National Association *of* Bond Lawyers

COMMENTS
OF THE
NATIONAL ASSOCIATION OF BOND LAWYERS
REGARDING
SECURITIES AND EXCHANGE COMMISSION RELEASE NO. 34-60332
FILE NO. S7-15-09

PROPOSED AMENDMENTS TO MUNICIPAL SECURITIES DISCLOSURE

The National Association of Bond Lawyers ("NABL") submits the following comments relating to Release No. 34-60332 (the "Proposing Release"), in which the Securities and Exchange Commission (the "Commission") proposes to amend its Rule 15c2-12 (the "Rule"). The comments were prepared by an *ad hoc* subcommittee of NABL members comprised of those individuals listed on Exhibit I and were approved by NABL's Board of Directors. We apologize for the tardiness of our comments but the delay has allowed us to review the other comments that have been submitted and to the extent others have made similar comments with which we concur, we have not duplicated them in our submission.

NABL is a nonprofit organization comprised of approximately 3,000 members. It exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the various laws affecting public finance. NABL supports the recent efforts by the Commission and the Municipal Securities Rulemaking Board (the "MSRB") to increase the efficiency of continuing disclosure as it pertains to municipal securities. Many of the proposed amendments to the Rule will improve the mix of information available to investors of municipal securities. However, we believe that certain of the proposed amendments will not further that goal. We have limited our comments to those proposed amendments. Our comments are as follows:

1. The proposal to condition offerings of demand securities on an undertaking to provide timely notice of specified events would benefit investors and should be approved, if certain events are appropriately qualified by materiality. On the other hand, there is no

need to repeal the exemption of such offerings from undertakings to provide annual financial information and audited financial statements, because owners of demand securities can (and do) protect themselves by putting the securities for repurchase, if current disclosure is not provided voluntarily. The Commission should not repeal this latter exemption unless it clarifies that the Rule will not require disclosure about underlying obligors (or undertakings by them to provide annual financial information and audited financial statements) in offerings of LOC-backed demand securities.

Thousands of local governments, businesses and non-profit charitable organizations have financed capital improvements with variable rate demand securities that qualify for the current exemptions from the Rule described in paragraph (d)(1)(iii) ("demand securities"). Some demand securities are fully backed by unconditional, irrevocable, direct-pay letters of credit issued by banks ("LOC-backed demand securities"). Others are backed with liquidity facilities such as standby bond purchase agreements, and others may be further secured by municipal bond insurance policies to provide credit support. The terms of these securities allow investors to tender (or "put") their securities to an issuer or designated agent, on a periodic basis, for purchase or redemption at face value. With respect to LOC-backed demand securities, the letter of credit is drawn upon to pay the principal of and interest on such bonds and, to the extent remarketing proceeds are not available for such purpose, the purchase price of the tendered securities.

The Proposing Release would expressly make paragraphs (b)(5) and (c) of the Rule applicable to demand securities. Our reading of the Proposing Release is that it (appropriately) maintains the current exemption from paragraphs (b)(1)-(b)(4) of the Rule.

As applied to the requirement for undertakings to provide timely notice of specified events, the proposed amendments would benefit and help investors without unduly burdening other market participants, if certain of the events are qualified by materiality as described in Comment 4 below. If this qualifier is added to those events, we recommend that this part of the proposed amendment be adopted.

As applied to the requirement for an undertaking to provide annual financial information and audited financial statements, however, the proposed amendment contains a confusing ambiguity, as described below. Unless appropriately resolved, this ambiguity, together with Commission interpretive comments, could impose new disclosure requirements in connection with offerings of LOC-backed demand securities. Any such requirement would materially impair access to the tax-exempt debt market by small governments, small businesses, and non-profit organizations.

The ambiguity arises because of the use of the defined term "final official statement" in the definition of the "annual financial information" that an obligated person must undertake to provide. Paragraph (b)(5)(i)(A) of the Rule requires that the contract for continuing disclosure include "[a]nnual financial information for each obligated person for whom financial information or operating data is presented in the final official statement, or, for each obligated person

meeting the objective criteria specified in the undertaking and used to select the obligated persons for whom financial information or operating data is presented in the final official statement, except that, in the case of pooled obligations, the undertaking shall specify such objective criteria." The term *annual financial information*, as defined in paragraph (f)(9), means "financial information or operating data, provided at least annually, *of the type included in the final official statement* with respect to an obligated person, or in the case where no financial information or operating data was provided in the final official statement with respect to such obligated person, of the type included in the final official statement with respect to those obligated persons that meet the objective criteria applied to select the persons for which financial information or operating data will be provided on an annual basis" (emphasis added).

Under the Rule, the requirement to obtain a final official statement derives from paragraph (b)(1). Demand securities are currently, and by our reading will continue to be, exempt from paragraph (b)(1) of the Rule. In those limited instances when no final official statement is produced, underwriters will encounter difficulty complying with the Rule if proposed paragraph (d)(5) requires a continuing disclosure undertaking to provide "annual financial information," defined by reference to the final official statement. In these instances, is no continuing disclosure undertaking required? or is one required for the annual financial information that would have been required had a final official statement been provided?

A final official statement is produced in connection with primary offerings of most, if not all, demand securities. In these instances, the Proposing Release is ambiguous as to whether some baseline of financial information and operating data must be included in a final official statement. Currently, the standard is set forth in the definition of "final official statement" in paragraph (f)(3) of the Rule. According to that definition, a final official statement must include "information, including financial information and operating data, concerning such issuers of municipal securities and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the Offering." However, for a variety of reasons explained in more detail in Appendix A, LOC-backed demand securities are often offered with no disclosure of financial information and operating data about the underlying obligor, relying instead on disclosure about the issuing bank and a warning not to rely on the underlying obligor in making an investment decision. This practice is frequently followed even in cases where the credit of the underlying obligor, if disclosed, might be material to an investment decision. In footnote 113 of the Proposing Release, the Commission implies (without clearly stating) that such offering practices are not appropriate. For the reasons explained in Appendix A, we believe these offering practices are both appropriate and consistent with federal securities laws, and that their elimination would impose substantial costs on small issuers, small businesses and non-profit organizations without materially increasing investor protection

During the comment period on the proposed 1994 amendments to the Rule, some market participants were concerned that an articulation of required disclosures in the Rule would have the effect of mandating disclosure in the final official statement that was not material to the offering, and that in certain instances may, in fact, be misleading. The solution was to leave to

the parties involved in the transaction the determination of whose financial information is material to the offering (including, without limitation, the credit supporting the securities being offered). In the release adopting the 1994 amendments (under the heading "a. The Starting Point—Definition of Final Official Statement"), the Commission was clear to state that "[t]he definition [of final official statement] does not set its own form and content requirements on the financial information and operating data to be included. . . . Instead it provides the flexibility that many commenters asserted is necessary in determining the content and scope of the disclosed financial information and operating data, given the diversity among types of issuers, types of issues, and sources of repayment."

If the Commission adopts the proposed amendment, it should clarify whether or not it intends effectively to prohibit the now common practice of offering LOC-backed demand securities without either initial or continuing disclosure on the underlying credit. If it does not, it should confirm that its proposed deletion of paragraph (d)(1)(iii) and the application of paragraphs (b)(5) and (c) to LOC-backed demand securities (1) would not require production of a final official statement where the financing team (usually the issuer, the underwriter, the remarketing agent and their counsel) concludes that one is not required by the antifraud provisions of the federal securities laws, and (2) would permit the continued offering of LOC-backed demand securities without disclosure in the primary offering (or any undertaking to provide continuing disclosure) on such underlying credit if, in the judgment of the financing team, such disclosure is not required by the antifraud provisions. For the reasons set forth in Appendix A, NABL believes that such offerings are an important financing option, the elimination of which is not justified under the federal securities laws.

For further support for our comments, see Attachment A. See also Comment 11, should the Commission propose to resolve the ambiguity in the proposed amendments so as to preclude offerings of LOC-backed demand securities without primary and continuing disclosure about each material obligated person.

