September 2, 2011

IDEA OF THE WEEK

NABL Holds Second Pension Task Force Meeting

On Wednesday, August 24, 2011, NABL hosted the second meeting of the municipal market's Task Force on Defined Benefit Public Pension Plan Disclosure. As with the first meeting, representatives of a large number of organizations representing stakeholders in municipal securities markets and public pension disclosures attended.

The meeting focused on a revised draft of NABL's May 2 Discussion Draft, which has been retitled "Considerations in Preparing Disclosure for Public Defined Benefit Pension Plan in Official Statements" (August 19 Draft). The August 19 Draft reflects written comments received by Task Force member organizations and other interested parties, which was incorporated into the text and edited by an Ad-Hoc Drafting Committee of NABL Members, under the leadership of project head Ken Artin.

The August 19 Draft reflects the premise that pension plan disclosure in the official statement is best viewed as a supplement to the three core documents that provide critical information for investors and analysts - the financial statements of the issuer, the financial statements of the pension plan, and the pension plan's actuarial report. Unlike the initial May 2 Discussion Draft, the August 19 Draft does not include any tables or text derived from the three core documents. Instead the Draft serves as guidance to counsel in addressing certain issues outside the scope of such documents. These issues include the impact of annual contributions on current and future budgets of the issuer; any plans the issuer has adopted to address future payments; and any statutory provisions or positions of the executive or legislative branches regarding priorities of funding of debt service, contractual obligations, current payroll, and current pension payments.

Members of the NABL Ad Hoc Drafting Committee include: NABL President John McNally, Andrea Bacon, Marybeth Braitman, Paul Braden, Bill Hirata, Andrew Kintzinger, Carol McCoog, John Overdorff, Jodie Smith, and Walter St. Onge.

Task Force member organizations include: the Government Financial Officers Association, the Investment Company Institute, the National Association of Public Pension Attorneys; the National Association of State Auditors, Comptrollers, and Treasurers; the National Association of State Retirement Administrators; the National Council on Teacher Retirement; the American Institute of Certified Public Accountants, Bond Dealers of America; the Governmental Accounting Standards Board; the Government Finance Officers Association; the National Association of State Treasurers;

the Securities Industry and Financial Markets Association, and the Conference of Consulting Actuaries.

LEGISLATIVE

NABL Recommendation to Authorize Treasury to Create Transition Rule for Refinancing Bonds

Following conversations with staff at the Department of the Treasury, Office of Tax Policy and the Internal Revenue Service, Office of Chief Counsel, regarding the uncertainty associated with the rules for refunding certain tax advantaged bonds authorized by the *American Recovery and Reinvestment Act*, NABL's Tax Committee, under the leadership of Committee Chair Michaela Daliana and Board Liaison Cliff Gerber, has prepared a draft of proposed statutory language that would enable the Department of the Treasury, in appropriate cases, to create transition or "grandfather" rules to allow the refinancing, subsequent to various statutory deadlines, of state and local bonds that were issued prior to such statutory deadlines. NABL has transmitted this proposal to staff at the Treasury Department, Office of Chief Counsel and relevant congressional committees. The draft proposal and explanatory statement can be accessed here.

The Deficit Reduction and Tax Reform Debate: Potential Impacts on the Tax-Exempt Bond Market

The National Association of Bond Lawyers has compiled a chart titled *The Deficit Reduction and Tax Reform Debate: Potential Impacts on the Tax-Exempt Bond Market* that tracks and explains various deficit reduction and tax reform proposals. The chart, which tracks both proposals currently pending before Congress and proposals developed by prominent think tanks and research groups, is intended to aid members in following the national debate surrounding deficit reduction and tax reform and the potential impact on tax-exempt bonds. The chart will be updated as necessary.

See Deficit Proposal Chart here.

REGULATORY

MSRB Publishes First Report on Municipal Bond Continuing Disclosure Documents

On August 25, 2011, The Municipal Securities Rulemaking Board (MSRB) published its first report summarizing the type and number of continuing disclosure documents for municipal securities available on the MSRB's EMMA website.

