the threshold may have been required to pay increased underwriting spreads compared to securities subject to the Rule's safeguards.

While the Commission has determined to lower the threshold to one million dollars, it is sensitive to concerns that the Rule not impose unnecessary costs on municipal issuers.¹⁸ Recent studies indicate that the large majority of issuers, 84% of municipal securities offerings, including both competitive and negotiated offerings, provide official statements.¹⁹ Even with the lower threshold, many commentators, including the MSRB and PSA, indicated that the Rule, as adopted, will not impose unnecessary costs or force a majority of responsible issuers to depart from their current practices. The commentators suggested that the Rule should, however, encourage more effective disclosure practices among those issuers that do not currently provide adequate and timely information to the market. In this connection, support for a one million dollar threshold also was found in the comment letters from some issuers and issuer trade associations.²⁰

In addition to requesting comment on whether the proposed threshold should be revised, the Commission also invited comment on whether thresholds should be implemented that distinguish among different types of offerings. A number of the commentators suggested that most of the problems in municipal disclosure had occurred in conduit offerings. In light of the low default rate of general obligation bonds, they argued that some distinction should be made according to the type of debt being offered.

The GFOA, among others, recommended that governmental purpose bonds should alternatively be exempt from the Rule's

¹⁷ See, e.g., Letter from John W. Rowe, Chairman, MSRB, to Jonathan G. Katz, Secretary, SEC (Nov. 8, 1988); Letter from PSA.

¹⁸ At the one million dollar threshold, the Rule will apply to 79% of all long-term bond issues, accounting for 99% of the total dollar amount of long-term municipal offerings. Release 53 FR at 37783. In 1988, approximately \$23,358 million in short-term debt (less than 13 months) was offered. At the current threshold of \$1 million, 99% of the dollar amount and 71% of short-term debt issues would be subject to the Rule. Source: IDD/PSA Database.

¹⁹ PSA Task Force Report, *supra* note 8, at 84.

²⁰ Letter from Earle E. Morris, Jr., President, National Association of State Auditors, Comptrollers and Treasurers ("NASACT") to Jonathan G. Katz, Secretary, SEC (Jan. 12, 1989); Letter from Janet C. Rzewnicki, President, National Association of State Treasurers, to Jonathan G. Katz, Secretary, SEC (Jan. 18, 1989); Letter from Carl W. Reidy, Jr. and Roy T. Deaton, National Council of State Housing Agencies, to Jonathan G. Katz, Secretary, SEC (Dec. 22, 1988).

requirements or subject to a \$25 million threshold.²¹ In contrast, an almost equal number of commentators, including issuers,²² objected to any distinction in applying the Rule. One issuer noted, for example, "if disclosure is good and most responsible issuers are currently complying with reasonable guidelines, no harm is done in requiring the 9% of government issuer's [sic] who are not making adequate disclosure (according to the PSA Survey) to comply with the proposed rule, and therefore strengthen acceptance for all of us in the market."²³

After reviewing the comment letters, the Commission has decided not to draw a distinction between types of offerings in the Rule. In reaching this decision, the Commission is mindful that there is a range of creditworthiness and risk associated with both governmental and conduit bonds that may vary significantly according to the issuer.²⁴ Moreover, while defaults may have the most severe impact on the value of a security, investors are more likely to be affected by the exercise of call provisions or other terms of the offering. The MSRB, in its comment letter, emphasized that as offerings have become more complex, information concerning the structure of the offering has acquired increased significance to investors. Thus, notwithstanding the relatively low default rate enjoyed by general obligation debt, the Commission believes that it is equally important for investors to receive timely and complete information about terms of the offering in all types of issues.²⁵

²¹ Letter from Jeffrey L. Esser, Executive Director, GFOA, to Jonathan G. Katz, Secretary, SEC, (Jan. 12, 1989).

²² See, e.g., Letter from John M. Gunyou, City Finance Officer, Minneapolis, Minnesota, to Jonathan G. Katz, Secretary, SEC (Feb. 16, 1989); Letter from Max R. Bohnstedt, Director of Finance, Montgomery County, Maryland, to Jonathan G. Katz, Secretary, SEC (Dec. 27, 1988); Letter from NASACT; and, Letter from National Council of State Housing Agencies.

²³ Letter from John M. Gunyou.

²⁴ One commentator noted, for example, that only the general obligation of an issuer of meaningful size, with full governmental powers, is likely to produce a distinct level of security to investors. Similarly, a "conduit" bond of a reporting company may have more in common with the general obligation debt of a major city than either does with the bonds of an irrigation district or conduit bonds for a start-up retirement facility. Moreover, a government hospital may have the identical credit risk as a hospital owned by a not-for-profit organization. Letter from Robert Dean Pope, Partner, Hunton & Williams, to Jonathan G. Katz, Secretary, SEC (Jan. 31, 1989).

²⁵ Although the Proposed Rule was published for comment at the same time that the Commission released the Supply System Report to Congress, the Proposed Rule was not aimed at preventing municipal defaults. While defaults may pose the most serious economic threat to investors, the Commission noted in the Release that "no amount of increased review of offering materials by municipal underwriters will prevent municipal defaults totally." 53 FR at 37781. The Commission is aware that municipal securities, particularly general obligation bonds, have enjoyed a relatively low default rate, when compared to corporate offerings. In addition, as discussed in the Release, efforts by the industry have improved greatly the quality of disclosure provided to investors in municipal securities.

2. Primary Offerings

The Commission also modified the Rule to clarify that it applies only to “primary offerings”, a term that is defined in paragraph (e)(7).²⁶ The Commission determined to restrict the scope of the Rule to primary offerings in response to concerns expressed by commentators that broader language in the Proposed Rule may have incorporated concepts concerning the registration of secondary offerings of securities under the Securities Act of 1933 (“Securities Act”).²⁷ While, as discussed later, the Rule will apply to certain reofferings of municipal securities conducted pursuant to the conversion of a multi-mode issue,²⁸ [FN28] the Rule does not generally apply to secondary distributions.

B. Requirements of the Rule

1. Obtain and Review “Near Final” Official Statement

The Proposed Rule would have required that underwriters receive a copy of a “near final” official statement before bidding for or purchasing an offering of municipal securities. The Release states that the purpose of this provision was to assure that underwriters have received and availed themselves of an opportunity to review an official statement containing “complete” disclosure about the issuer and the basic structure of the financing, before becoming obligated to purchase a large issue of securities. The Proposed Rule identified specific information that could be excluded from the official statement at the time that the underwriter bid for or purchased the securities. Specifically, the “near-final” official statement need not have contained information regarding the “offering price, interest rate, selling compensation, amount of proceeds, delivery dates, other terms depending on such factors, and the identity of the underwriter.”

Paragraph (b)(1) of the Rule requires any underwriter that bids for, purchases, offers, or sells, whether as principal or as agent, municipal securities in a primary offering, to obtain and review an official statement that is deemed final by the issuer, except for the omission of certain information. Thus, in a

Several commentators provided statistics on the current default ratios for municipal securities by type of issuer. The GFOA stated that the default rate, by type of issuer, was as follows: conduit securities--1.2%; governmental obligations (Supply System default included)--0.5%; governmental obligations (Supply System default excluded)--0.1%. It compared municipal default rates to a corporate default rate of 1.1%.

²⁶ The term “primary offering,” for purposes of Rule 15c2-12, is defined in paragraph (e)(7) to mean an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing of municipal securities that is accompanied by a decrease in the authorized denominations of the securities to less than \$100,000 or by an increase in the maturity of such securities to more than nine months.

²⁷ 15 U.S.C. 77a et seq.

²⁸ See discussion *infra* at note 81 and accompanying text.

competitive offering, an underwriter will need to receive a copy of disclosure documents prepared in conjunction with the offering by the issuer, or on its behalf, before bidding on the issuer's securities.

The Commission recognizes that in most negotiated offerings the underwriter has a much closer relationship with the issuer and generally participates in drafting the issuer's official statement. In negotiated offerings, the Rule would require the underwriter to obtain a copy of the official statement, deemed final by the issuer, prior to the earlier of the time it executes the bond purchase agreement or the first sale of the bonds. Generally, in negotiated offerings, bonds are offered to investors immediately following the pricing of the securities and the bond purchase agreement is executed a few days later. Consequently, for practical purposes, the underwriter would need to have a copy of a “near-final” official statement at the time of pricing.²⁹

As adopted, paragraph (b)(1) contains modifications from the Proposed Rule that are designed to reflect the views of commentators. In response to commentators' suggestions, the Rule specifies that any determination concerning whether the official statement provided to underwriters should be deemed final for purposes of satisfying the terms of the paragraph is made by the issuer. In changing this provision from the Proposed Rule, the Commission was persuaded that allowing the issuer to determine whether the official statement would be deemed final for purposes of paragraph (b)(1) will eliminate uncertainty as to how, and in what manner, an underwriter should ascertain that the disclosure document is “complete”³⁰ prior to its review of the document.³¹

Although paragraph (b)(1) requires the underwriter to obtain a

²⁹ Furthermore, an underwriter in a best efforts offering or remarketing that meets the definition of “primary offering” also would have to comply with the provisions of the paragraph, unless it could take advantage of one of the exemptions discussed below.