2. If the Commission acts to repeal any part of the exemption currently afforded to demand securities, it should clarify that periodic remarketings of demand securities that are not made in connection with a change in authorized denominations from $100,000 (or more) to less than $100,000, or a change in the period during which such securities may be tendered to the issuer or its designated agent for redemption or purchase from nine months (or less) to more than nine months, or a substitution of the principal obligor for the securities, are *not* "primary offerings" within the meaning of the Rule.

The Commission does not propose to amend the definition of "primary offering" that appears in paragraph (e)(7) of the Rule. In the Proposing Release, the Commission observes that a remarketing of demand securities[1] may be a primary offering of such securities.[2] This is

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1 For this purpose, a "demand security" is any security that qualifies for the exemption from the Rule currently set forth in paragraph 15c2-12(d)(1)(iii).

2 Proposing Release, commencing at n. 49.

consistent with the Rule's existing definition of "primary offering" and with the Commission staff's written guidance.[3] We suggest that, if the Commission acts to repeal any part of the exemption currently afforded to demand securities, it also clarify when remarketings of demand securities (including demand securities initially issued before such amendments are adopted) are "primary offerings" under the Rule. To prevent unwarranted disruption of the market for demand securities, we believe remarketings should be treated as primary offerings only when accompanied by: (i) a change in the authorized denominations of such securities from $100,000 or more to a lesser amount; (ii) a change in the period during which such securities may be tendered to an issuer or its designated agent for redemption or purchase from a period of nine months or less to a longer period; or (iii) a substitution of the principal obligor on the securities (excluding credit enhancers, since the Rule does not require disclosure about them). This clarification would be crucial if the proposed amendments are adopted and paragraphs (b)(5) and (c) of the Rule are applied to demand securities for which primary offerings are made on or after the effective date of the amendments. Unless this clarification is provided, many remarketings could be disrupted due to inadequacies in disclosure about the underlying obligor, even when that information is not material to an investment in the securities. Any such disruptions could increase already substantial stress on the liquidity of many issuers, obligated persons, and banks alike.

Please see the more detailed explanation for this recommendation in Attachment A.

3. The Commission should not require in paragraph (b)(5)(i)(C) of the Rule that undertakings made pursuant to the Rule establish a fixed period of time (as proposed, not in excess of ten business days) during which event notices must be filed with the MSRB. Rather, it should give examples of timeliness in the adopting release. If a fixed time limit is enacted, it should not begin until the person making the undertaking becomes aware of the event.

The proposed amendment to paragraph (b)(5)(i)(C) of the Rule (requiring that event notices be provided to the MSRB within ten business days after the occurrence of the event) would impose substantial new compliance burdens on persons obligated to provide such notices (whether they be issuers or other obligated persons). To comply with such an undertaking, a person would be required to investigate for occurrences of each of the enumerated events at least once a week (to leave time to prepare and file a notice, if an event is discovered). In many cases (for example, rating changes and changes in the name of the trustee), specified events are not likely to be within the filer's knowledge on a timely basis, at least not without undertaking expensive affirmative due diligence. In the following order of priority, and for the reasons discussed below, NABL proposes that: the Commission not qualify the phrase "timely manner" as it appears in paragraph (b)(5)(i)(C); or, if clarification of "timeliness" is desired, that the Commission use a series of examples to show what might be timely under various circumstances; or, if the Commission determines that a fixed number of days must be included in

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[3] *See* Pillsbury, Madison & Sutro, Mar. 11, 1991.

the paragraph, that the first of such days occurs at the time that the obligated person responsible for providing notices first becomes aware that the event has occurred.

In its 1994 release promulgating amendments to the Rule, the Commission stated, "[t]he amendments do not establish a specific time frame as "timely," because of the wide variety of events and issuer circumstances. In general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice." Release No. 34-34961 (November 10, 1994). We believe that not defining "timely" was sound logic in 1994, and that it should still apply in 2009.

We are aware of concerns raised by different market constituents as to the timeliness of notices being provided under existing undertakings. The Commission may be able to influence compliance with this requirement by including a few examples in the adopting release as to what the Commission considers to be "timely" under various scenarios. Such guidance would have the added benefit of assisting persons responsible for submitting notices under both existing undertakings and future undertakings.

If the Commission nonetheless determines to impose a time limit on the filing of event notices, then we recommend that the applicable notice period commence with knowledge of the event by the obligated person who has undertaken to provide such notices. Absent such a change, NABL is concerned that persons obligated to provide notices under paragraph (b)(5)(i)(C) of the Rule may encounter significantly increased financial burdens in order to comply with such obligations. It does not appear that those financial burdens were evaluated in the Proposing Release.

4. The proposed amendment to delete a materiality qualifier from six listed events is not useful, but also would not unduly burden issuers and obligated persons except in three circumstances. Limited materiality qualifiers should be retained in those circumstances.

The Commission proposes to amend the Rule to delete the materiality qualifier for notices of six specified events. NABL believes that, with three exceptions, this amendment is not objectionable. At the same time, if revised to avoid these exceptions, the amendment should not be expected to result in a change the submission of notices, since issuers already recognize that these events are material to an investment in the affected securities.

If this amendment is adopted, it should be revised so as not to require an event notice in the following three circumstances: First, the amendment, if coupled with repeal of the exemption currently afforded to LOC-backed demand securities, would require notices of unscheduled draws on debt service reserves that reflect financial difficulties of the obligated person, even when not material to an investment in the securities because they are traded on the strength of a bank letter of credit. Second, if coupled with repeal of the exemption for demand securities, the amendment would require notice of each failure to remarket securities when they are put, even though not material to an investor due to the existence of a letter of credit or other liquidity

facility. Third, the amendment would require notice of defeasances of securities regardless of how short the remaining term of the securities, and therefore would require an issuer to give notice whenever it creates a 30-day or shorter escrow for refunded bonds in order to avoid giving notice of redemption before an issue of refunding bonds is closed.

5. Paragraph (b)(5)(i)(C)(6) of the Rule (pertaining to notices of specified tax events), as proposed to be amended, should continue to be qualified by materiality (except for final determinations of taxability).

NABL recommends that the materiality standard be maintained. The proposed amendment does not condition notice of preliminary determinations, and does not clearly condition notice of "other events affecting the tax-exempt status of the security," on materiality (or, in the latter case, even adversity). Many persons who are obligated on demand (or otherwise callable) securities believe that a preliminary adverse determination of taxability is not material to the owners of demand securities, if the obligated person has both the wherewithal and the intention of settling the matter with the Internal Revenue Service without adversely affecting the tax-exempt status of the securities. In that case, the obligated persons may choose not to issue a public notice of the determination in order (a) not to undermine their negotiating position with the Internal Revenue Service, and (b) to avoid confusing–and possibly misleading–investors. However, if the Commission were to determine that this event, as amended, should be disclosed, NABL requests that receipt of an Internal Revenue Service "Notice of Proposed Issue (IRS Form 5701-TEB)," which may include merely a reminder of action that must be taken to retain tax-exempt status, not necessarily be disclosed if the issue discussed has no impact on the current examination.

6. The proposed addition of "tender offers" under paragraph (b)(5)(i)(C)(8) of the Rule as a notice event should be clarified to apply only to tender offers that are made to all owners of the municipal securities or should be qualified by materiality.

Pursuant to Section 14(e) of the Securities Exchange Act of 1934, tender offers made with respect to tenders for municipal securities are subject only to the antifraud provisions of that Act. Consequently, it is not uncommon for issuers to offer to buy less than all of their securities and to make the tender offer only to certain owners. For example, an issuer may tender for, or otherwise seek to purchase, only from those investors that own in excess of a certain principal amount of bonds. The person making an offer to purchase or exchange securities has adequate incentive to inform offerees of the offer; no rule is necessary to accomplish that result. On the other hand, if an offer is not extended to some owners, there is no reason they should be informed of the offer unless, if accepted, the offer would have a material effect on them. The burden falls to the participants to determine the notice required to be given in order to satisfy Section 14(e) of the Securities Exchange Act of 1934.