Between July 2009 and June 2011, the MSRB received 258,162 continuing disclosure documents, according to the MSRB's *Continuing Disclosure Statistical Summary*. The

report shows fairly steady month-over-month increases in all types of continuing disclosures submitted to the MSRB by municipal bond issuers and obligated persons.

The MSRB collects and makes available to investors for free continuing disclosure documents associated with most municipal bonds on its EMMA website. These activities support the MSRB's mission to provide broad and timely access to key municipal market documents and data.

The MSRB also publishes an annual Fact Book and quarterly municipal securities statistics, which are available electronically on www.msrb.org.

MSRB Proposes Permanent 21 Member Board and Names 2011-12 Officers and Directors

On August 11, 2011**,** the Municipal Securities Rulemaking Board (MSRB) proposed the creation of a permanent 21 member Board to accommodate the representation of municipal advisors. *The Dodd-Frank Wall Street Reform and Consumer Protection Act* conferred upon the MSRB authority to regulate activities of municipal advisors, as defined by the Securities and Exchange Commission. Permanently increasing the membership of the Board to 21 members that serve staggered three-year terms is intended to address this change.

Separately, on August 18, 2011, the MSRB announced the names of its new officers and Board of Director members who will begin their terms on October 1, 2011. Alan D. Polsky, Senior Vice President, at Dougherty & Co. LLC, will serve as Chair of the MSRB. Robert A. Lamb, President, Lamont Financial Services Corp., will serve as Vice Chair. Officer terms are for one year

The MSRB Notices can be found here.

MSRB Proposes Two Conduct Rules for Municipal Advisors to State and Local Clients

On August 23, 2011, the MSRB proposed a rule and related guidance to govern the fiduciary duty owed by municipal advisors to state and local government clients, and other municipal entity clients.

Under proposed MSRB Rule G-36 and related guidance, municipal advisors would owe a duty of loyalty and a duty of care that would require them to act in the municipal entity's best interest. Municipal advisors, which provide advice to municipal entities about municipal securities and financial products, would also be required to make clear written disclosure of certain conflicts of interests and to receive written consent to any such conflicts by authorized government officials. The proposed rule also would prohibit an engagement with a state or local government where an "unmanageable" conflict exists, such as kickback payments to the municipal advisor from third parties.

The proposed rule also establishes the concept that compensation received by a municipal advisor may be so disproportionate to the nature of the services performed

that it represents a violation of the municipal advisor's duty to act in the best interests of its municipal entity client.

On August 24, 2011, the MSRB requested that the Securities and Exchange Commission (SEC) approve a notice that would establish fair dealing obligations of municipal advisors when providing advice to obligated person clients or when soliciting business from state or local governments or other municipal entities (such as public pension funds) on behalf of third parties. The proposal is one of a series of rulemaking initiatives the MSRB has filed with the SEC under the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

The notice sets forth detailed guidance for municipal advisors on the application of MSRB Rule G-17 "fair dealing," rule, which requires municipal advisors to deal fairly with all persons and prohibits engaging in any deceptive, dishonest or unfair practice. Rule G-17 covers municipal advisors' engagements with obligated persons and advisors' solicitation of municipal entities.

The MSRB is proposing that that the rule related to the fiduciary standard for municipal advisors and the notice setting for the fair dealing obligations both be effective on the effective date of the SEC's definition of the term "municipal advisor" under the *Securities Exchange Act of 1934* or at a later date as approved by the SEC.

These two MSRB Notices can be found here (August, 23 2011) and here (August 24, 2011).

IRS Releases Final Regulations: Definition of Solid Waste Disposal Facilities for Tax-Exempt Bond Purposes

On August 18, 2011, the Internal Revenue Service released final regulations TD 9546, Definition of Solid Waste Disposal Facilities for Tax-Exempt Bond Purposes. The final regulations modify proposed regulations REG-140492-02, which were published in 2009.

The final regulations are available on the NABL web site library under Federal Tax Materials here.

Material Event Notices for Defeased Bonds After S&P Downgrade of U.S. Debt

In light of Standard & Poor's downgrade of the long-term sovereign credit rating of the United States of America to "AA+," any bonds that are defeased (pre-refunded) by an escrow of U.S. Treasury securities, and for which a new rating was obtained in connection with the refunding to correspond to the rating of the securities in the escrow portfolio, would be correspondingly downgraded from "AAA" to "AA+". This Alert addresses whether a material event notice for a "rating change" must be filed pursuant to a continuing disclosure agreement entered into pursuant to SEC Rule 15c2-12 as a result of such downgrade.