³⁰ Reference to a final official statement as a complete document has been moved to the definition of “final official statement” and, accordingly, will be applicable only to the final disclosure documents required to be contracted for under paragraph (b)(3) and disseminated to potential customers upon request under paragraph (b)(4).

³¹ Some commentators suggested that use of the term “complete” in the Proposed Rule implied substantive disclosure obligations concerning the offering documents. The Rule was not intended to govern the content of the offering documents. The Commission is aware that efforts by the industry have produced disclosure guidelines that are widely followed in the preparation of municipal official statements. The GFOA's Disclosure Guidelines were first exposed for comment in 1975 and have been revised on several occasions, most recently in January of 1988. In addition, the National Federation of Municipal Analysts has recently proposed draft disclosure guidelines that would provide guidance on disclosure for 17 separate sectors of municipal securities. The Commission believes that both of these guidelines will assist issuers in fulfilling their current obligations under the general antifraud provisions of the federal securities laws. Moreover, these guidelines, in conjunction with the underwriter's own disclosure experience, aid the underwriter in satisfying its own obligation to assess the accuracy and completeness of key representations contained in the issuer's disclosure documents.

copy of an official statement that is deemed final by the issuer, the Commission recognizes that certain information frequently is omitted from preliminary official statements. As provided in the Rule, the official statement required by paragraph (b)(1) need not include the offering price(s), interest rate(s), selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, 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 underwriter(s). The types of information that can be omitted also has been modified based on comment letters that suggested a need for greater flexibility with respect to disclosure concerning ratings, as well as credit enhancements and other information that may be specified by the underwriter in a competitively bid offering.

The GFOA's Disclosure Guidelines suggest that "the preliminary official statement should be as complete and accurate as possible".³² [FN32] The absence of the information specified above should not prevent the underwriter from soliciting indications of interest, so long as material information is supplied to potential investors prior to the time that an investment decision is made. In this regard, the Commission wishes to emphasize that, while the Rule requires that the underwriter obtain official statements which are deemed final by the issuer, except for the omission of certain information, disclosure is a dynamic process and even substantial changes to the document required by paragraph (b)(1) may be necessary to comply with the federal securities laws at the time of sale to investors.³³

By requiring the underwriter to receive information concerning the offering at the time that it will most actively be engaged in selling efforts, the Rule is intended to assist the underwriter in satisfying its responsibilities under the antifraud provisions of the federal securities laws. As emphasized in the Interpretation, by participating in an offering, an underwriter makes an implied recommendation about the securities. This recommendation implies that the underwriter has a reasonable basis for belief in truthfulness and completeness of the key representations contained in the official statement. Once the

³² Procedural Statement No. 2, "Use of Preliminary and Final Official Statements", GFOA Disclosure Guidelines, *supra* note 6 at 81.

³³ Although the Rule does not require the highlighting of changes that occur between the preliminary official statement and final official statement, some commentators have suggested that this practice is desirable. Hunton & Williams, for example, recommended that alterations and amendments suggested by the winning syndicate could more easily be brought to the attention of investors by (a) noting information in the final official statement not appearing in the preliminary or (b) providing a special section that makes reference to such information in the final official statement (other than ordinary completion of pricing data). The Commission believes that these practices are beneficial to investors and would encourage their use.

underwriter has received and reviewed the official statement, it will be in a better position to assess the accuracy of the disclosure and to make informed recommendations to investors. Moreover, since the issuer is responsible for the disclosure in the final official statement, it is the ultimate beneficiary of any objective review of its disclosure prior to sale.³⁴ In this regard, it is important to note that paragraph (b)(1) of the Rule need not prevent an underwriter from bidding on an issuer's securities in a competitive offering, even when it determines that disclosure problems exist, so long as the underwriter receives assurances that the disclosure will be corrected.³⁵

The comment letters indicate that many issuers routinely provide potential bidders with preliminary official statements that would satisfy the requirements of paragraph (b)(1). Nevertheless, some commentators were concerned that the requirement in paragraph (b)(1) might conflict with certain practices used in connection with refundings and other interest rate sensitive offerings. While the Rule requires that the underwriter have disclosure documents before it bids for, purchases, offers or sells the securities, the Commission has changed the definition of a "final official statement" in paragraph (e)(3), discussed below, to reflect the fact that adequate disclosure may be made through the use of multiple documents. A similar philosophy would apply to the official statement required by paragraph (b)(1). Frequent issuers, for example, may be able to meet market windows for refundings or other types of offerings by supplying a recent official statement, together with supplementary information that contains the terms of the current offering and highlights any material changes from the previous offering materials. Nevertheless, the Commission expects that the Rule will require greater planning and discipline by some issuers.

2. Distribute Copies of Preliminary Official Statements in Non-Competitive Offerings

Paragraph (b)(2) of the Rule requires that, except in competitively bid offerings, an underwriter must send a single copy

³⁴ The GFOA Disclosure Guidelines recognize the importance of objective review of the issuer's disclosure. Procedural Statement No. 5, "Assistance by Issuers to Underwriters and Investors Inquiring about Information", states;

Issuers, underwriters and investors are concerned that information in official statements prepared by issuers be accurate and sufficient in all material respects. It has become common practice for underwriters and investors to assist in this effort by raising questions with issuers based on reviews of official statements and upon other information to which the underwriters and investors have access. Generally, the questions raised will relate to (i) possible information voids in an official statement, (ii) possible inconsistencies within the document, or (iii) possible inconsistencies between the document and other available information.

GFOA Disclosure Guidelines, *supra* note 6, at 86.

³⁵ See Release, 53 FR at 37790, n. 94 (discussing the need for the underwriter to provide in the underwriting agreement for the ability to correct inaccurate or incomplete disclosure).

of the most recent preliminary official statement, no later than next business day, to any potential customer, on request. As proposed, paragraph (b)(2) would have required that the underwriter distribute copies of any preliminary official statement that is prepared by the issuer, to any person upon request. The purpose of the requirement is to provide potential investors with access to any preliminary official statement prepared by the issuer, at a time when it may be of use in making their investment decision. The Release noted that preliminary official statements frequently are used as selling documents to large investors, but that practices among underwriters may vary. Commentators confirmed that the current practice of providing preliminary official statements to investors varies from firm to firm and may depend, in great measure, upon a number of factors, including the issuer, whether the offering is conducted on a competitive or negotiated basis, and the position of the underwriter in the syndicate.

The preliminary official statement is an important disclosure document, even though in some cases the information concerning the precise terms of the offering is incomplete and must be supplemented. Despite the importance of the disclosure provided in preliminary official statements, the Commission has received comment from one major institutional investor which indicates that when preliminary official statements are prepared, only 70% arrive in time for the investor to conduct a professional review prior to the time of purchase.³⁶ Moreover, potential customers who are not institutional investors may not have access to either a preliminary or final official statement until several days following the sale of the securities.

While the Commission has chosen to require that preliminary official statements be provided by the underwriter, upon request, it has narrowed the original proposal in several respects. As adopted, the Rule requires an underwriter in a negotiated offering to send a single copy of the most recent preliminary official statement to any “potential customer” who requests a copy. Dissemination of preliminary official statements is beneficial for both issuers and investors. Nevertheless, paragraph (b)(2) does not require that issuers prepare a preliminary official statement for delivery to investors. If a preliminary official statement is produced, however, and any potential customer requests a copy, the underwriter would be required to send it by first class mail or another equally prompt means.

In response to concerns expressed in the comment letters that the original proposal would have placed unnecessary costs on underwriters, the Commission decided to limit the scope of persons to whom underwriters would be required to provide copies of the preliminary official statement to potential

³⁶ Letter from T. Rowe Price.

customers. In many cases, however, the commenters noted that it was their practice, as a matter of course, to honor such requests. The Commission believes that a decision about whether to provide copies of such documents to persons other than potential customers³⁷ should be left to the business judgment of the underwriter.³⁸

The Commission also is modifying the Proposed Rule to except underwriters who participate in competitively bid offerings from the requirements of paragraph (b)(2). Many commentators suggested that the Proposed Rule would have forced underwriters bidding competitively on offerings to incur the cost of reproducing preliminary official statements at a point in the selling process when they may have had only limited access to copies of the preliminary official statement and could not be assured of winning the competition. Moreover, underwriters were concerned about distributing preliminary official statements that they had no role in preparing and had not had a full opportunity to review. By limiting application of the paragraph to negotiated offerings, the underwriter only will have to provide copies of the preliminary official statement in those offerings in which it has had the opportunity to participate in the preparation of the disclosure document and will have the direct ability to recover any expenses incurred in providing copies of preliminary official statements through sales of the issuer's securities.