7. Paragraph (b)(5)(i)(C)(11) (pertaining to rating changes) should be deleted from the Rule.

The requirement for an undertaking to provide timely notice of rating changes has been particularly burdensome for issuers and obligated persons, due in many cases to the frequency with which credit enhancer ratings have changed in the past two years, often with no notice to issuers. If the Rule is amended to require that notice be given within ten business days after a rating change, these burdens would become substantially greater, as explained in Comment 3 above. Under both the current and proposed Rule, a change in the rating assigned to a single bond insurance company may require separate (and pointless) filings by thousands of issuers or other obligated persons.

To avoid the substantial burdens and inefficiencies that result from this requirement, NABL suggests that the Commission (1) remove rating changes from the list of specified events and (2) revise the qualifications for nationally recognized statistical rating organizations to require that they file directly with the MSRB's Electronic Municipal Market Access (EMMA) System notice of each change in their ratings assigned to municipal securities, together with identifying CUSIP numbers. NABL believes that this would establish a much more efficient and timely process for informing the market rather than doing so indirectly through the regulation of broker-dealers and ultimately relying on issuers and obligated persons, many of whom never receive notice of such rating changes.

8. Proposed new paragraphs (b)(5)(i)(C)(12) of the Rule (pertaining to notices of bankruptcy, insolvency, receivership or similar event of an obligated person) and (b)(5)(i)(C)(13) of the Rule (pertaining to notices of mergers, consolidations and acquisitions and similar events with respect to an obligated person) should be added to the Rule, but revised so that they only apply with respect to those obligated persons covered by paragraph (b)(5)(i)(A) of the Rule (*i.e.* those obligated persons for whom annual financial information or operating data is presented in the final official statement), and should further be revised or clarified to clearly be limited to events that are material.

NABL believes that timely notice of the events enumerated in the proposed paragraphs (b)(5)(i)(C)(12) and (b)(5)(i)(C)(13) should be provided to investors, if the events are limited to those with respect to obligated persons who are material to an investment in the municipal securities. However, because the events described in proposed paragraph (b)(5)(i)(C)(12) are not qualified by a materiality determination, and the events described in both paragraphs are not limited to obligated persons who are otherwise covered by (b)(5)(i)(A) of the Rule, the proposed amendments could result in obligations to provide notices with respect to events that are largely irrelevant to a decision to buy, sell or hold a particular issue of municipal securities.

For example, unless the notice events described by paragraphs (b)(5)(i)(C)(12) and (b)(5)(i)(C)(13) are limited to bankruptcies, insolvencies, receiverships, mergers, consolidations, acquisitions or similar events with respect to obligated persons who are otherwise covered by paragraph (b)(5)(i)(A) of the Rule, the issuer (or another obligated person who has undertaken to

provide the notices described in paragraph (b)(5)(i)(C)) will be required to undertake perpetual due diligence on all obligated persons, including those for whom financial information or operating data is not included in a final official statement, to determine whether any such events have occurred.[4] Under the proposed paragraphs (b)(5)(i)(C)(12) and (b)(5)(i) (C)(13), a person obligated to provide notices under paragraph (b)(5)(i)(C) (whether it be the issuer or another obligated person) will be required to (i) track the identities of all obligated persons (including those committed to make nominal payments with respect to an offering of municipal securities), and (ii) verify on a periodic basis (as often as once a week, to leave time to prepare and file a notice, if the Commission's proposed deadline for providing notices is adopted) whether those obligated persons have been the subject of any of the events specified in the proposed paragraphs. This continuous monitoring could result in an administrative burden that outweighs any potential benefit conferred upon the market. Moreover, with respect to obligated persons deemed to be immaterial to an evaluation of the municipal securities at the time of their primary offering (and for whom no information is included in the final official statement), notices of the type required by proposed paragraph (b)(5)(i)(C)(13) may lead to confusion when they are filed with the MSRB.

The efficacy of notices filed pursuant to the proposed paragraphs (b)(5)(i)(C)(12) and (b)(5)(i)(C)(13) also could be improved if each paragraph were to be qualified by inserting the phrase "if material." This change would relieve the person(s) obligated for providing notices under paragraph (b)(5)(i)(C) from the need to provide notices regarding bankruptcies, insolvencies, receiverships, mergers, consolidations, or acquisitions that are otherwise inconsequential. For instance, if an obligated person undertakes to provide the notices required by proposed paragraph (b)(5)(i)(C)(13), and such obligated person later acquires a company that is expected to account for no more than 1% of the obligated person's annual net income, a notice filing must be made to the MSRB notwithstanding the fact that the acquisition might be irrelevant to any investor's decision to buy, sell or hold an issue of municipal securities. Finally, a materiality qualifier would be especially important if the exemption currently afforded to demand securities were to be repealed. In the case of LOC-backed demand securities, events with respect to the underlying obligor often are immaterial to an investment in the securities.

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4 The determination not to include financial information or operating data about a particular obligated person in an official statement results from an analysis that such information is not material. See Rule 15c2-12(f)(3). This might occur if, for example, an obligated person is committed by contract to support payment of only a nominal amount of the debt service on an offering of municipal securities.

9. The effective date of the proposed amendments to the Rule should occur no earlier than six months after the final adoption of the amendments in order to give underwriters, brokers, dealers, and issuers more time to familiarize themselves with the new requirements and establish procedures to comply with the amended requirements. Any repeal of the exemption currently afforded to demand securities should have an even later effective date.

Because broker-dealers may not be able to sell inventory left from an underwriting after the effective date of the amendments unless the issuer or an obligated person has entered into an undertaking that complies with the Rule as amended, new forms of agreements would need to be executed or otherwise committed to four to six weeks before the effective date of the amendments. In particular, if the exemption for demand securities is repealed in part, issuers of and obligated persons would need sufficient time to establish and implement procedures and practices to address an obligation that previously did not exist for them, particularly if the Rule would apply to remarketings even when they are not accompanied by changes to the terms of the securities that would make them ineligible for the exemption from the primary disclosure provisions of the Rule.

If the exemption for LOC-backed demand securities is repealed, ordinary remarketings of demand securities are treated as primary offerings, and the official statement used in the remarketing must contain financial or operating data about the obligated persons for the demand securities (*i.e.*, persons other than the letter of credit bank), then we suggest that the Commission consider a later effective date for the proposed deletion of existing paragraph (d)(1)(iii) and addition of new paragraph (d)(5) to allow issuers, conduit borrowers, remarketing agents and other transaction participants sufficient time to modify the terms of such demand securities to satisfy the Rule, as amended. Otherwise issuers and obligated persons would be forced to restructure their indebtedness or prepare disclosure documents in a very short period of time.

10. The interpretive guidance with respect to obligations of participating underwriters set forth in Part III of the Proposing Release should be revised to clarify that a participating underwriter's obligation under Rule 15c2-12(b)(5)(i) is satisfied once that underwriter has made its "reasonable determination" that a written agreement providing for the required delivery of continuing disclosure documents is in place and, in the case of offerings that are not exempt from the primary disclosure portions of the Rule, that material breaches of prior continuing disclosure undertakings are disclosed in the final official statement.

Rule 15c2-12(b)(5)(i) requires a "participating underwriter" to "reasonably determine" that an issuer or obligated person has undertaken in a written agreement to provide the required continuing disclosure prior to the participating underwriter's purchase or sale of municipal securities in an offering. Accordingly, an underwriter needs assurance that the undertaking meeting the requirements of the Rule will be made before agreeing to act as underwriter. This assurance is typically provided through a bond purchase agreement or inducement letter in

negotiated offerings and the notice of sale or preliminary official statement in competitively bid offerings.

In addition to this requirement under the Rule, the Commission has set forth interpretations of the obligations of municipal underwriters under the antifraud provisions of the federal securities laws. Two previous releases issued in connection with the adoption of the Rule (Securities Exchange Act Release No. 26100 (September 22, 1988) (the "1988 Proposing Release") and Securities Exchange Act Release No. 26985 (June 28, 1989) (the "Rule Adoption Release" and, together with the 1988 Proposing Release, the "Rule Releases")), discussed the duty of underwriters to have a "reasonable basis" for recommending any municipal securities and, in fulfilling that obligation, their responsibility to review an issuer's or obligated person's disclosure document. The Rule Releases and the Proposing Release state that the provisions of paragraph (b) of Rule 15c2-12 are intended to assist a municipal underwriter in satisfying its reasonable basis obligations.

