



# Overview of Disclosure Obligations for a Primary Offering of Municipal Securities

## Introduction<sup>1</sup>

Investors require accurate and complete information to make informed decisions about investments in municipal securities. In a primary offering of municipal securities, information is typically available in the form of an “official statement” or other offering document.<sup>2</sup> While the issuer of the municipal securities is primarily responsible for the content of the official statement, federal securities laws impose disclosure obligations and liabilities on other parties as well, depending on their role and responsibilities in the offering.

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<sup>1</sup> This is a summary of the general disclosure obligations of participants in a primary offering of municipal securities. This summary does not cover all aspects of disclosures or exceptions that might apply in certain circumstances. Please consult the resources cited herein for more information.

<sup>2</sup> In a private placement of municipal securities, the offering document may take the form of a private placement memorandum or a limited offering memorandum, for example.



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## Legal Framework and Requirements

Disclosure obligations applicable to issuers and underwriters in primary offerings of municipal securities are derived primarily from Securities Exchange Act Rule 15c2-12, on municipal securities disclosures, and MSRB Rule G-32, on disclosures in connection with primary offerings. In addition, MSRB Rule G-47, on time of trade disclosure, requires brokers, dealers and municipal securities dealers (collectively, “dealers”) in the purchase or sale of a municipal security to disclose to the client, orally or in writing, at or prior to the time of trade, all material information<sup>3</sup> known about the transaction, as well as material information about the municipal security that is reasonably accessible to the market.<sup>4</sup>

While these rules set forth the disclosure obligations related to the dissemination of information to investors, the content of the disclosure documents is subject to the anti-fraud provisions of Section 17(a) of the Securities Act of 1933 (1933 Act);<sup>5</sup> Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 (1934 Act);<sup>6</sup> and MSRB Rule G-17 on conduct of municipal securities and municipal advisory services. Rule G-17 has been interpreted to require disclosure by the dealer to the customer, at or prior to the time of trade, of all material facts about the transaction, including a complete description of the security. Rule G-47 codifies these Rule G-17 interpretations.

Municipal securities are exempt from certain sections of the 1933 Act and the 1934 Act, such as the registration and periodic reporting requirements. However, as noted above, the anti-fraud provisions of both the 1933 and the 1934 Acts apply to certain aspects of the offer, purchase and sale of a municipal security. These anti-fraud provisions prohibit any person, including municipal issuers, as well as dealers, “from making a false or misleading statement of material fact, or omitting any material fact necessary to make statements made by that person not misleading

in connection with the offer, purchase or sale of any security.”<sup>7</sup>

In addition to requirements under the 1933 and the 1934 Acts, MSRB Rule G-17, on conduct of municipal securities and municipal advisory activities, includes a general anti-fraud provision that prohibits any dealer and municipal advisor from engaging in any deceptive, dishonest or unfair practice. MSRB Rule G-17 also includes interpretive guidance concerning an underwriter’s duties to municipal issuers, including its duties in connection with the issuer’s offering documents.<sup>8</sup>

### SEC Rule 15c2-12

SEC Rule 15c2-12 prohibits a dealer from serving as an underwriter in a primary offering of municipal securities with an aggregate principal amount of \$1 million or more unless it complies with the provisions of the rule (or it or the offering is exempt from the requirements of the rule).

Prior to submitting an offer or bid to purchase or sell bonds in a primary offering, an underwriter is required to obtain and review an official statement “deemed final” by the issuer. A “deemed final” official statement is typically complete, subject to omissions for certain information, such as interest rates and aggregate principal amounts, that may only be determined at pricing. This requirement ensures that an underwriter has an opportunity to review the “deemed final” official statement and to perform the necessary inquiry and investigation required to establish the basis for recommending the security to an investor. As noted above, until a final official statement is available, the underwriter must provide the most recent preliminary official statement, if available, within one business day to any potential customer upon request.