As stated in the Rule, the underwriter's obligation under paragraph (b)(2) arises “from the time that * * * [it] has reached an understanding with an issuer that it will become an underwriter until a final official statement is available.” Generally, the underwriter's formal contractual obligation to purchase the bonds will arise following pricing, at the time that it signs the bond purchase agreement. Notwithstanding the fact that the underwriter has not signed a document agreeing to purchase the bonds in a negotiated offering, its obligation under the Rule would begin at the time it has reached an understanding with the issuer that it will offer the bonds, either directly, or by agreeing to join a syndicate.³⁹ In many cases, this would mean that the managing underwriter's obligation to provide copies of preliminary official statements will commence at the point that it is chosen by the issuer pursuant to the request for proposal process. Once the underwriter's obligation is

³⁷ At the suggestion of the PSA, and others, the term “potential customer” is defined in paragraph (e)(4) to mean a person contacted by the participating underwriter concerning the purchase of municipal securities that are intended to be offered or have been sold in the offering; any person who has expressed an interest in purchasing such securities; and any person who has a customer account with the participating underwriter.

³⁸ Copies of preliminary official statements also frequently are available to anyone, upon request, from the issuer.

³⁹ Cf. Rule 10b-6(c)(2)(ii) (17 CFR 240.10b-6(c)(2)(ii)) (defining a “prospective underwriter” to include one “who has reached an understanding, with the issuer or other person on whose behalf a distribution is to be made, that he will become an underwriter, whether or not the terms and conditions of the underwriting have been agreed upon”).

incurred, the Rule requires that the underwriter continue to provide copies of the most recent preliminary official statement, upon request, until the final official statement becomes available.⁴⁰

The Proposed Rule contained no definition of “preliminary official statement,” although it suggested that a preliminary official statement was a document “prepared by the issuer for dissemination to potential bidders or purchasers.” Commentators expressed confusion about the relationship between a “preliminary official statement” and the official statement required to be reviewed by underwriters pursuant to paragraph (b)(1) of the Rule. The Rule now contains a definition of a preliminary official statement in paragraph (e)(6).

The definition of preliminary official statement contains no description of the disclosure content of the document. Instead, the term preliminary official statement is defined only by reference to the issuer's intention that it be distributed to potential customers. Thus, a document (or set of documents) utilized to comply with paragraph (b)(1) need not be disseminated pursuant to paragraph (b)(2), unless the document also is intended to be, or has been, disseminated to any potential customer.⁴¹ This definition is consistent with the purpose of paragraph (b)(2), the only paragraph in which the term is used, in that paragraph (b)(2) is designed to assure access by all potential customers to information prepared by issuers for dissemination to prospective investors.⁴²

3. Receive Copies of Final Official Statements

Paragraph (b)(3) of the Rule requires that an underwriter contract with the issuer, or its agents, to receive sufficient quantities of the final statement to provide them to potential customers upon request and to comply with any rules of the MSRB. The purpose of the provision is to facilitate the prompt distribution of disclosure documents so that investors will have a reference document to guard against misrepresentations that may occur in the selling process. In addition, the paragraph, in conjunction with paragraph (b)(4), will assure that both investors and dealers in the secondary market have greater access to information regarding the terms of the securities.

⁴⁰ If a broker, dealer or municipal securities dealer reaches an initial understanding that it will offer an issuer's securities, and later, for example, at pricing, determines not to act as an underwriter, its obligations under paragraph (b)(2) would cease.

⁴¹ The Commission does not expect that an underwriter who determines that the preliminary official statement is inaccurate or contains misleading omissions regarding the issuer, would provide copies to potential customers, upon request, pursuant to paragraph (b)(2).

⁴² Whether a document identified by an issuer as a preliminary official statement meets the requirements of paragraph (b)(1) depends on whether it is deemed final by an issuer, except for the information specifically permitted to be omitted by that paragraph.

As noted earlier, while the quality of disclosure has improved greatly in the municipal markets, the PSA Task Force Report reveals that significant problems exist in the distribution of disclosure documents. Currently, the MSRB's rule G-32 requires that, if an official statement is prepared, an underwriter participating in a primary offering of municipal securities must make the official statement available to investors “promptly after the date of sale of the issue but no later than two business days before the date all securities are delivered by the syndicate manager to the syndicate members.” In addition, the GFOA's Disclosure Guidelines note that “it is important for the official statement to be made available at such time and in such quantity as will permit the official statement to be mailed expeditiously by the underwriters in time for receipt by investors at or prior to settlement.”⁴³

Notwithstanding underwriters' current obligations under the MSRB's rules, the MSRB stated its concern that the task of distributing official statements often is relegated to a low priority by underwriters. By adopting paragraph (b)(3), which serves as a foundation for fostering compliance with the requirements of MSRB rule G-32, the Commission wishes to emphasize the importance it places on the prompt distribution of final official statements.

Under paragraph (b)(3), the underwriter would be required to contract with the issuer or its agents to receive copies of the final official statement within the time periods mandated by the Rule. Generally, issuers will state in notices of sale for competitive offerings that the successful bidder will be provided with a “reasonable number” of final official statements. Before bidding on a competitive offering, or as a condition to bidding, the underwriter would need to determine that it can comply with the terms of the Rule.

Because the bond purchase agreement in a negotiated offering typically is not signed until a late point in the offering process, the underwriter would need to be sure that contractual terms meeting the requirements of paragraph (b)(3) are separately negotiated or are otherwise a clear condition to its participation in the offering. Either the issuer or its agent may be the party contractually bound to provide the underwriter sufficient copies of the final official statement. In syndicated offerings, members of the syndicate would need to assure themselves that provision has been made by the managers to comply with the terms of the Rule and may require such an undertaking in the agreement among underwriters.

Generally, the underwriter's responsibility would be satisfied under paragraph (b)(3) if it has arranged for sufficient quantity of the final official statement to be made available from either the issuer or a financial printer within the time periods stated in the Rule. While the Rule does not provide rigid quantitative standards

⁴³ Procedural Statement No. 3, “Availability of Official Statements to the Public and Delivery of Official Statements to Underwriters”, GFOA Disclosure Guidelines, *supra* note 6, at 83.

for the minimum number of official statements that would be required, the underwriter would need to obtain copies sufficient to comply with paragraph (b)(4) of the Rule and to satisfy MSRB rule G-32 or any other rules adopted by the MSRB. Under current MSRB rule G-32, therefore, the underwriter would have to provide each investor a copy of the final official statement no later than settlement. Also, as discussed below, paragraph (b)(4) generally requires that the underwriter provide copies of the final official statement, upon request, to any potential customer for a period of at least 25 days, and up to 90 days following the end of the underwriting period.

Any contract with the issuer or its agents would have to provide that copies of the final official statement will be delivered, at the latest, within seven business days following the bond purchase agreement, and in sufficient time to accompany or precede any confirmation requesting payment (“money confirmation”).⁴⁴ Apart from requiring that the underwriter contract to obtain copies of the final official statements within a reasonable period of time, the Commission has chosen to leave the determination of the precise method and timing of delivery to the MSRB. Moreover, if the MSRB determines that specific recordkeeping requirements are necessary to assure compliance with this or other provisions of the Rule, it would be able to use its authority under section 15B(b)(2)(G) of the Exchange Act to adopt such rules.

(a) *Definition of “issuer”*. In addition to comments on the mechanical requirements of paragraph (b)(3) of the Rule, the Commission received numerous comments on the content of disclosure required in a final official statement and the persons who would be considered “issuer(s)” for purposes of the Rule. The term “issuer of municipal securities” is used in the Rule to identify the person from whom disclosure documents must be received, for purposes of paragraph (b)(1), and with whom the underwriter must contract to obtain disclosure documents, for purposes of paragraph (b)(3). In response to commentators’ concerns that the Proposed Rule did not properly distinguish between governmental issuers and the private borrower in conduit offerings, the Commission has specifically defined the term “issuer of municipal securities” in paragraph (e)(4). Commentators had argued that, among other things, the conduit borrower is the economic beneficiary of the transaction and that review of information by the underwriter for purposes of paragraph (b) of this Rule should be focused on the conduit

⁴⁴ The Commission is aware that in many cases underwriters provide interim confirmations to investors, notifying them of the precise amount of municipal securities purchased and the terms of the purchase. This interim confirmation is followed later by a money confirmation requesting payment for the bonds purchased. The Rule requires only that the underwriter contract to receive copies of the final official statement prior to the time that money confirmations are sent to customers.

borrower. In light of these comments,⁴⁵ the Commission has determined to clarify the Rule by defining the term “issuer of municipal securities” to account for the multiple credit sources that may be considered issuers for purposes of the Rule.⁴⁶ As defined, the term encompasses both the governmental issuer specified in section 3(a)(29) of the Exchange Act,⁴⁷ as well as the issuer of any separate security, including a separate security as identified in Rule 240.3b-5(a) of the Exchange Act.⁴⁸ Accordingly, underwriters would be free to contract with any issuer, or its agent, that is in a position to supply the documents required by paragraph (b)(3) of the Rule.

(b) *Definition of “final official statement”*. The term “final official statement”, which is used in both paragraphs (b)(3) and (b)(4), is defined in paragraph (e)(3) to mean a document or set of documents prepared by an issuer of municipal securities, or its agents, setting forth, among other matters, information concerning the issuer of the municipal securities and the proposed issue of securities, that is complete on the date of delivery to the Participating Underwriter. As adopted, the term “final official statement” contains several modifications from the Proposed Rule that are designed to reflect the views of commentators.