It is our understanding that underwriters generally satisfy these obligations by making inquiry as to whether notice filings and annual report filings have been made by the issuer or obligated person in accordance with past undertakings, reviewing the offering document to make sure that past filing failures are disclosed and, if there have been past instances of noncompliance, confirming that the issuer or obligated person has cured prior noncompliance, and has taken affirmative steps to ensure future compliance, with the requirements of past continuing disclosure undertakings.

The Proposing Release creates ambiguity with respect to an underwriter's obligation to "reasonably determine" that an undertaking is in place under Rule 15c2-12(b)(5)(i) and the general obligation of an underwriter under the applicable antifraud provisions of securities laws to have a "reasonable basis" for recommending a municipal security. In particular, the Commission casts doubt on whether "an underwriter could form a *reasonable basis* for relying on an issuer's or obligated person's ongoing disclosure representations, if such issuer or obligated person has a history of persistent and material breaches or has not remedied such past failures by the time the offering commences" (emphasis added). The Commission also suggests that the failure of an issuer or obligated person to satisfy its continuing disclosure obligations during the previous five years would make it difficult "for an underwriter to make a *reasonable determination* that the issuer or obligated would provide such information under a continuing disclosure agreement in connection with a subsequent offering" (emphasis added).

This language creates confusion by suggesting that a municipal security would not be suitable unless the issuer or an obligated person has made a reliable undertaking to make annual and event filings and that, consequently, an underwriter would have to take more aggressive steps to determine whether an issuer or obligated person has satisfied its past continuing disclosure obligations or, in the case of past noncompliance, will comply in the future. The language suggests an impossible standard of conduct. For example, although a participating underwriter can check to see if annual financial information and audited financial statements have been filed, how would an underwriter reasonably determine whether an issuer or obligated

person has, in fact, met all of its event notice filings other than through representations made by the issuer or obligated person (with the exception, of course, for those events which are in the public domain, such as rating changes)? More fundamentally, especially in the case of issuers that are subject to public open records laws, or that make available information on their internet websites, it is simply not true that an issuer's securities are not suitable without a reliable continuing disclosure undertaking. If that were the case, then most municipal securities sold before 1995 would have been unsuitable.

The 1988 Proposing Release noted that, while underwriters may not "merely rely upon formal representations by the issuer, its officials, or employees regarding the general accuracy of disclosure contained in the official statement" (emphasis added), factors indicating that an underwriter took reasonable care in an investigation of the official statement would include the extent to which the underwriter "relied upon municipal officials, employees, experts, and other persons whose duties have given them knowledge of particular facts." On the basis of this guidance, underwriters generally have relied upon specific certifications by public officials whose duties have given them knowledge of particular facts, such as previous filings made pursuant to their continuing disclosure undertakings. We believe that practice, when coupled with a review of pertinent event notice and annual report filings, is appropriate as it pertains to the issue of disclosing material breaches of prior continuing disclosure undertakings in the final official statement. Absent a reason to suspect the accuracy of the representation, underwriters may rely upon specific certifications by an issuer's officials concerning their compliance with event notice filings required by prior continuing disclosure undertakings. Moreover, if material noncompliance is detected, an underwriter has satisfied its duties under the Rule by assuring that the noncompliance is remedied and adequately disclosed, including in appropriate cases by clearly disclosing any pattern of noncompliance with prior disclosure undertakings and possible implications for future compliance.[5]

11. The Commission's estimates of costs and other regulatory impacts so greatly underestimate the likely impact of the amendments that the Commission staff should recompute and resubmit its impact estimates to the Office of Management and Budget for further review, and ideally resubmit the amendments for public comment, before the Commission considers adoption of the amendments as proposed.

The Commission substantially underestimates the additional costs that the amendment would impose on issuers, obligated persons, and broker-dealers. The Proposing Release largely fails to assess (i) the substantial additional time and expense required by issuers and other obligated persons to prepare (and for underwriters and remarketing agents to professionally review and check) disclosure about obligated persons in offerings of demand securities, unless the proposed amendments are clarified so as not to preclude offerings of LOC-backed demand

[5] NABL understands that, in very rare cases, existing MSRB rules might restrict a participating underwriter, broker or dealer from underwriting, or recommending to certain investors, the purchase of municipal securities if a material obligated person without either stable credit or publicly-accessible financial data has shown a persistent unwillingness to comply with its past continuing disclosure undertaking.

securities without primary or continuing disclosure about the underlying obligor, or (ii) the substantial expense required for issuers and other obligated persons to establish and implement procedures to ascertain and disclose events within ten business days after they occur, including the additional events.

Consider, for example, the proposed requirement to provide notice of rating changes within ten business days after they occur. In its release adopting the 1994 Rule amendments, the Commission noted that any determination of whether an event notice has been provided in a timely manner "must take into consideration the time needed to discover the occurrence of the event." Accordingly, many issuers and obligated persons have considered notices to be timely if provided promptly after they have ascertained that the event has occurred. Consequently, many issuers and obligated persons have not instituted procedures to ascertain whether events outside of their control and knowledge have occurred. They clearly would need to do so if the Rule were to require an undertaking to file within ten business days after the occurrence of an event, whether or not the event is known to them. In fact, if the Commission were to require an event notice within ten business days after the occurrence of the specified event, it would force conscientious issuers to undertake weekly diligence to determine whether an event that might not otherwise be known to them has occurred. In order to ensure compliance with event disclosure requirements, an issuer would have to check with each rating agency for any change in rating of the insurers of its bonds on at least a weekly basis (52 times a year), which on average (given three rating agencies, internet access for the issuer and appropriate training), one would expect to take at least 30 to 60 minutes per week (or 26 to 52 hours a year), simply to monitor for the occurrence of one of the specified events. Many issuers request that their counsel or financial advisors prepare event notices for filing (and, in some cases, determine whether an event notice should be filed). If the issuer were to outsource the due diligence efforts to determine whether listed events have occurred, its costs would be substantially higher. The Commission, on the other hand, includes in its cost estimates only 45 minutes of time per notice filing and no time to ascertain whether an event has occurred.

The Commission also fails to describe and, in assessing the regulatory impact, fails to take into account the substantial adverse effect that repeal of the exemption for demand securities would have on small businesses and non-profit organizations and their ability to raise capital and compete, if the proposed amendments are not clarified as we recommend. Examples of these anticipated regulatory impacts are included in Appendix A.

We believe the Commission's estimates of costs and other regulatory impacts so greatly underestimate the true impact of the amendments (unless they are revised and clarified as we recommend) that the Commission staff should recompute and resubmit its impact estimates to the Office of Management and Budget for further review, and ideally resubmit the amendments for public comment, before the Commission considers adoption of the amendments as proposed.

ATTACHMENT A

PROPOSED MODIFICATION OF THE EXEMPTION FOR DEMAND SECURITIES

This attachment provides further discussion of the issues raised in our comment letter regarding demand securities. In particular, it demonstrates that (1) the widespread offering of demand securities supported by a direct-pay letter of credit, without disclosure on the underlying credit, is an appropriate and important financing option for many small governments, small businesses and non-profit organizations, (2) there is no evidence that such offerings have damaged investors or encouraged fraud, and (3) the proposed amendments, unless clarified, would in many cases effectively preclude such offerings.