SEC Rule 15c2-12 requires an underwriter to contract with the issuer for delivery of official statements and to deliver the official statements (and preliminary official

<sup>3</sup> Rule G-47 defines “material information” as information that has a substantial likelihood of being considered important or significant by a reasonable investor in making an investment decision.

<sup>4</sup> Rule G-47 provides guidance on information that may be material to investors. In addition, the rule indicates that the availability of information through other sources does not obviate a dealer’s obligation to make the required disclosures. A dealer does not have an obligation to disclose material information reasonably accessible to the market to its clients that are sophisticated municipal market professionals (see MSRB Rule G-48).

<sup>5</sup> 15 U.S.C §77q(a).

<sup>6</sup> 15 U.S.C. §78j(b) and 17 C.F.R. 240.10b-5.

<sup>7</sup> See Release No. 34-33741 (March 9, 1994); 59 FR 12749 (March 17, 1994).

<sup>8</sup> See Interpretive Notice Concerning the Application of MSRB Rule G-17 to Underwriters of Municipal Securities - August 2, 2012.

statements, if available and upon request) to investors at or prior to specified times. An underwriter is also prohibited from purchasing or selling the bonds until it has “reasonably determined” that the issuer (or obligated person)<sup>9</sup> has agreed to certain undertakings, such as providing to EMMA certain annual financial information and operating data, and notices about specified events, such as payment defaults and defeasances. This requirement is typically satisfied by the issuer and/or obligated person entering into a continuing disclosure agreement.<sup>10</sup> By signing the agreement, the issuer indicates it will provide disclosure in the form of an annual report and notices of any material events, as defined in Rule 15c2-12. Both disclosures must be filed on EMMA. If an issuer is deemed to be in material noncompliance with the ongoing disclosure requirements, it must indicate this point in its official statements for five years following the noncompliance.

## The Official Statement

In the context of a primary offering of municipal securities, the parties subject to disclosure obligations are those involved in preparing and/or distributing the official statement. The official statement provides information about the issuer, the securities and the project to be financed, among other things, and is the main document on which investors should be able to rely in making investment determinations. Frequently, until a final official statement is available, a “preliminary official statement” is prepared by the issuer and distributed in advance of the offering by the underwriter to potential customers.

An issuer is responsible for the content of its offering document and is subject to the general anti-fraud provisions of the securities laws.<sup>11</sup> The issuer is also subject to the general anti-fraud laws when disclosing pertinent information relating to

an offering of securities and/or underlying credit to current or prospective investors during the course of activities such as presentations in advance of an offering, conferences and one-on-one investor calls or meetings.

Before bidding on, purchasing or selling a new issue, the underwriter must obtain and review the official statement that is “deemed final” by the issuer (except for certain information typically not known until later in the process, such as interest rates, and aggregate principal amounts, that may only be determined at pricing).<sup>12</sup> Dealers acting as underwriters are subject to federal anti-fraud provisions, and other participants contributing to the preparation of the official statement may also be subject to the anti-fraud provisions and MSRB rules, depending upon their role and level of participation in the offering.<sup>13</sup>

## Underwriter Due Diligence

Underwriters of a municipal securities offering are deemed to be making an implied recommendation about the securities they are underwriting, which “... implies that the underwriter...has a reasonable basis for belief in the truthfulness and completeness of the key representations contained in any disclosure documents used in the offering.”<sup>14</sup> Prior to making a recommendation, an underwriter has a duty to investigate and ascertain the basis for the facts and the key representations and other information in an official statement prepared in connection with the issuance of municipal securities.<sup>15</sup>

An underwriter in a primary offering of municipal securities is obligated to undertake a reasonable investigation to ensure that the official statement is accurate and does not contain any material misstatements or omissions. The duty to investigate and ascertain the basis for the facts and key

<sup>9</sup> Rule 15c2-12 defines an “obligated person” as any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities). See 17 CFR 240.15c2-12(f)(10).