The term “complete” is used to indicate that the final official statement should not be in preliminary form or intended by the issuer to be subject to amendment after its delivery to the underwriters, except to take account of subsequent events or to correct any errors that are discovered. Also, in response to suggestions from the American Bar Association,⁴⁹ and other commentators, the date as of which the official statement must be complete has been changed from the time of the agreement to purchase the securities, to the time at which the final official statement is to be delivered to the underwriters. This avoids the problem that might otherwise arise if events occur between the time of agreement to purchase the securities and the date on which the final official statement is made available to underwriters for dissemination pursuant to this Rule and the rules of the MSRB.

Another modification to the definition of final official statement in the Proposed Rule relates to the use of multiple documents. In the Proposed Rule, the term final official statement referred to a

⁴⁵ Apart from the mechanical requirements of the Rule, the Commission notes that the actual disclosure responsibilities of the parties under the general antifraud provisions of the federal securities laws will depend on the facts and circumstances in each case.

⁴⁶ Under the definition in paragraph (e)(3), the issuer of a letter of credit would also be considered an issuer of the securities for purposes of this Rule.

⁴⁷ 15 U.S.C. 78c(a)(29).

⁴⁸ 17 CFR 240.3b-5(a).

⁴⁹ Letter from James H. Cheek, Chairman, Committee on Federal Regulation of Securities, and Robert S. Amdursky, Chairman, Subcommittee on Municipal and Governmental Obligations, American Bar Association, to Jonathan G. Katz, Secretary, SEC (Jan. 26, 1989).

single document that has generally been viewed by the industry as the final official statement. As noted in the Release, the Commission is aware that in competitive offerings a preliminary official statement may be circulated to potential bidders which omits the information described in paragraph (b)(1). In some cases, the issuer will prepare a final official statement containing all the terms of the offering, while in other cases, pricing, underwriting, and other information is appended to the preliminary official statement, which is then regarded by the issuer as its final official statement.

The revised definition of a final official statement specifically recognizes that the issuer's final official statement may be comprised of one or more documents, "not necessarily bound together in a single booklet."⁵⁰ Thus, in the context of competitive offerings described above, the term would encompass a preliminary official statement coupled with pricing information. In addition, the term "final official statement" would incorporate a group of documents, containing disclosure about the offering, that collectively present an accurate description of its terms. Some commentators maintained that if an issuer had prepared a complete disclosure document for a recent offering, underwriters should be permitted to use that document, together with supplemental information updating the disclosure and describing the terms of the current offering, to satisfy the requirements of the Rule. It was suggested that this procedure may be appropriate in the context of certain "wire deals" and short-term offerings.⁵¹

4. Provide Copies of Final Official Statements to Potential Customers

As adopted, paragraph (b)(4) of the Rule requires that underwriters provide copies of any final official statement to any potential customer, on request. Once it receives a request for a copy of the final official statement, the underwriter must send the copy no later than the next business day, by first class mail or another equally prompt means. The requirements in this paragraph of the Rule differ from the Proposed Rule in two limited respects.

First, there no longer is a requirement that copies of the final official statement be provided to "any person." Many of the commentators suggested that this requirement was too broad, and would have placed an unnecessary burden on the underwriter. Accordingly, the Commission has limited the obligation of underwriters so that, consistent with paragraph (b)(2), they need respond only to requests for copies from

⁵⁰ See Letter from the American Bar Association.

⁵¹ As defined in paragraph (e)(3), these documents would constitute a final official statement when combined. In order to meet the requirements of paragraph (b)(3), however, it would be necessary for the underwriter to contract with the issuer for a sufficient quantity of the combined documents for dissemination to investors.

potential customers.⁵²

A second modification is the addition of specific time periods during which the underwriter must supply copies of the final official statement. The Proposed Rule would have required underwriters to supply copies of the final official statement, on request, for an indefinite period. Many of the commentators indicated that this requirement would have placed an unreasonable burden on underwriters and suggested that the Commission limit the delivery period. Suggestions for the termination of the delivery obligation ranged from completion of the offering to the maturity or redemption of the bonds. If a municipal disclosure repository were created, commentators argued that the underwriters' obligation to distribute copies of the final official statement should terminate at the time the documents were available from the repository.

After reviewing the comment letters, the Commission has decided to limit the underwriter's delivery obligation to a period commencing with the availability of the final official statement and terminating at a maximum of 90 days following the "end of the underwriting period," a term that is defined in paragraph (e)(2) of the Rules.⁵³ Moreover, while the underwriter must supply copies of the final official statement to potential customers on request for a period of at least 25 days following the end of the underwriting period,⁵⁴ its obligation under paragraph (b)(4) will terminate after the 25-day period, if the final official statement is made available to any person from a nationally recognized municipal securities information repository ("NRMSIR").⁵⁵ If the final official statement is not available from a NRMSIR, the underwriter's

⁵² As pointed out earlier, underwriters commenting on the Proposed Rule informed the Commission that in many cases they routinely respond to requests for copies of documents, regardless of the source of the request. In addition, copies of final official statements are generally maintained by the issuer. For example, Procedural Statement No. 3 of the GFOA's Disclosure Guidelines, "Availability of Official Statements to the Public and Delivery of Official Statements to Underwriters", states "all parties other than underwriters who contact the issuer should receive, without charge, at least one copy of the official statement." GFOA Disclosure Guidelines, supra note 6 at 83.

⁵³ The term "and of the underwriting period" differs from similar terms utilized in MSRB rules G-11 and G-32. As used in paragraph (b)(4) of the Rule, the term identifies the period from which the underwriter's obligation to provide final official statements to potential customers is measured. For issues that are sold prior to settlement with the issuer, the settlement date (i.e. the date the issuer delivers the securities to the underwriter) would be the "end of the underwriting period". For securities that are not sold by settlement, the underwriting period is defined to end when the underwriter sells its unsold balance of securities. The definition recognizes that generally in municipal securities offerings, until the syndicate breaks, each underwriter is considered responsible for a portion of the unsold syndicate balance.

⁵⁴ During the underwriting period, the underwriter must remain sensitive to developments that impact the accuracy and completeness of the key representations contained in the final official statement. If there are material changes, the final official statement should be amended or "stickered" to provide complete and accurate disclosure.

⁵⁵ The elements the Commission would consider in determining whether a particular entity is a NRMSIR are discussed in infra note 65.

obligation to deliver copies of the final official statements, upon request, would continue for the full 90-day period.

(a) *Nationally Recognized Municipal Securities Information Repository*. In the Release, the Commission solicited comment on the creation of a central repository for municipal disclosure documents.⁵⁶ Of the more than 60 comment letters the Commission received, 45 commentators expressed a view on the concept of a central repository. Forty commentators supported some form of a central repository.⁵⁷ The primary reason given for supporting the creation of one or more central repositories was the need to have a readily accessible central source of information on municipal bonds.

Even among the 40 commentators that supported the development of a central repository, there was a substantial difference of opinion on how it should be implemented, what documents should be filed, and who should file them. A number of commentators argued that competing private organizations that meet government-imposed standards offer a better approach than a single governmental or quasi-governmental service.⁵⁸

The Commission strongly supports the development of one or more central repositories for municipal disclosure documents.⁵⁹ The use of such repositories will substantially increase the availability of information on municipal issues and enhance the efficiency of the secondary trading market. In this regard, the Commission welcomes the recent announcement of the MSRB⁶⁰ that it is prepared to establish and manage a central repository that would be funded both by the MSRB and user fees, and would provide for the collection and dissemination of

official statements and refunding documents.⁶¹ The Commission understands that in conjunction with the adoption of Rule 15c2-12, the MSRB intends to propose an amendment to its rule G-32, that would require underwriters to submit copies of final official statements to the repository. Once the documents are received from the underwriter, the MSRB has indicated that the repository will function like a public library that stores and keeps an index of its documents. Private vendors will be encouraged to utilize the MSRB's repository as a means of collecting documents for dissemination, in complete or summary form, to their customers.

Although the Commission supports the MSRB's recent initiative, it recognizes the benefits that may accrue from the creation of competing private repositories.⁶² The Commission, therefore, views positively the recent statements by disclosure services indicating their intention to acquire information from the MSRB's repository, once created.⁶³ Regardless of whether private vendors choose to utilize the services of the MSRB's proposed repository, or to gather information independently, the creation of central sources for municipal offering documents is an important first step that may eventually encourage widespread use of repositories to disseminate annual reports and other current information about issuers to the secondary markets.⁶⁴

The Commission believes that paragraph (b)(4) of Rule 15c2-12 provides an important incentive to underwriters that will further encourage the development of one or more central repositories. By submitting copies of final official statements to any NRMSIR,⁶⁵ the underwriter avoids the responsibility to deliver, upon request, copies of final official statements to any potential customer for the

⁶¹ Under section 15B(b)(2)(J) of the Exchange Act, 15 U.S.C. 78o-4(b)(2)(J), any fees charged by the MSRB must be reasonable.

⁶² For example, the Bond Buyer maintains a repository for municipal securities information under the name "Munifiche."

⁶³ See e.g., Letter from J. Kevin Kenny, Chairman and Chief Executive Officer, J.J. Kenny Co., Inc. to Jonathan G. Katz, Secretary, SEC (June 6, 1989).