1. ***Background.*** Demand securities provide an important tool to municipal issuers, because they enable issuers to enjoy for a longer term the lower interest rates generally borne by shorter term debt securities, but without incurring the substantial issuance expenses required to satisfy state and federal tax law conditions to issuing a series of back-to-back tax-exempt short-term municipal securities. The volume of outstanding demand securities evidences that they are an important part of the investment portfolio of most tax-exempt money market funds. Any disruption of the market for demand securities would adversely affect both municipal issuers and investors.

a. ***Relevant Features.*** To qualify for the existing exemption from the Rule, demand securities must include features that in most cases make the long-term financial prospects of the issuer or other obligated persons immaterial to an investment in the securities. Owners of demand securities must have a right to put the securities for repurchase at face value or more at least once every nine months, and the most commonly offered demand securities may be put on any business day on merely seven days' notice. Moreover, the interest rate on the securities is adjusted periodically (normally as frequently as they may be put) to assure that they have a market value (and, accordingly, may be remarketed for a price) equal to face value. Finally, the demand securities are callable at face value at the option of the issuer at any time, so investors do not have any legitimate expectancy as to the term of their investments.

b. ***Liquidity and Credit Enhancement.*** In addition, demand securities are almost always supported by a liquidity facility, and often are also supported by a credit facility, each of which generally make the credit of the issuer or other obligated person less important and, in many cases, irrelevant to investors, depending on the terms of the demand securities and the type of third-party support.

Because most issuers and other obligated persons lack adequate liquid assets to be able to honor substantial puts, demand securities are generally supported by a liquidity facility issued by a well-rated commercial bank. Payment of most demand securities is made by means of a direct-pay letter of credit issued to a trustee by a highly rated commercial bank. The letter of credit may be drawn on both to pay principal of and interest on the securities in full when due and to repurchase the securities if and when they are put. The bank is committed to investors or their representative to buy put demand securities, and the bank in turn looks to the account party to retire the purchased securities over time if they cannot be remarketed. In these circumstances,

investors are interested in the short-term solvency of the obligated person but not in its long-term financial prospects. Unlike long-term credit enhanced debt securities, investors have no material term or contract risk, since demand securities are constantly re-priced to equate face and market value.

c. ***LOC-Backed Demand Securities, Including Those Offered with No Disclosure About Obligated Persons, Are Common and Important Means of Capital Formation.*** LOC-backed demand securities are often offered to investors solely on the basis of a bank's credit, with no disclosure of financial or operating data about the issuer, conduit borrower, or other obligated person. Rather, the offering document cautions investors not to rely on any ability of the obligated person to pay the securities, but rather to make their investment decision solely on the basis of the letter of credit issued by the bank.

This practice, endorsed by many thoughtful issuers, borrowers, bankers, and lawyers, reflects several important realities. First, investors are willing to purchase demand securities backed solely by the credit of the bank. Second, the creditworthiness of the obligated person generally does not affect the pricing or value of the security. Third, in some cases, an obligated person cannot responsibly provide meaningful disclosure about itself, either because it does not have audited financial statements, or because doing so would require disclosure of competitive or other confidential information (*e.g.*, merger discussions). Accordingly, obligated persons often make rational decisions to avoid the substantial expense of disclosure that the market does not require and that provides no apparent benefit.

Many small businesses, local governments, and non-profit organizations cannot make responsible disclosure about their financial condition and affairs without very substantial costs and delay. They may lack audited GAAP financial statements, or they may be involved in negotiations regarding material transactions that may not be disclosed, or they may lose a competitive advantage if their affairs are disclosed. Although these obligated persons would ordinarily borrow from commercial banks to meet their capital needs, Section 265 of the Internal Revenue Code prevents banks from buying tax-exempt securities at the lower yields offered by other investors. To obtain loans at competitive tax-exempt interest rates for eligible projects, many small governments, non-profit organizations, and businesses arrange for demand securities to be offered on the strength of a letter of credit issued by their bank (which is adequately informed about their credit) without disclosure about the obligated person in the official statement.

Contrary to the Commission's surmise, many small businesses and non-profit organizations utilize only LOC-backed demand securities in accessing the tax-exempt debt markets.[1] They have no existing undertaking to provide annual financial information. Accordingly, any new undertaking to provide such information would impose a new burden that they do not now face. As noted in section 5.b. below, any such burden would likely be imposed at least quarterly for the term of the demand securities.

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[1] The Commission notes that, because rating agencies discourage more than 20% of a governmental issuer's debt from bearing interest at a floating rate, issuers of demand securities will have already undertaken to provide annual financial information. This ignores the many non-governmental obligated persons with no prior undertakings, as well as issuers and obligated persons who use interest rate swaps and demand securities to achieve synthetic fixed rate debt.

d. *LOC-Backed Demand Securities Offered without Disclosure About Obligated Persons Are Consistent with Federal Securities Laws.* Offerings of LOC-backed demand securities without disclosure about obligated persons are not legally prohibited. In enacting the Securities Act of 1933, Congress exempted offerings of municipal securities from the Commission's authority to regulate the content of offering documents. Instead, it required only that the offering document (i) contain no material misstatements and (ii) omit to state no material facts that must be disclosed to prevent a misleading statement. When obligated person disclosure is omitted from offering documents for LOC-backed demand securities, investors are cautioned not to rely on the obligated person for payment of the securities. In addition, unlike long-term credit enhanced securities, there is no term risk, since demand securities are callable at any time and, if put or redeemed, are paid off at 100% of face amount.[2] Accordingly, as investors are urged to (and reasonably do) assume the worst about the credit of the obligated person, and as they have no term risk, the omission of disclosure about the obligated person does not result in any misleading statement that adversely affects investors. It merely leaves open the possibility that the credit for the demand securities is stronger than disclosed.

Similarly, omitting disclosure about obligated persons does not violate any MSRB rule. MSRB Rule G-17 requires that brokers, dealers, and municipal securities dealers disclose to investors in connection with transactions only material facts known to them or readily accessible from market sources. If an obligated person declines to disclose information about its affairs, that information need not be disclosed to comply with Rule G-17. MSRB Rule G-19 requires that brokers, dealers, and municipal securities dealers reasonably conclude that a municipal security is suitable before recommending it to investors. Demand securities payable from a letter of credit issued by a bank with suitable credit can reasonably be determined to be suitable for investment without recourse to information about the obligated person. Otherwise, short-term obligations issued by the bank directly could not be suitable.

When information about an obligated person is disclosed in an offering document, the issuer or other obligated person typically incurs substantial costs in preparing the disclosure, and the underwriter incurs costs of counsel (and often requires the obligated person to incur costs of accountants) in vetting the disclosure.[3] When, in offerings of LOC-backed demand securities, these costs outweigh any potential interest rate savings that would result from disclosing the obligated person's credit, selling the demand securities without disclosure about the obligated person is the appropriate course. There should be no anti-fraud concern, since investors are told not to rely on the undisclosed credit, and in that case they make their investment decision solely on the basis of their knowledge of the bank issuing the letter of credit.

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[2] This feature distinguishes demand securities from other credit-enhanced municipal securities. If a credit enhancer may accelerate the maturity of fixed rate, long-term securities due to default by the primary obligor, investors are exposed to the risk that they may be forced to reinvest the returned principal at a lower rate. The extent of this risk depends on the credit of the primary obligor. For this reason, the Commission has stated that "the presence of credit enhancements *generally* would not be a substitute for material disclosure concerning the primary obligor on municipal bonds" (emphasis added). SEC Release No. 34-26986 at n. 89. This risk is *not* present in offerings of demand securities, so the Commission's reasoning does not apply.

[3] The Commission has stated 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." SEC Release 34-26985 at n. 89.

e. ***Unless Limited, Commission Comments Will Encourage Unnecessary Disclosure About Obligated Persons in Offerings of LOC-Backed Demand Securities to the Detriment of Issuers and Broker-Dealers.*** Even though LOC-backed demand securities may be lawfully and appropriately offered to investors without disclosure about obligated persons, prior Commission and staff statements have unnecessarily discouraged some broker-dealers from underwriting offerings of such securities without such disclosure. In the Proposing Release, the Commission repeats its oft-stated comment: "The presence of credit enhancement generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds."[4] The comment is included in a note to a discussion of the need for proposed additions to required event notices, which would apply to long-term fixed-rate securities and demand securities alike, if the amendment is adopted. Accordingly, the "generally" caveat could be read to reference only credit-enhanced municipal securities that are not LOC-backed demand securities. However, unless this comment is clarified, many broker-dealers will remain reluctant to underwrite offerings of or remarket LOC-backed demand securities without disclosure about obligated persons for fear of an enforcement action by the Commission, even if the Rule is not amended to require such disclosure. Any such reluctance would result in expenditures to prepare and vet information that is not needed to make an informed investment decision, and would drive up the cost of capital for small businesses, governments, and non-profit organizations.

