MSRB REPORTS

Volume 14, Number 5 | Municipal Securities Rulemaking Board | December 1994

## In This Issue


- **Reporting Inter-Dealer Transactions to the Board** ..... 3
  **Amendment and Transaction Reporting Procedures Approved: Rule G-14**
- **Political Contributions and Prohibitions on Municipal Securities Business** ..... 7
  **Board Withdraws from SEC Certain Amendment and Publishes Additional Questions and Answers: Rule G-37**
- **Underwriting Assessment** ..... 9
  **Amendment Approved: Rule A-13**
- **Continuing Education Requirements** .. 11
  **Amendment Filed: Rule G-3**
- **Requiring Underwriters to Apply for Depository Eligibility of New Issues** .. 15
  **Amendment Approved: Rule G-34**
- **Letter of Interpretation** ..... 17
  **Rule G-37**
- **Recommendations Requested for Board Nominations** ..... 19
- **Recommendation Form** ..... 21
- **T+3 Brochure Available** ..... 23
- **SEC Adopts Amendments to Rules Relating to Municipal Securities Disclosure and Confirmation of Transactions** ..... 25


## Also in This Issue


- **Calendar** ..... 2
- **Staff Appointment** ..... 2
- **Board's Rules Available on C-Text** ..... 2
- **Publications List** ..... 53
- **Publications Order Form** ..... 55
- **MSRB Seminar on Recent Initiatives** .... 56


# Board Elects Drysdale Chairman; Peters Vice Chairman

The Board has elected its Chairman and Vice Chairman for its 1995 fiscal year. Mr. Robert H. Drysdale is serving as Chairman and Mr. Phillip E. Peters as Vice Chairman. They began their terms on October 1, 1994.

Mr. Drysdale is President and Chief Executive Officer of PNC Securities Corp. Prior to joining PNC Securities Corp. in 1988, he was President and Chief Executive Officer of Jesup & Lamont Securities Group, Inc. in New York City. His experience includes 10 years with Tucker Anthony & R.L. Day, Inc., where he was President and Chief Operating Officer; Blyth Eastman Dillon; and Security Pacific National Bank in Los Angeles. He received a B. S. degree in business administration from the University of Southern California.

Mr. Peters is Executive Vice President and Chief Investment Officer of Boatmen's Bancshares, Inc. He was previously associated with Mellon Bank, Pittsburgh and Citizens & Southern Corporation, Atlanta. Prior to joining Boatmen's, he was a principal with Carolina Securities Corporation, a Raleigh, N.C. based member of the NYSE. At Carolina Securities, Mr. Peters was responsible for the firm's fixed income underwriting, trading and institutional sales activities. He received an A. B. degree in economics from Dartmouth College.

## From Chairman Robert H. Drysdale

As the calendar year comes to a close, this is traditionally a time for looking forward and to the recent past. For us in the municipal securities industry it is a time to note that we have gone through many changes over the last year and that the next year will witness many additional changes. Five years from now we will look back and see that a complete transformation of this industry occurred in the mid-90's.

In the last year, the MSRB, the industry, and the SEC have addressed the need for fundamental changes in the way we do business. In the next year we will all be implementing and adapting to these changes. There are five principal areas of change; let me note what has happened and what will take place in 1995:

**1. Political Contributions** — The MSRB adopted Rule G-37 prohibiting dealers, with few exceptions, from doing busi-

*(continued on next page)*

MSRB REPORTS (SSN-0277-0911) is published by the Municipal Securities Rulemaking Board, 1150 18th Street, NW, Suite 400, Washington, DC 20036. Editor: Ronald W. Smith
POSTMASTER send address changes to MSRB, 1150 18th Street, NW, Suite 400, Washington, DC 20036. Telephone (202) 223-9347 Fax (202) 872-0347

## From Chairman Robert H. Drysdale

*(continued from front page)*

ness for two years with any issuer to whom a political contribution was made. In 1995, the MSRB will be putting out further advice on its application and considering requirements for recordkeeping and public disclosure relating to consultants used by dealers.

**2. Disclosure** — The SEC issued an interpretation of the antifraud rules in March 1994 and reinforced it with new rules requiring issuers to make disclosure of material events to the market and to furnish annual reports to market participants. In July 1995, these new rules take effect and the MSRB's Continuing Disclosure Information System is available for issuers to disclose those events that will have a significant impact on the market.

**3. Transaction Reporting and Pricing** — The MSRB amended Rule G-14 as the first step in its Transaction Reporting System, which will provide the public with actual trade information and the examination and enforcement authorities with a comprehensive surveillance and audit trail. The SEC acknowledged the MSRB's efforts by deferring action on its proposal for markup disclosure in riskless principal transactions. In January 1995, the System will begin operation using all inter-dealer trades and, by the end of 1995, including dealer-institutional customer trades.

**4. T+3 Settlement Cycle** — The MSRB, in keeping with actions taken by the SEC for corporate securities, amended its rules to require a three-day settlement cycle for municipal securities transactions. In June 1995, all securities transactions will settle in this shorter time frame.