⁶⁴ The Commission notes that the GFOA Disclosure Guidelines currently state: "Submission of documents to a public or private central repository may be used as one part of accomplishing the purposes of disseminating and preserving official statements, annual reports, information statements, releases, and escrow arrangements. [. . .] Issuers are strongly urged to send, promptly upon availability, a copy of each document to a repository." Procedural Statement No. 8, "Dissemination of Information and Providing Statements, Reports, and Releases to a Central Repository," GFOA Disclosure Guidelines, supra note 6, at 91.

⁶⁵ In determining whether a particular entity is a NRMSIR, the Commission will 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 limits 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.

⁵⁶ The concept of a central repository for municipal official statements has been discussed by the industry for a number of years and was specifically presented to the Commission in a proposal by the MSRB. See Letter from James B.G. Hearty, Chairman, MSRB, to David S. Ruder, Chairman, SEC (Dec. 17, 1987). As initially envisioned by the MSRB, participation in the repository by municipal issuers would have been mandatory and information concerning new issues would have been made available of interested persons for a fee.

⁵⁷ The Commission received comments from a broad spectrum of entities on this issue. As indicated earlier, a detailed description of the comments is included in the comment summary, which is available in the Commission's Public File No. S7-20-88.

⁵⁸ See, e.g., Letter from J. Kevin Kenny, Chairman and Chief Executive Officer, J.J. Kenny Co., Inc., to Jonathan G. Katz, Secretary, SEC (Dec. 27, 1988).

⁵⁹ The Commission notes that the creation of multiple repositories should be accompanied by the development of an information linkage among these repositories. The advent of a linked repository system would afford the widest retrieval and dissemination of information to the secondary markets.

⁶⁰ Letter from John W. Rowe, Chairman, MSRB, to Jonathan G. Katz, Secretary, SEC (June 1, 1989).

full 90 day period specified in the Rule. In this regard, the provisions of paragraph (b)(4) are consistent with the views of a significant number of commentators who suggested that an underwriter's responsibility to distribute copies of the final official statement should terminate upon deposit of the documents in a central repository. At the same time, the Commission believes that investors will benefit by having access to information directly from underwriters during the twenty-five days after the end of the underwriting period, when the issuer's securities are most likely to be traded actively.

C. Exemptions.

In addition to inviting comments about the specific provisions of the Proposed Rule, the Release noted that there may be a range of credit risks and disclosure concerns that vary according to the type of municipal bonds being offered, the presence of unusual or complex financing techniques, and the maturity of the securities. Moreover, the Release recognized that many offerings of municipal securities are conducted in a manner that is akin to a "private placement." In light of this practice, the Commission requested the views of commentators on whether exemptions from the Rule should be created for, among other things, offerings made to a limited number of sophisticated investors or offerings of securities with short maturities.

While the Rule is designated to emphasize the implementation of responsible disclosure practices, it is not intended to restrict access to the capital markets by any issuer. Many of the commentators stated that, as a general matter, the Proposed rule would not have affected significantly the manner in which they conduct offerings currently. There were, however, suggestions that some provisions of the Proposed Rule should be modified, or exemptions created, in order to accommodate certain offerings where application of the Proposed Rule would have created unnecessary hardships.

The National Association of Bond Lawyers ("NABL"), along with others, commented that if the Rule were adopted as proposed, it may have impeded the use of certain efficient market practices.⁶⁶ The exemptions contained in the Rule are designed to facilitate certain of those offerings where the

⁶⁶ Letter from Paul S. Maco, Chairman, Special Committee on Securities Law and Disclosure, NABL, to Jonathan G. Katz, Secretary, SEC (Jan 31, 1989). Specifically, NABL noted that the Proposed Rule may have effectively eliminated: (1) tax-exempt commercial paper programs; (2) flexible mode and variable rate issues; (3) municipal short-term note issues used as cash management techniques; (4) competitive bid local issues whose only purchases are local banks and institutions, where bidding practice is mandated by statute; (5) underwritten sales limited to sophisticated investors and privately placed issues where purchasers conduct their own credit investigation; and (6) "subject to delivery of paper deals" or "wire deals," where an advantageous rate may be achieved if satisfactory disclosure and other documents are delivered prior to closing.

Commission believes that, given the sophistication of the investors and the alternative mechanisms developed by the industry to facilitate disclosure in connection with such offerings,⁶⁷ the specific requirements of the Rule are not necessary to prevent fraud and encourage the dissemination of disclosure into the secondary market.

After reviewing the comment letter, the Commission has determined to provide exemptions from the Rule for offerings of municipal securities in authorized denominations of \$100,000, (1) that are sold in "limited placements," (2) that have maturities of less than nine months, or (3) that contain provisions that allow the investor to redeem or sell to the issuer or its agent the securities at least as frequently as every nine months. In addition, the Rule would permit the Commission to grant exemptions that are consistent with the public interest and the protection of investors. The Commission wishes to emphasize that underwriters participating in offerings that are able to utilize an exemption from the Rule, nevertheless remain subject to the general antifraud provisions of the federal securities laws.⁶⁸ Moreover, any participating underwriter in a remarketing of securities initially offered in reliance upon the exemptions contained in paragraph (c)(3), when the remarketing is a primary offering as that term is defined in paragraph (e)(7), would be subject to the Rule, unless that primary offering qualified for exemptions under paragraph (c)(1) or (c)(2).

A condition of each of the exemptions discussed below is the requirement that the municipal securities be offered in authorized denominations of \$100,000 or more. In choosing the \$100,000 minimum denomination, the Commission was persuaded by the comments of NABL and others that, in this context, minimum denominations on the securities would not unnecessarily interfere with the ability of underwriters to sell securities to sophisticated

⁶⁷ For example, the Commission notes that issues of tax-exempt commercial paper generally prepare a commercial paper memorandum, containing disclosure about the issuer, that is then used in subsequent roll-overs. A "10b-5 certificate" is usually obtained from the issuer's chief financial officer on each roll-over date to assure the accuracy of the issuer's disclosure. Similarly, commentators indicated that in traditional municipal private placements, many investors condition their purchases upon receipt of a placement memorandum containing complete disclosure about the securities being sold.

⁶⁸ NABL suggested that use of a \$100,000 minimum denomination would assure that only sophisticated purchasers are sold bonds in offerings not subject to the Rule and would have the benefit of: (1) not interfering with cost-savings financing programs using commercial paper, variable rate demand notes, multimode securities and cash flow borrowings; (2) not require elaborate development of concepts such as accredited investor, safe harbor, restricted resale, etc.; (3) not adversely affect the institutional market, where investors are often loath to purchase (or are prohibited from purchasing) restricted or legended securities; (4) set the focus of the exemption on the type of investors to be protected, not on the type or volume of the issue (thus avoiding a complicated scheme of distinctions among issuer type); (5) be applied easily in both the initial issuance and secondary market context; and (6) preserve existing avenues of funding for municipal issuers, without imposing unnecessary costs.

investors in situations where the investors currently obtain adequate information.⁶⁹

The term “authorized denomination of \$100,000 or more” is defined in paragraph (e)(1) of the Rule. The definition recognizes that municipal securities currently are issued in registered form and that instructions to the transfer agent are necessary to assure that securities sold in denominations of \$100,000 are not resold in smaller amounts. At the suggestion of the commentators, the definition also is tailored to address the offering of securities with original issue discount, such as zero coupon securities, by making the reference to the purchase price, rather than the principal amount of the securities.⁷⁰

1. Limited Placements

The Release requested comment on whether the Rule should contain some type of “private placement” exemption.⁷¹ The Release noted that the primary intent of the Proposed Rule was to focus on those offerings that involve the general public and are likely to be actively traded in the secondary market. The absence of a limited placement exemption in the Proposed Rule reflected the Commission's concern that, without transfer restrictions, municipal securities initially sold on a limited basis to sophisticated investors could be resold to numerous secondary market investors, who lacked the sophistication of the initial purchasers.

Comment was requested on whether, and in what manner, the Rule should distinguish between offerings sold to a limited number of investors and those involving broader sales and related efforts. The Commission inquired whether the Rule should contain an exemption for offerings sold to no more than 10, 25, 35 or 50 investors, and whether the exemption should look at the institutional nature or sophistication of the investors. To avoid having securities that are sold to sophisticated investors pursuant to a limited placement exemption immediately be resold in the retail market, the Commission inquired about whether the underwriter should be required to assure that initial investors purchase with

⁶⁹ Underwriters also must be aware that separate MSRB provisions may be applicable, as well as state securities laws. For example, even where the provisions of the Rule are not applicable, the MSRB may require dissemination of final official statements, if they are prepared by the issuer. See, e.g., *Disclosure Requirements for New Issue Securities: Rule G-31*, MSRB Reports, (Sept. 1986) at 17 (indicating that rule G-32 applies to both private and public offerings).

⁷⁰ For zero coupon and deep discount securities, the term authorized denomination is defined in paragraph (e)(1) based on the market value of the security.

⁷¹ In 1988, approximately \$2,716 million in municipal private placements were reported, amounting to 2.3% of total long-term bond offerings. These figures, however, are considered to underestimate the actual issuance of municipal securities through private placements. Source: IDD/PSA Database.

investment intent, or whether holding periods or transfer restrictions should be required.