2. ***Is it appropriate for the Commission to revise the Rule's exemption for demand securities by proposing to apply paragraphs (b)(5) and (c) of the Rule to the offering of demand securities?*** NABL believes that the Rule should not be amended to apply continuing disclosure requirements to demand securities. The amendment is not needed, as investors in demand securities are able to protect themselves by tendering their bonds for purchase. Repealing the exemption would impose unnecessary and substantial burdens on obligated persons, underwriters, and remarketing agents. These burdens far outweigh the questionable antifraud benefits of applying the continuing disclosure requirements of the Rule to offerings of demand securities. In addition, if read to require disclosure about obligated persons in offerings of LOC-backed demand securities, the amendment would substantially and unnecessarily burden (a) small businesses, governments, and non-profit organizations (and effectively deny to many of them the benefits of tax-exempt financings) as well as (b) broker-dealers serving as underwriters and remarketing agents, who would be required by the antifraud provisions to vet the additional disclosure periodically if remarketings are treated as primary offerings, as suggested by the Proposing Release.

a. ***No Need for Amendment.*** When the Commission first adopted the Rule, in response to comment letters it correctly chose to exempt demand securities offered with minimum denominations of $100,000. In doing so, it stated that "given the sophistication of the investors and the alternative mechanisms developed by the industry to facilitate disclosure in connection with such offerings, the specific requirements of the Rule are not necessary to prevent fraud and encourage the dissemination of disclosure in the secondary market."[5] When the Commission amended the Rule in 1994 to add continuing disclosure requirements, it not only exempted large denomination demand securities from these new requirements, but also added an exemption from annual filing requirements for short-term securities (those issued with a term of

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4 Proposing Release n. 113.

5 SEC Release No. 34-26985 at n. 67.

18 months or less). The Commission stated that it was doing so "in response to comments suggesting that the rule not require annual financial information in situations where the securities would mature shortly after, or possibly even before, the annual financial information would be due."[6] The reasons for exempting demand securities from continuing disclosure requirements are as compelling today as they were in 1988 and 1994.

(i) ***Demand Securities Are Effectively (and Should Be Treated Consistently with) Short-Term Securities.*** In both adopting and amending the Rule, the Commission exempted offerings of large denomination securities with terms of nine months or less. The Commission noted that "the philosophy of the exemption is consistent with the exemption in section 3(a)(3) of the Securities Act, which exempts commercial paper with like maturities from registration requirements." In the case of demand securities, the term of an owner's investment commitment and rate risk is no greater than for commercial paper, and typically is much shorter (seven days in the case of the most commonly offered demand securities). In adopting exemptions to the Rule, the Commission sensibly made no distinction between tax-exempt commercial paper and the commercial paper mode in longer term multi-modal securities.[7] Just as an owner of tax-exempt commercial paper notes may choose either to invest in other securities, or to reinvest in rollover notes, when the notes mature (no more than nine months after purchase), an owner of demand securities can either demand repurchase at face value and reinvest in other securities, or retain the investment. Although the procedural action required to effect an investment decision may differ, the two types of securities are indistinguishable in terms of (A) the committed term of the investment, (B) the value of the security at the end of the term, and (C) the credit risk of nonpayment. Accordingly, for purposes of the Rule, there is no reason for treating demand securities differently from tax-exempt commercial paper notes. The Commission has not advocated legislative repeal of the exemption for corporate commercial paper from the registration requirements under the Securities Act, nor has it proposed a repeal of the exemption from the Rule afforded to tax-exempt commercial paper notes. Accordingly, it should not repeal the exemption afforded to demand securities.

(ii) ***Owners of Demand Securities Can Protect Themselves.*** Owners of demand securities that qualify for the current exemption may choose to terminate their investment by exercising an option to put the securities for repurchase at face value or more no less frequently than once every nine months (which is shorter than the interval at which annual financial information must be provided for non-exempt securities under the Rule). In addition, we understand that demand securities are overwhelmingly purchased by professionally managed tax-exempt money market funds, sophisticated corporations (as part of their money management programs), or high net worth individuals with access to professional investment advice.[8] Because

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6 SEC Release No. 34-34961 at n. 203.

7 "Variable rate demand notes, as well as tax-exempt commercial paper, may be a component of multi-mode offerings . . ." and "tax-exempt commercial paper with an automatic rollover feature . . . would be eligible for the exemption." SEC Release No. 34-26985, Part II.C.3.

8 In presenting municipal securities market statistics that purport to explain why it is proposing the Rule, the Commission confuses beneficial and direct ownership of securities by individuals, and it fails to disclose the portion of outstanding demand securities that are owned by individuals in either capacity. Proposing Release §I.B. The fact that individual investors beneficially own demand securities held by tax-exempt money market funds is no more relevant to the need for disclosure than is the fact of individual policy owner ownership of a mutual life insurance company's qualification to purchase securities in a private placement. Similarly, the

investment commitments in demand securities are so short, and purchasers of demand securities are typically so sophisticated, there is no need for a contractual undertaking on the part of the issuer or other obligated person to update annual financial information once a year. If investors are not voluntarily provided adequate information about those persons on whose credit an investment in the securities is evaluated, they may terminate their investment by exercising their put right. This fact was well demonstrated by recent events. When investors lost confidence in the credit afforded by letter of credit banks last year and felt inadequately informed about the credit of underlying obligors, they liquidated their investments. Similarly, if adequate information about essential credits is not provided to investors, the put securities cannot be remarketed. Issuers of demand securities have a financial incentive to provide the disclosure required by the marketplace, and investors in demand securities have means to demand adequate disclosure as a condition to their investments, notwithstanding the current exemption of demand securities from the Rule. In the minority of offerings in which payment of demand securities is not fully supported by a letter of credit, or when a pricing advantage can be gained by providing current information on the underlying obligated person (*e.g.*, by obtaining a rating upgrade for dual, uncorrelated obligors), in the experience of contributors to this letter, obligated persons generally provide periodic financial and operating data to investors on a voluntary basis. In other words, despite the Rule's exemption, disclosure is already provided when appropriate.

(iii) ***The Amendment Would Not Require Disclosure of Information Needed for Investments in LOC-Backed Demand Securities.*** In the case of LOC-backed demand securities, the letter of credit bank is often the only entity about which investors demand financial information. When the Commission amended the Rule to add continuing disclosure requirements in 1994, it expressly excluded letter of credit banks from the definition of "obligated person." The Commission does not now propose to change that exclusion. Therefore, the proposed amendments would not affect the content or frequency of disclosure provided for the obligor (the credit enhancer) whose credit is of most interest (and often the only interest) to investors.[9]

Similarly, most events for which timely notice must be given under continuing disclosure undertakings required by the Rule are not material to investors in LOC-backed demand securities, with three exceptions: substitution of credit or liquidity providers; rating changes; and adverse tax events. Due to market demand, the contributors to this letter believe that adequate information about these events is currently provided to the market, when material. First, bond documents supporting demand securities uniformly require at least advance notice (and usually repurchase of the securities) before a credit or liquidity facility supporting payment of the securities terminates or is replaced. Investors in such securities will receive notice of such an event even if the proposed amendments are not adopted. Second, due to the sophisticated nature of investors in demand securities or their advisers, and because changes in LOC-backed demand securities generally are a result of widely publicized changes in the ratings assigned to the bank,

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Commission provides statistics concerning the extent of payment defaults on municipal securities, but it does not state whether any are attributable to demand securities. *Id.* In short, it is not clear that the Commission's statistical market analysis supports the proposal to repeal (in part) the exemption afforded to demand securities.