The SEC staff advised in a letter to NABL dated June 23, 1995, in the response to question 15, that a written undertaking could terminate if the obligated person "no longer has any liability for repayment of the municipal securities (for example, . . . as a result of a defeasance of the municipal securities with no remaining liability.") [emphasis in original] See also the SEC staff response to question 16, which specifically discusses legal defeasance as terminating "an obligated person's liability with respect to municipal securities."

In a "legal defeasance," which includes an express contractual provision that the obligation on the bonds terminates once, for example, an escrow of U.S. Treasuries has been established which, without reinvestment, is sufficient to pay principal and interest when due (and certain other conditions, such as notice, are satisfied), there is no remaining contractual liability. In such case, Rule 15c2-12 would permit (based on the SEC staff advice quoted above) the continuing disclosure agreement to terminate.

On the other hand, in an "economic defeasance," by which Treasuries (or other securities) are set aside with the intent that they will be sufficient to pay debt service when due, but there is no contractual provision which terminates the obligated person's obligation to pay debt service if the escrow proved to be insufficient or otherwise, it would not satisfy the condition established by the SEC staff ("no longer has any liability"), and therefore the continuing disclosure obligation would continue.

The above analysis reflects the SEC staff guidance regarding Rule 15c2-12, but in each instance, the actual terms of the bond authorizing documents and continuing disclosure agreements will govern. Based on the SEC staff advice, in a legal defeasance the continuing disclosure agreement would terminate absent an express provision that it does not.

Issuers should consult with their bond counsel or disclosure counsel whether a material event notice is required. NABL notes that, in light of the MSRB's EMMA system, regardless of whether a notice is contractually required to be provided, the filings can be readily accomplished by an EMMA filing. Although the MSRB is working on integrating the EMMA system to receive notices directly from the rating agencies that would tie to particular CUSIP numbers, such system is not yet operational.

IRS Announces Updated Procedures and Educational Resources for the TEB Voluntary Closing Agreement Program

On August 11, 2011, the Internal Revenue Service Office of Tax Exempt Bonds (TEB) released updates to Internal Revenue Manual (IRM) Section 7.2.3, TEB Voluntary Closing Agreement Program (VCAP), and IRM section 4.81.6, TEB Closing Agreements.

The updates included additional TEB VCAP resolution standards for tax-exempt bonds and direct-pay bonds, as well as a new provision allowing reduced closing agreement amounts for issuers who implement written post-issuance compliance procedures.

Information on updated IRM Sections 7.2.3 and 4.81.6 are available on the TEB web site under Information for the Tax Exempt Bond Community.

Additionally, TEB also released web-based educational resources providing basic information about post-issuance compliance and voluntary compliance programs available to help issuers ensure the preferential tax status of their bonds. To access these educational resources visit TEB Post-Issuance Compliance and TEB Voluntary Compliance.

OTHER NEWS FROM WASHINGTON

S&P Revises Criteria for Rating Muni Bond Insurance

On August 25, 2011, Standard & Poor's published *Bond Insurance Rating Methodology and Assumptions*, a criteria article that follows upon S&P's *Request for Comment: Bond Insurance Criteria*, published January 24, 2011.

The criteria considers a common set of 11 analytic categories, including industry risk, competitive position, management and corporate strategy, operating performance, capital adequacy, investments, largest obligors, financial flexibility, enterprise risk management, liquidity, and leverage.

Assured Guaranty, one of the largest remaining insurer of municipal debt products, had actively sought changes from the proposal advanced by S&P in January. Assured Guaranty was highly critical of the increased capital required by the January proposal. The revised criteria still requires a capital charge higher than S&P has historically deployed, but does represent a change from the January draft.

Assured Guaranty announced that it was still evaluating the final rule, but noted that the largest obligor test "appears to have the effect of significantly reducing our allowed single risk limits and limiting our financial strength rating level. "

The S&P notice can be found here.