Commentators discussing the issue almost unanimously favored an exemption from the requirements of the Rule for offerings that are similar to traditional municipal private placements. Nevertheless, there were a variety of opinions given on how the exemption should be structured. Among other things, commentators drew analogies to concepts developed under the Securities Act, including proposed Rule 144A.⁷²

As some of the commentators noted, the federal securities laws have traditionally distinguished between sales of securities to the general public and limited offerings made to sophisticated investors. In general, offerings of securities to sophisticated investors are not required to comply with the more formal disclosure regimen applicable to registered offerings, because of the investors' perceived ability to “fend for themselves” by demanding the disclosure necessary to make an informed investment decision, and by having such knowledge and experience to be capable of evaluating the merits of the prospective investment. Based in part on similar reasoning, the Commission has determined to incorporate a conditional exemption in the Rule for offerings of securities that are sold to a limited number of sophisticated investors in denominations of \$100,000 or more.

Paragraph (c)(1) provides an exemption from the Rule for offerings sold to no more than 35 investors, each of whom the underwriter reasonably believes is not purchasing for more than one account and has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment. As discussed above, the Commission was concerned that any securities offered pursuant to a limited placement exemption could immediately be resold to public investors without the benefit of the Rule's requirements. Accordingly, the Commission requested comment on whether, in conjunction with a limited offering exemption, any specific terms or restrictions, such as minimum holding periods, should be imposed on securities offered in reliance on the exemption. A number of commentators, including the PSA and NASACT, suggested that some limitations on resales may be appropriate. Commentators also indicated that current practice in many municipal private placements is to require letters of investment intent.⁷³

The Commission is aware that restrictions on resales of securities are of concern even to institutional investors who initially purchase securities as part of a buy and hold strategy, because they

⁷² See Securities Act Release No. 6806 (October 21, 1988) 53 FR 44016 (proposing Rule 144A).

⁷³ See also, Procedural Statement No. 6, “Practices in Note and Bond Sales; Private Placements” GFOA Disclosure Guidelines, *supra* note 6, at 88 (indicating that the issuer should receive assurances that the transaction is in fact a direct placement).

limited the institution's ability to resell securities in changing market conditions. Rather than imposing specific transfer restrictions, the Commission has chosen to require that the securities be issued in relatively large denominations and that the underwriter have a reasonable belief that the securities are being acquired by the purchaser for investment.

Consistent with current practice, the Commission believes that an underwriter will satisfy its obligation under paragraph (c)(1) if it obtains a statement indicating that the investor has purchased the securities with investment intent. Furthermore, as suggested by the American Bar Association, in order to maintain the integrity of the 35 person limit, the Rule requires that each of the purchasers acquire securities for only one account. Finally, the Rule requires that the underwriter make a subjective determination that each investor have the knowledge and experience required to evaluate the merits and risks of the prospective investment.⁷⁴ The Commission believes that this procedure also is consistent with the current practice in the municipal securities markets, where limited placements are generally made only to institutional purchasers.

(a) *Definition of Underwriter.* Some commentators suggested that since the term “underwriter” in the Proposed Rule⁷⁵ was defined as a broker, dealer, or municipal securities dealer who participated in a “distribution” the Commission had created an implicit private placement exception.⁷⁶ Specifically, they noted that persons selling securities in an offering that did not involve a distribution would not be subject to the Rule. The word “distribution”, which was used in the definition of “underwriter” in the Proposed Rule, has been replaced with the term “offering”. This change is intended to clarify that a broker, dealer or municipal securities dealer may be acting as underwriter, for purposes of the Rule, in connection with a private offering. Unless the offering meets the requirements of paragraph (c)(1), the underwriter would be subject to the requirements of the Rule.

⁷⁴ This differs from Regulation D under the Securities Act, which provides that the issuer in private placements may presume that accredited investors meet the purchaser qualifications.

⁷⁵ The Proposed Rule defined “underwriter” to include “any person who has purchased from an issuer with a view to, or offers or sells to, an issuer in connection with the distribution of, any security . . .” The definition in the Proposed Rule paralleled the definition in section 2(11) of the Securities Act, 15 U.S.C. 77b(11), with one modification to more clearly reflect the terminology used in the municipal securities industry for a customary distributor's or seller's commission. See Release, 53 FR at 37786, n. 58.

⁷⁶ See generally Securities Act Release No. 6806 (October 21, 1988) 53 FR 44016, at n.145 (discussing the term “distribution” in the context of the definition of “underwriter” found in section 2(11) of the Securities Act). But see Rule 10b-6(c)(5) of the Exchange Act, 17 CFR 10b-6(c)(5) (defining for purposes of that rule, the term distribution to mean an offering of securities that is distinguished from ordinary trading by the magnitude of the offering and special selling efforts and selling methods).

2. Short-Term Securities

Another issue on which the Commission requested comment was whether an exemption should be provided for short-term debt. Of the commentators who responded to this issue, many distinguished between traditional short-term debt, such as bond, tax, and revenue anticipation notes, which may be sold to a variety of investors, and tax-exempt commercial paper, which primarily is sold in large denominations to institutional investors.⁷⁷ Commentators argued that imposition of the requirements of the Rule to tax-exempt commercial paper would seriously impact an issuer's ability to enter the market. The MSRB, along with others, also compared short-term municipal debt to corporate commercial paper that is exempt from the registration provisions of the Securities Act.⁷⁸ The MSRB noted that its own rule G-32 contains a specific exemption for tax-exempt commercial paper.

After reviewing the comment letters, the Commission has determined to provide an exemption for offerings of short-term debt with fixed maturities of less than nine months.⁷⁹ As with the other exemptions, underwriters would only be able to use the exemption in those offerings in which the securities are issued in authorized denominations of \$100,000 or more. The Commission believes that the philosophy of the exemption is consistent with the exemption in section 3(a)(3) of the Securities Act.⁸⁰ Nevertheless, the Commission does not want to imply a direct correlation between tax-exempt commercial paper, as the term is used frequently in the municipal markets, and commercial paper offered pursuant to Section 3(a)(3).

3. Securities With Demand Features

In addition to traditional short-term debt issues with fixed maturities of less than nine months, many issuers have utilized multi-mode bonds and variable rate demand notes as a means of efficiently financing their operations. Variable rate demand notes

⁷⁷ The Commission understands that concerns about reissuance problems under the federal tax laws have reduced true tax-exempt commercial paper offerings in recent years. In 1988, for example, only 16 issues of tax-exempt commercial paper, amounting to \$1,142 million were offered. This figure is up from 6 offerings in 1987, amounting to \$65 million. Source: IDD/PSA Database.

⁷⁸ Section 3(a) (3) of the Securities Act, 15 U.S.C. 77c(a)(3) exempts from registration “[a]ny note, draft, bill of exchange, or bankers acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transactions, and which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited”.

⁷⁹ In 1988, 1,482 short-term bond issues (less than 13 months), totaling \$23,125 million, were offered with par amounts exceeding \$1 million. Four hundred ninety offerings above one million, with a total par amount of 6,246.9 million, had final maturities of less than nine months. Source: IDD/PSA Database.

⁸⁰ See generally, Securities Act Release 4412 (Sept. 20, 1961) 26 FR 9158 (discussing short-term corporate debt).

have fixed maturities equivalent to long-term bonds, but provide the purchaser with the opportunity to tender the bonds to the issuer or a third-party liquidity facility at preset tender dates that may be weekly, monthly, or annually. By offering variable rate demand notes, or tender option bonds, the investor is able to reduce interest rate risk, while the issuer can offer short-term yields on long-term bonds.

Variable rate demand notes, as well as tax-exempt commercial paper, may be a component of multi-mode offerings that permit the issuer to convert outstanding debt from short-term variable rates to long-term fixed rates. Investors are notified of the issuer's determination to exercise its conversion option and typically are given the opportunity to redeem their securities at par or retain the securities in their converted form. Bonds that are redeemed upon conversion are generally offered pursuant to a remarketing agreement, with liquidity support typically provided by a third-party financial institution.

Although the use of variable rate financing has declined in recent years in response to a flattening of the yield curve, the Commission recognizes that variable rate debt remains an important method of financing for many issuers.⁸¹ Some commentators expressed concern that applying the provisions of the Proposed Rule to variable rate demand notes, or similar securities, might unnecessarily hinder the operation of this market, if underwriters were required to comply with the provisions of the Proposed Rule on each tender or reset date. To assure that these means of financing are not unnecessarily affected, the Commission has provided an exemption in Rule 15c2-12 that permits sales of variable rate demand notes and other flexible mode securities with effective maturities of less than nine months.

Paragraph (c)(3) provides an exemption for securities issued in authorized denominations of \$100,000 or more that, at the option of the holder, 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, or earlier redemption, or until such securities are remarketed in a primary offering. Thus, variable rate demand notes, tax-exempt commercial paper with an automatic roll-over feature, and tender option bonds with maturities or reset dates of less than nine months, would be eligible for the exemption. In multi-mode offerings, upon conversion to a fixed maturity of greater than nine months, the exemption would no longer be applicable and any primary offering of the securities by a remarketing agent would be subject to the Rule.