9 The Commission implies that the significant volatility experienced by the market for demand securities in late 2008 is reason to adopt the amendment. Proposing Release at n. 33. That volatility, however, was due to a loss of confidence in the credit of letter-of-credit banks, and nothing in the amendment would affect the adequacy of disclosure about banks or other credit enhancers.

investors generally receive notice of rating changes related to LOC-backed demand securities from market sources before the issuer or other obligated persons receive notice. An undertaking by the issuer or other obligated person to give notice of rating changes would be redundant. Just as the Rule excludes disclosure about credit enhancers from required continuing disclosure undertakings due to other available market access, the Commission should not be concerned that investors rely on market sources (rather than continuing disclosure undertakings) to learn of changes in bank credit. Third, remarketings of demand securities are subject to Rule 10b-5, even if exempt from Rule 15c2-12. If events have occurred that adversely affect the tax-exempt status of demand securities, they must be disclosed to investors whenever the securities are marketed as tax-exempt, if material. If material to the offering, existing Commission rules require that events be disclosed, and as demand securities are regularly remarketed, issuers or other obligors must provide timely notice of material adverse tax events to investors. Finally, in the case of the minority of demand securities that are not LOC-backed, the market generally has demanded, and issuers and other obligated persons have agreed to provide, an undertaking to provide the same material event notices as those that are required by continuing disclosure undertakings for securities that are not exempt from the Rule. For these reasons, the amendment would not appear to be necessary to adequately inform investors in demand securities of events that are material to their investment.

b. ***The Amendment Could (But Should Not) Adversely Affect Offerings of LOC-Backed Demand Securities.*** As noted in section A.5.a. below, depending on how the amendment and existing provisions of the Rule are interpreted, the amendment (if adopted) could require that (i) financial or operating data about obligated persons be disclosed in primary offerings of LOC-backed demand securities, and (ii) each remarketing be treated as a primary offering. Each of these consequences would, at best, often result in a substantial investment of time and expense and, at worst, would prevent access to tax-exempt capital markets by small businesses and put them at a disadvantage compared to their larger competitors. If so interpreted, the amendment is unnecessary and could adversely affect the market for municipal securities and impair capital formation by small businesses.

In fact, if the amendments are intended to mandate disclosure about obligated persons in offerings of LOC-backed demand securities, the Commission should not adopt the amendments without additional Congressional authority. The Commission lacks statutory authority to regulate the content of prospectuses used to offer exempt securities, except possibly under the authority of the antifraud provisions of the federal securities laws. Because, as explained above, there is no clear need for the amendment, especially when applied to LOC-backed demand securities, there is also little, if any, effect that the amendment would have on preventing fraud in offerings of municipal securities. The antifraud benefits, if any, of the proposed amendments are not well defined. In the case of LOC-backed demand securities, the Proposing Release offers no evidence that the current exemption has resulted in fraud or harm to investors. NABL is concerned that the Commission's legal authority to adopt the proposed amendments may be subject to legal challenge, unless the amendments are clarified so as not to require disclosure about obligated persons in offerings of LOC-backed demand securities.

3. ***What are investors' and other municipal market participants' need for continuing disclosure information relating to demand securities?*** This question confuses two distinct questions: First, is the information that would be required to be provided to investors

under the amended Rule needed by them? Second, is the amendment needed to give investors access to that information? The answers to these questions are different.

To make sound investment decisions and, in many cases, to comply with Rule 2a-7, investors admittedly would often need much of the information that would be provided under the proposed continuing disclosure undertakings when they invest in some types of demand securities (*e.g.*, demand securities supported by a liquidity facility, but not credit enhancement), but (except for the information that would be provided in some event notices) not in the case of LOC-backed demand securities. In the experience of the contributors to this letter, however, when financial and operating data is needed by investors to evaluate an investment in demand securities that are not LOC-backed demand securities, obligated persons voluntarily provide the information in order to support pricing and remarketing. As investors are able to get the information concerning demand securities that they need through voluntary disclosure, and even if they do not, they are able to disinvest without loss through put features, there does not appear to be a need for the amendments, especially in a form that would require expensive undertakings to provide continuing disclosure of annual financial information (or even most event notices) concerning obligated persons in order to offer LOC-backed demand securities.

4. ***To what extent would the proposed amendment provide benefits to investors and other municipal market participants?*** If the proposed amendment would effectively require continuing disclosure by all obligated persons in offerings of credit-enhanced demand securities, it could benefit investors when the credit enhancer suffers a precipitous credit failure and, unless effectively required by the Rule, the obligated person would not have not voluntarily provided continuing disclosure about itself. These benefits, however, are too remote to justify the substantial burdens on obligated persons and broker-dealers that would result from adoption of the proposed amendment.

If the proposed amendment would effectively require continuing disclosure by all obligated persons in offerings of credit-enhanced demand securities, it would benefit investors when an obligated person has substantial credit that is independent of (*i.e.*, not correlated to) the credit of a credit enhancer and, unless effectively required by the Rule, the obligated person would not have voluntarily provided continuing disclosure about itself (*e.g.*, because it is privately held and does not wish to disclose information to competitors, or because the costs of disclosure outweigh the benefit). The Commission, however, should not by rule effectively preclude obligated persons from offering LOC-backed demand securities without disclosure about the obligated person.

Investors can be expected to benefit from notice of substitution of credit or liquidity providers, adverse tax actions, modifications to rights of securities holders, and rating changes, if material, and, except in the case of LOC-backed demand securities, would also benefit from other event notices required by the existing Rule for non-exempt offerings. In many cases, obligated persons voluntarily undertake to provide these notices in order to win market acceptance (and efficient pricing) of their demand securities, but not uniformly. Investors can also be expected to benefit from notice of changes in the trustee or, except in the case of LOC-backed demand securities, the other proposed new notice events. However, since investors are free to demand undertakings to provide these notices as a condition to purchasing or maintaining

an investment in demand securities, we question why a rule change is needed to accomplish what investors have failed to seek on their own.

5. ***How will the proposed amendment affect Participating Underwriters, issuers and obligated persons, and others?*** If the proposed amendment is interpreted to require disclosure of financial or operating data about obligated persons in offerings of LOC-backed demand securities, the amendment will impose substantial burdens on (a) obligated persons, particularly small businesses and charitable organizations, in making unnecessary disclosure and (b) participating underwriters in vetting both the undertaking and the disclosure.

a. ***The Amendment Could Require Primary and Continuing Disclosure About Obligated Persons in Offerings of LOC-Backed Demand Securities.*** The existing Rule mandates a baseline of continuing disclosure in undertakings for non-exempt offerings by requiring that underwriters (A) contract to receive a "final official statement,"[10] which must include quantitative financial and/or operating data about each obligated person material to the offering,[11] and (B) confirm that the issuer or an obligated person has undertaken to provide annually for those material obligated persons both financial statements, if audited, and "annual financial information,"[12] which is information of the same general type as the data disclosed in the "final official statement."[13] The proposed amendment is ambiguous as to whether it would mandate this same baseline of initial and continuing disclosure in offerings of demand securities.

Under the proposed amendment, underwriters would not be required to contract for or receive a final official statement in an offering of demand securities,[14] so they could underwrite the offering with no disclosure about a material obligated person in the final official statement, when doing so is not barred by the antifraud provisions (as explained in section A.2.d. above). Under the amendment, however, underwriters would be required to determine that the issuer or an obligated person has undertaken to provide audited annual financial statements, if available, and "annual financial information" for each obligated person for which quantitative financial information or operating data is presented in the "final official statement."[15] Under the proposed amendment, must there be such an undertaking (I) only for obligated persons for which quantitative financial information or operating data is presented in the official statement for the offering, if any, or (II) for each obligated person which is material to the offering, since the definition of "final official statement" requires inclusion of such quantitative data for each such person?[16] This question must be answered clearly in order to inform underwriters of their duties under the amendment, if adopted, and to evaluate the probable effect of the amendment. Under the currently effective exemptions afforded to demand securities, this issue has not been presented, because the meaning of "annual financial information" has been irrelevant to the offerings.