<sup>10</sup> SEC Rule 15c2-12 requires that the underwriter determine that the obligated person has agreed in a written agreement to be responsible for certain primary and secondary market disclosure obligations under SEC Rule 15c2-12.

<sup>11</sup> See Adoption of Final Rule 15c2-12; Release No. 34-26985 at fn.84 (June 28, 1989); 54 FR 28799 (July 10, 1989), (“Although the focus of the Commission’s Interpretation was on underwriter practices, issuers are primarily responsible for the content of their disclosure documents and may be held liable under the federal securities laws for misleading disclosure.”)

<sup>12</sup> See SEC Rule 15c2-12.

<sup>13</sup> MSRB Rule G-42 Supplementary Material Sec. 01. Duty of Care (c).

<sup>14</sup> SEC Release No. 34-26100 (September 22, 1988): Proposed Rule 15c2-12.

<sup>15</sup> See Office of Compliance Inspections and Examinations: National Examination Risk Alert, Vol. II, Issue 3 (March 19, 2012).

representations in the official statement is generally referred to as “due diligence.” The scope of the underwriter’s due diligence will depend upon the type of municipal securities being offered, the complexity and risk associated with the transaction, and the type of issuer, among other factors. An underwriter’s due diligence might include meetings with the issuer and its governing board, visits to the facility or project being financed, and a review of the issuer’s financial and governing books and records.

In addition to investigating the basis of the facts and the key representations stated in the offering document, the underwriter is required to consider the completeness of the material included in the document. This requirement is necessary to determine if other facts and circumstances should be disclosed to avoid material omissions in the information provided to the investor. Examples of this might include consideration of currently known facts that could affect the future ability of an issuer to repay the bonds when due, such as pending litigation, adverse environmental factors, adverse trends in the issuer’s tax base or revenue stream, and status of its unfunded pension liability.

The SEC has provided interpretive guidance about how underwriters may satisfy the reasonable basis standard for new offerings of municipal securities.<sup>16</sup>

### **MSRB Rule G-32 on Disclosures in Connection with Primary Offerings**

MSRB Rule G-32 sets forth disclosure requirements applicable to dealers engaged in primary offerings of municipal securities. Among other things, Rule G-32 requires the underwriter in primary offerings to submit electronically to the MSRB’s [EMMA® website](#) certain information about the offering. Note, however,

that Rule G-32 requires a dealer offering municipal securities in a primary offering to a customer — whether acting as an underwriter or otherwise — to deliver a copy of the official statement no later than the settlement of the transaction. If an official statement is not prepared, the dealer must provide a notice indicating this together with a copy of a preliminary official statement if one exists.<sup>17</sup>

Rule G-32 requires the underwriter of a primary offering to submit the official statement for the offering to EMMA within one business day after receipt of the official statement from the issuer, but by no later than the closing date. If the underwriter cannot meet this obligation, it must submit a notice indicating this on EMMA and submit the official statement to EMMA within one day of receiving it from the issuer. If the official statement is not available, by the closing date, the underwriter must submit the preliminary official statement, if available, to EMMA no later than the closing date. If a preliminary official statement has not been prepared, the underwriter must submit a notice indicating this. This rule is designed to ensure timely access to relevant information about primary offerings. While Rule G-32 obligates the underwriter in a primary offering to make certain submissions to EMMA, the issuer can voluntarily file the preliminary official statement on EMMA.

If the preliminary official statement is the disclosure document used in the primary offering of the municipal securities, the issuer must ensure there are no material misstatements or omissions therein. Any amendments to an official statement, preliminary official statement or advance refunding document submitted to EMMA must be updated by the underwriter for the primary offering within one business day after receiving the amendment from the issuer.

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<sup>16</sup> *Id.*

<sup>17</sup> The underwriter of a primary offering also is required to complete and submit Form G-32 through EMMA to provide certain data on the offering. See MSRB Rule G-32(b)(vi) for more information on this requirement.