D. Exemptive Authority

⁸¹ Issuance of variable rate demand obligations peaked in 1985, at \$66,855 million (based on issues with a par amount exceeding \$5 million). In 1988, 903 issues were offered, with a total volume of \$21,622 million. Source: IDD/PSA Database.

In addition to the express exemptions contained in paragraphs (c)(1), (2) and (3) of the Rule, paragraph (d) provides that the Commission may, upon written request, or upon its own motion, exempt any participating underwriter from any requirement of the Rule. The Commission recognizes that there is a continuing evolution in financial products and the means of selling securities. While the Commission believes that the exemptions contained in the Rule will accommodate those offerings in which current practice is appropriate, without the need for the additional requirements of the Rule, it is also aware that instances may arise where the objectives of the Rule can be achieved without strict compliance with its provisions.

Paragraph (d) permits the Commission to exempt from the Rule underwriters participating in particular primary offerings of municipal securities, or classes of transactions, either unconditionally, or upon specified terms and conditions. In determining whether any exemption is appropriate, the Commission would consider whether such an exemption is consistent with the public interest and the protection of investors. Among other things, the Commission would, in some cases, expect persons requesting an exemption to demonstrate that the objectives of the Rule can be achieved using alternative procedures. In light of the fact that the Rule codifies, to a great degree, responsible industry practice, and the fact that the current exemptions are designed to adequately accommodate financing techniques where departure from the specific provisions of the Rule is appropriate, the Commission does not expect that exemptions will be granted routinely.⁸²

E. Transitional Provision

Paragraph (f) of the Rule provides an exemption from the provisions of the Rule relating to the dissemination of the final official statements, for remarketings of securities that were initially issued prior to July 28, 1989, and where the underwriter has a contractual commitment to act as remarketing agent. The transition period applies only to paragraphs (b)(3) and (b)(4) of the Rule. The Commission does not believe there is a need for an exemption from the other paragraphs of the Rule, since dissemination of a preliminary official statement is only required if one is prepared and the information needed to comply with paragraph (b)(1) of the Rule is information reasonably foreseeable as necessary to facilitate compliance with the anti-fraud provisions of the Federal securities laws that were in effect at the time of the contract. In this regard, the Commission understands that it is common to provide in remarketing agreements that the remarketing agent will have access to the information necessary to comply with the federal securities laws.

⁸² The Interpretation was based on judicial and administrative decisions applying the federal securities laws and did not address the responsibilities of underwriters under the MSRB's rules or the provisions of state securities laws. Underwriters should be aware that their responsibilities under state securities laws may be different from those articulated in the Commission's Interpretation.

III. Interpretation of Underwriter Responsibilities

In the Release, the Commission also included an interpretation of the responsibilities of underwriters of municipal securities under the general antifraud provisions of the federal securities laws.⁸³ In light of the practices revealed in the staff's investigation of the Supply System default, the Commission determined it was appropriate to articulate clearly the obligations of underwriters participating in municipal offerings. While the focus of the Interpretation was on activities of underwriters, the Commission recognizes that the primary responsibility for disclosure rests with the issuer.⁸⁴

The Interpretation applies to all offerings of municipal securities, regardless of whether the offering is subject to the provisions of Rule 15c2-12. The Interpretation emphasized the obligation of underwriters under the general antifraud provisions of the federal securities laws to have a reasonable basis for recommending any municipal securities. The Interpretation noted that when the underwriter provides disclosure documents to investors, it makes an implied representation that it has a reasonable basis for belief in the accuracy and completeness of the key representations contained in the documents.

The Interpretation stated that the extent of review necessary for the underwriter to attain a reasonable basis for its belief in the accuracy and completeness of key representations in the

final official statement will depend upon all the circumstances. The factors enumerated in the Interpretation were: the extent to which the underwriter relied upon municipal officials, employees, experts and other persons whose duties have given them special knowledge of particular facts; the type of underwriting arrangement (e.g. firm commitment or best efforts); the role of the underwriter (manager, syndicate member, or selected dealer); the type of bonds being offered (general obligation, revenue, or private activity); the past familiarity of the underwriter with the issuer; the length of time to maturity of the bonds; the presence or absence of credit enhancements; and whether the bonds are competitively bid or are distributed in a negotiated offering. The Interpretation stated that, at a minimum, the Commission expects that in all offerings underwriters will review the issuer's disclosure document(s) in a professional manner for possible inaccuracies and omissions.⁸⁵

The Interpretation presented the Commission's view of the current responsibilities of underwriters of municipal securities under the federal securities laws. It did not create new standards of liability.⁸⁶ Moreover, although the Interpretation was based on judicial decisions and previous administrative actions, the Commission sought comment on the extent to which underwriters currently meet the standards articulated in the Interpretation, and whether alternative formulations of the Interpretation would be more appropriate.

The Commission received comments on the Interpretation from all segments of the municipal industry. Most comments addressing the issue agreed that the Interpretation accurately reflected practices currently employed by responsible underwriters of municipal securities. In light of the comments, the Commission remains convinced that the Interpretation correctly articulates the legal responsibilities of underwriters of municipal securities under the federal securities laws. Nevertheless, the Commission has determined to clarify and modify limited portions of the Interpretation to address concerns raised by commentators.

Some commentators suggested additional factors that should be included among those enumerated in the Interpretation, while others disputed the relevance of some factors that were cited. In this regard, the Commission wishes to further emphasize that the factors enumerated in the Interpretation were not intended to be an exclusive list of factors bearing upon the reasonableness of the underwriter's investigation. While the Commission believes that, as modified below, the factors cited generally will be relevant in

⁸³ In conjunction with the adoption of the Rule, the Commission also is adopting Rule 30-3(a)(48) of the Rules of Practice, 17 CFR 241.30-3(a)(48), which delegates to the Division of Market Regulation, the authority to grant exemptive requests under Rule 15c2-12. Securities Exchange Act Release No. 26986 (June 28, 1989). The Commission expects that the Division will consider any exemptive requests in light of the goals of the Rule and will submit such matters to the Commission for consideration as appropriate. Requests for exemptive relief, as well as interpretive and no-action advice concerning the Rule, should conform with the Commission's published procedures and should be addressed to the Chief Counsel, Division of Market Regulation, Mail Stop 5-1, Securities and Exchange Commission, Washington, DC 20549. The procedures to be followed in requesting no-action or exemptive relief are outlined in Securities Act Release No. 5127, 36 FR 2600 (Jan. 25, 1971); see generally, Lemke, *The SEC No-Action Letter Process*, 42 Bus. Law. 1019 (1987).

⁸⁴ Although the focus of the Commission's Interpretation was on underwriter practices, issuers are primarily responsible for the content of their disclosure documents and may be held liable under the federal securities laws for misleading disclosure. See, e.g. *In re Washington Public Power Supply System Securities Litigation*, 623 F. Supp. 1466, 1478-1480 (W.D.Wa. 1985), *aff'd*, 823 F.2d 1349 (9th Cir. 1987); *In re Citisource, Inc. Securities Litigation*, 694 F. Supp. 1069, 1072-1075 (S.D.N.Y. 1988); *In re New York City Municipal Securities Litigation*, 507 F. Supp. 169, 184-185 (S.D.N.Y. 1980). Because they are ultimately liable for the content of their disclosure, issuers should insist that any persons retained to assist in the preparation of their disclosure documents have a professional understanding of the disclosure requirements under the federal securities laws.

⁸⁵ In offerings where the issuer has not produced disclosure documents, including those that are exempted from Rule 15c2-12, the underwriter must take other measures to develop a reasonable basis for its recommendation.

⁸⁶ The Commission explained in the Release that the factors set forth in the Interpretation do not change the applicable legal standards against which the underwriter's conduct must be measured, or attempt to set an objective standard against which to measure recklessness for purposes of any scienter requirement under specific antifraud provisions. Release 53 FR at 37789, n. 84.

most offerings, any determination about the reasonableness of the underwriter's investigation in a particular offering "will depend upon all the circumstances" and will likely include factors not enumerated in the Interpretation as modified.⁸⁷

Similarly, certain factors specifically enumerated in the Interpretation may not be relevant in some offerings.⁸⁸ In this regard, the Commission had determined that the comments generated in response to two of the factors enumerated in the Interpretation suggest that these factors are sufficiently ambiguous so as not to be relevant in most offerings. Thus, the Interpretation is modified to the extent that it indicates that the nature of the underwriting arrangement (e.g., best efforts or firm commitment) would generally be a significant factor in assessing the reasonableness of the underwriter's investigation in municipal offerings. In addition, although the Commission included the presence or absence of credit enhancements as a consideration that might be relevant in gauging the underwriter's investigation, it is apparent, based upon the comments, that there is a diversity of opinion among participants in the municipal markets regarding the protection actually provided by credit enhancements.

In the Commission's view, the presence of credit enhancements generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds.⁸⁹ Several commentators, including analysts, investors, and insurers, have indicated that even in credit enhanced offerings they rely upon disclosure concerning the primary obligor. In credit enhanced offerings, there is event risk, including default

⁸⁷ Indeed, the factors that have been withdrawn below may be relevant in particular circumstances.