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10 Rule 15c2-12(b)(3).
11 Rule 15c2-12(f)(3).
12 Rule 13c2-12(b)(5)(i).
13 Rule 15c2-12(f)(9).
14 Prop. Rule 15c2-12(d)(5).
15 Rule 15c2-12(b)(i)(A), (B).
16 Rule 15c2-12(f)(3).

b. *The Amendment Could Require Quarterly or More Frequent Updating and Vetting of Disclosure About Obligated Persons in Remarketings of Demand Securities.* In the Proposing Release, the Commission states that a remarketing of demand securities "may" be a primary offering of the securities.[17] The term "primary offering" is defined by the Rule as "an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing of municipal securities."[18] The Commission staff has read the definition of "primary offering" expansively and not limited it to remarketings that result in disqualification of the securities for exemption.[19] If the amendment were to require disclosure about obligated persons in primary offerings of demand securities (by reference to the definition of "final official statement" in the definition of "annual financial information, as described in the preceding section), then obligated persons would be required not only to update such disclosure annually, but also to update it whenever it becomes materially dated or otherwise misleading, if it is to be used in remarketing demand securities to investors when they are put.

c. *Any Requirement for Initial or Continuing Disclosure About Obligated Persons Would Adversely Affect Issuers and Underwriters.* If the proposed amendment were effectively to require primary and continuing disclosure for each obligated person that is arguably material to an offering of demand securities, then many small businesses, governments, and non-profit organizations would be denied access to cost effective tax-exempt financing, and broker-dealers would have substantial new burdens in underwriting offerings of and remarketing demand securities.

(i) *Disclosure About Obligated Persons Would Be Demanded.* The proposed amendment would preclude, in many cases, LOC-backed demand securities from being offered without disclosing quantitative financial and operating data about obligated persons at least annually. Whenever an obligated person's credit is independent of the credit of the bank (which is almost always the case), and the obligated person is capable of paying principal of and interest on the demand securities, and of borrowing to purchase the securities when put, underwriters likely will be unable to conclude confidently that the obligated person is not material to an evaluation of an investment in the securities, if its credit were know to investors. As a condition to underwriting an offering of LOC-backed demand securities, in most cases underwriters would require an undertaking to update financial and operating data about the obligated person annually, even if such information is irrelevant to pricing and unnecessary to protect investors. In other words, the proposed amendment would effectively eliminate the use of LOC-backed demand securities without disclosure of financial information about obligated persons, despite the absence of any evidence that such offerings afford an opportunity for fraud in the sale of demand securities.

(ii) *Small Issuers and Other Obligated Persons Would Be Substantially Burdened.* The proposed amendment would require obligated persons in LOC-backed demand securities to incur the substantial burdens of disclosure or (when unable to meet requirements for responsible disclosure) be prevented from access to the market for tax-exempt securities altogether. Small governments, non-profit organizations, and businesses that borrow

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17 Proposing Release at n. 49.

18 Rule 15c2-12(f)(7).

19 *See* Pillsbury, Madison & Sutro, Mar. 11, 1991.

through tax-exempt industrial development bonds issued as LOC-backed demand securities would be particularly affected. Due to the relatively small size of small issue industrial development bond and other small issuer financings, the cost of responsible primary and continuing disclosure about a small business in many cases would outweigh the interest savings and effectively deny them access to tax-exempt financings available to larger, more creditworthy businesses. By using LOC-backed demand securities, small businesses are able to obtain the benefits of tax-exempt financing without the expense of disclosure that the market does not require. If denied this access to tax-exempt financing, small business would be denied an important means of capital formation. Since their larger competitors may be reporting companies that can reference IDEA filings to easily make disclosure about themselves, small businesses would be put at a competitive disadvantage, if required to disclosure their finances and affairs in offerings of tax-exempt LOC-backed demand securities.[20]

(iii) ***Broker-Dealers Would Be Substantially Burdened.*** The proposed amendment would require broker-dealers to face substantial additional burdens in offering and remarketing LOC-backed demand securities. First, an underwriter would be required either to make sufficient inquiry to determine that the obligated person is not material to an investment in the securities or, if the underwriter cannot, to review the offering document to assure that it includes financial or operating data about the obligated person. These are some of the same burdens intended to be avoided by proposed Rule 15c2-12(d)(5), which purports to exempt demand securities from the primary offering portions of the Rule. Second, underwriters would be required by the antifraud provisions of the Securities Act and Exchange Act to perform a reasonable investigation of the key representations about the obligated person in the offering document before passing it on to investors, *i.e.*, a "due diligence" investigation. Moreover, since every remarketing of a put demand security that is made on the basis of (or while investors have access to) disclosure about the obligated person, broker-dealers acting as remarketing agents may be required to repeat their investigations periodically. Third, underwriters would be required to review the continuing disclosure undertaking for sufficiency, including by comparing it to the data disclosed in the offering document to assure that it "specifies" for annual updating all data of the type included in the offering document. Since the offering materials may be supplemented over time to avoid material misstatements and misleading statements in remarketing the securities, it is likely that the continuing disclosure undertaking will have to be reviewed and possibly amended from time to time.[21] Fourth, if remarketings are primary offerings within the meaning of the Rule, as suggested in the Proposing Release, remarketing agents will be required to obtain continuing disclosure undertakings as a condition to continuing to remarket the demand securities. Since primary offerings of demand securities are exempt from the Rule, the staff's reading has had little impact. The Commission should not repeal any part of the exemption without clarifying the circumstances in which remarketings are primary offerings for purposes of the Rule.

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[20] NABL is concerned that the Commission's failure to mention this important effect as part of its required regulatory assessment might provide grounds for challenging the sufficiency of the assessment and, in turn, the proposed amendments as they pertain to obligated person disclosure in offerings of LOC-backed demand securities.

[21] The Commission correctly observed in adopting the Rule that "applying the provisions of the Rule to variable rate demand notes, or similar securities, might unnecessarily hinder the operation of the market, if underwriters were required to comply with the provisions of the Proposed Rule on each tender or reset date." SEC Release 34-26985 at n. 68.

d. *The Amendment Could Adversely Affect Liquidity for Demand Securities.* If remarketings are considered primary offerings of demand securities, and if those offerings of LOC-backed demand securities must be accompanied by disclosure of some financial or operating data about obligated persons, then broker-dealers may be unable to remarket put securities when that data cannot be responsibly disclosed (even though investors are well-informed about and would make an investment based solely on the bank's credit). In such a case, draws on the letter of credit would be required to honor puts. If the disclosure breakdown is due to an industry-wide development (*e.g.* a change in federal regulation of or payment for services provided by health or senior care facilities that makes historical results of operation no longer indicative of future financial prospects), the resulting number of draws on banks could adversely affect the liquidity of the banking system.

e. *The Commission's Regulatory Impact Assessment is Inadequate to Support Adoption of Such an Amendment.* The Commission's regulatory impact assessment fails to mention the adverse effect on capital formation and competition for small businesses, or the substantial additional costs of preparing and vetting disclosure in offerings and remarketings of LOC-backed demand securities. The Commission should not adopt the amendment without either (i) clarifying that it does not require disclosure about obligated persons in offerings of LOC-backed demand securities or (ii) recalculating and resubmitting to the Office of Management and Budget a more complete assessment of the amendment's likely impact. If obligated persons must disclose financial or operating data in primary offerings of LOC-backed demand securities, and if ordinary remarketings are treated as primary offerings, then those obligated persons will have to provide such disclosure periodically (probably at least quarterly), and remarketing agents can be expected to require 10b-5 statements from the persons' counsel and consents and agreed upon procedures letters from their outside auditors at least as frequently, in circumstances where no disclosure about such persons is presently provided (and, consequently, the very substantial costs of such procedures are avoided). These additional costs would weigh especially heavily on smaller issues by small governments, small businesses, and non-profit corporations and, in many cases, would make the costs of financing prohibitive. In those cases, an underestimated cost of the amendment would be substantially higher borrowing costs for affected obligated persons. Finally, if obligated persons must disclose financial and operating data to participants in an offering of demand securities, many will be effectively precluded from accessing the tax-exempt debt markets, and others would experience substantial increases in their net borrowing costs.

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