⁸⁸ For example, the Commission stated in the Interpretation that the fact an offering is nominally classified as competitively bid would not be relevant to the scope of an underwriter's review, where there is little uncertainty about the choice of underwriters or where other factors are present that would command a closer examination.

⁸⁹ The Commission noted in 1987, in the context of an examination of the financial guarantee markets, that:

[w]hile the presence of a guarantor is a material factor that investors may wish to consider in determining whether to invest in a particular debt issue, the Commission does not believe that it can, in general, serve as a substitute for disclosure of material information regarding the offering.

Investors in public offerings of securities backed by insurance policies have an interest in information allowing them to assess the financial resources of both the issuer and the insurer. Investors also have an interest in assessing other material matters in addition to the solvency of the issuer and its guarantor. * * * Thus, the Commission observes that the presence of an insurance policy may not, in general, serve as an adequate substitute for disclosure of material terms of the proposed transaction.

Report of the United States Securities and Exchange Commission on the Financial Guarantee Market: The Use of the Exemption in Section 3(a)(2) of the Securities Act of 1933 for Securities Guaranteed by Banks and the Use of Insurance Policies to Guarantee Debt Securities (1987) at 82, 83.

or the primary obligor, that may impair the value of the municipal bonds. Empirical evidence was provided by the Association of Financial Guarantors illustrating the discount imposed by the market on credit enhanced offerings, compared to offerings with similar ratings without credit enhancements.⁹⁰ In light of these comments, the Commission wishes to emphasize that the presence of credit enhancement does not foreclose the need for a reasonable investigation of the accuracy and completeness of key representations concerning the primary obligor. Accordingly, the Interpretation is modified to the extent that it suggests the presence or absence of credit enhancements generally would be a significant factor in assessing the reasonableness of the underwriter's investigation.

The Commission's Interpretation is modified in accordance with the discussion presented above.

IV. Effects on Competition and Regulatory Flexibility Act Considerations

Section 23(a)(2) of the Exchange Act⁹¹ requires that the Commission, in adopting rules under the Act, consider the anticompetitive effects of such rules, if any, and balance any anticompetitive impact against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission is of the view that Rule 15c2-12 will not result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

In addition, the Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA"), pursuant to the requirements of the Regulatory Flexibility Act,⁹² regarding the Rule. Commentators were invited in the Release to provide data concerning the costs and benefits of the Proposed Rule. The FRFA indicates that Rule 15c2-12 could impose some additional costs on small broker-dealers and municipal issuers. Nevertheless, the Commission believes that many of the substantive requirements of the Rule already are observed by underwriters and issuers as a matter of good business practice, or to fulfill their existing obligations under the general antifraud provisions of the federal securities laws. Moreover, in the Commission's view, any costs are substantially outweighed by the benefits of improved disclosure and access to information that are provided by the Rule.

A copy of the FRFA may be obtained from Edward L. Pittman, Assistant Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5-1, Washington, DC 20549, (202) 272-2848.

⁹⁰ Letter from Phillip R. Kastlelec, Chairman, Disclosure Committee, Association of Financial Guaranty Insurers, to Jonathan G. Katz, Secretary, SEC (Dec. 22, 1988).

⁹¹ 15 U.S.C. 78w(a)(2).

⁹² 5 U.S.C. 604.

V. Statutory Basis and Text of Amendments

The Commission proposes to adopt s 240.15c2-12 in Chapter II of Title 17 of the Code of Federal Regulations as follows: (List of Subjects in 17 CFR Part 240) Reporting and recordkeeping requirements, securities.

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

1. The authority citation for Part 240 is amended by adding the following citation:

Authority: Sec. 23, 48 Stat. 901, as amended; 15 U.S.C. 78w. * * * s 240.15c2-12 also issued under 15 U.S.C. 78b, 78c, 78j, 78o, 78o-4 and 78q.

2. By adding s 240.15c-12 as follows:

§ 240.15c2-12 Municipal securities disclosure.

(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 (hereinafter “Participating Underwriter”) to act as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more (hereinafter “Offering”) unless the Participating Underwriter complies with the requirements of this rule or is exempted from the provisions of this rule.

(b) *Requirements.* (1) Prior to the time the Participating Underwriter bids for, purchases, offers, or sells municipal securities in an Offering, the Participating Underwriter shall obtain and review an official statement that an issuer of such securities deems final as of its date, except for the omission of no more than the following information: The offering price(s), interest rate(s), 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 underwriter(s).

(2) Except in competitively bid offerings, from the time the Participating Underwriter has reached an understanding with an issuer of municipal securities that it will become a Participating Underwriter in an Offering until a final official statement is available, the Participating Underwriter shall send no later than the next business day, by first-class mail or other equally prompt means, to any potential customer, on request, a single copy of the most recent preliminary official statement, if any.

(3) The Participating Underwriter shall contract with an issuer of municipal securities or its designated agent to receive, within seven business days after any final agreement to purchase, offer, or sell the municipal securities in an Offering

and in sufficient time to accompany any confirmation that requests payment from any customer, copies of a final official statement in sufficient quantity to comply with paragraph (b)(4) of this rule and the rules of the Municipal Securities Rulemaking Board.

(4) From the time the final official statement becomes available until the earlier of--

(i) Ninety days from the end of the underwriting period or

(ii) The time when the official statement is available to any person from a nationally recognized municipal securities information repository, but in no case less than twenty-five days following the end of the underwriting period, the Participating Underwriter in an Offering shall send no later than the next business day, by first-class mail or other equally prompt means, to any potential customer, on request, a single copy of the final official statement.

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

(1) Are sold to no more than thirty-five persons each of whom the Participating Underwriter reasonably believes (i) 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 (ii) is not purchasing for more than one account or with a view to distributing the securities; or

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

(3) 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.

(d) *Transactional Exemptions.* The Commission, upon written request, or upon its own motion, may exempt any Participating Underwriter that is a participant in a transaction or class of transactions from any requirement of this rule, 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.

(e) *Definitions.* For the purposes of this rule--(1) The term “authorized denominations of \$100,000 or more” means municipal securities with a principal amount of \$100,000 or more and with restrictions that prevent the sale or transfer of such securities in principal amounts of less than \$100,000 other than through a primary offering; except that, for municipal securities with an original issue discount of 10 percent or more, the term means municipal securities with a minimum purchase price of \$100,000 or more and with restrictions that prevent the sale or transfer of such securities, in principal amounts that are less than the original principal amount at the time of the primary offering, other than through a primary offering.

(2) The term “end of the underwriting period” means the later of such time as

(i) the issuer of municipal securities delivers the securities to the Participating Underwriters or

(ii) the Participating Underwriter does not retain, directly or as a member or an underwriting syndicate, an unsold balance of the securities for sale to the public.

(3) The term “final official statement” means a document or set of documents prepared by an issuer of municipal securities or its representatives setting forth, among other matters, information concerning the issuer(s) of such municipal securities and the proposed issue of securities that is complete as of the date of delivery of the document or set of documents to the Participating Underwriter.

(4) The term “issuer of municipal securities” means the governmental issuer specified in section 3(a)(29) of the Act and the issuer of any separate security, including a separate security as defined in rule 3b-5(a) under the Act.

(5) The term “potential customer” means (i) Any person contacted by the Participating Underwriter concerning the purchase of municipal securities that are intended to be offered or have been sold in an offering, (ii) Any person who has expressed an interest to the Participating Underwriter in possibly purchasing such municipal securities, and (iii) Any person who has a customer account with the Participating Underwriter.

(6) The term “preliminary official statement” means an official statement prepared by or for an issuer of municipal securities for dissemination to potential customers prior to the availability of the final official statement.

(7) The term “primary offering” means an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing of municipal securities.

(i) That is accompanied by a change in the authorized denomination of such securities from \$100,000 or more to less than \$100,000, or

(ii) That is accompanied by a change in the period during which such securities may be tendered to an issuer of such securities or its designated agent for redemption or purchase from a period of nine months or less to a period of more than nine months.

(8) The term “underwriter” means any person who has purchased from an issuer of municipal securities with a view to, or offers or sells for an issuer of municipal securities in connection with, the offering of any municipal security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct

or indirect underwriting of any such undertaking; except, that such term shall not include a person whose interest is limited to a commission, concession, or allowance from an underwriter, broker, dealer, or municipal securities dealer not in excess of the usual and customary distributors' or sellers' commission, concession, or allowance.

(f) Transitional Provision. If on July 28, 1989 a Participating Underwriter was contractually committed to act as underwriter in an Offering of municipal securities originally issued before July 29, 1989, the requirements of paragraphs (b)(3) and (b)(4) shall not apply to the Participating Underwriter in connection with such an Offering.

List of Subjects in 17 CFR Part 241

Reporting and recordkeeping Requirements, Securities, Issuers, Broker-Dealers, Fraud.

PART 241--INTERPRETIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

Part 241 of Title 17 of the Code of Federal Regulations is amended by adding Securities Exchange Act Release No. 26100 (53 FR 37778) concerning “Municipal Securities Underwriter Responsibilities” and this Release “Modifying and confirming the Interpretation of Municipal Underwriter Securities Responsibilities” to the list of interpretive releases set forth thereunder.

By the Commission.

Dated: June 28, 1989.

Jonathan G. Katz,

Secretary.

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