**5. Continuing Education** — The MSRB amended its professional qualifications rule to implement a continuing education program agreed upon by all of the self-regulatory organizations in the securities industry. In July 1995, the new requirements will take effect.

These momentous changes make it imperative for all of us in this industry to take the necessary steps to make this a smooth transition. To provide the industry with information about these changes and to keep us informed of the industry's efforts, we will be holding meetings in different regions of the country to discuss these matters with you. Your active involvement in all aspects of this transformation of the industry is imperative if we are to maintain a viable and efficient municipal securities market of the highest integrity.

The recent events in Orange County, California, have also underscored the need for these changes. We must do all that we can to demonstrate that this market has and will serve the best interests of the investor. Investors deserve the opportunity to participate in a market with greater liquidity, greater disclosure, and greater efficiency.

I hope you will join me and other members of the MSRB to participate in the municipal securities industry self-regulatory structure.

Sincerely,

Robert H. Drysdale
MSRB Chairman, 1994-95

## Calendar

| | |
|---|---|
| **Nov. 9** | — Effective date of amendment to rule G-14, on reports of sales or purchases, and associated transaction reporting procedures |
| **Nov. 21** | — Effective date of amendment to rule A-13, on underwriting assessment fee |
| **Jan. 12** | — MSRB Seminar on Recent Initiatives to be held in Dallas, Texas |
| **Jan. 31** | — Due date for Form G-37 to be filed with the Board (for the period October 1, 1994 – December 31, 1994) |
| **Feb. 7** | — Effective date of amendment to rule G-34, on CUSIP numbers and dissemination of trade date information |
| **March 17** | — Due date for recommendations for Board nominations |
| **April 13** | — MSRB Seminar on Recent Initiatives to be held in New York City |
| **Pending** | — Amendments to rules G-12 and G-15 concerning T+3 settlement procedures |
| | — Amendments to rule G-37, on political contributions and prohibitions on municipal securities business, and rule G-8, on recordkeeping |
| | — Amendment to rule G-3 concerning continuing education requirements |

## Staff Appointment

Marianne I. Dunaitis has been appointed Assistant General Counsel. Ms. Dunaitis came to the Board from Jordan Coyne & Savits in Washington, D.C., where she was an Associate. She has previously served as an Attorney in the Chicago Regional Office of the Securities and Exchange Commission and as an Attorney at the Federal Trade Commission in Washington, D.C. She received her law degree from The University of Detroit School of Law, and her B.A. degree from Michigan State University.

## Board's Rules Available on C-Text

Compliance International, Inc. offers the Board's rules, certain interpretations, and publications, including *MSRB Reports*, as part of their computerized C-Text software system. For further information, contact Compliance International, Inc., 28 Bloomfield Avenue, Pine Brook, NJ 07058, telephone (201) 808-0955, fax (201) 808-0664.

The Board's rules will continue to be published in hard and soft cover editions.

Volume 14, Number 5

MSRB REPORTS

December 1994

**Notice of Approval**


**Route to:**

- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☒ Trading
- ☒ Sales
- ☒ Operations
- ☐ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

# Reporting Inter-Dealer Transactions to the Board: Rule G-14

**Amendment and Transaction Reporting Procedures Approved**

**Effective November 9, 1994, the amendment to rule G-14 approved by the Commission requires dealers to report inter-dealer transaction information to the Board or its designee, in a manner sufficiently timely and accurate so as to produce a compared trade in the automated comparison system in the initial comparison cycle. The transaction information will be used to make public reports of market activity and prices and will be made available to the regulatory agencies responsible for the enforcement of Board rules. The transaction reporting procedures designate National Securities Clearing Corporation as the Board's agent to receive inter-dealer transaction information. Dealers should ensure that their procedures for submitting inter-dealer transactions for automated comparison satisfy the new requirement for submission of transactions for trade reporting.**

On November 9, 1994, the Securities and Exchange Commission (Commission) approved an amendment to rule G-14, on reports of sales or purchases, and associated transaction reporting procedures.[1] The amendment requires brokers, dealers and municipal securities dealers (dealers) to report inter-dealer transaction information to the Board or its designee. The Commission also approved the procedures that dealers must use to report transactions, which are essentially those procedures currently used for automated comparison of inter-dealer transactions. The amendment and procedures became effective on November 9, 1994.

The collection of inter-dealer transaction information under the amendment represents the beginning of the Board's pilot program for transaction reporting, which is the first phase in the Board's four-phase plan to achieve "transparency" in the municipal securities market. Under the pilot program, aggregate data about market activity and certain volume and price information about frequently traded securities will be disseminated to promote investor confidence in the market and its pricing mechanisms. In addition, all transaction information collected will be made available to regulatory agencies responsible for enforcement of Board rules. The Board's ultimate goal is to disseminate comprehensive, contemporaneous pricing data. In the future, the Board plans to enhance the pilot transaction reporting program for inter-dealer transactions. In Phase II, the Board plans to include institutional customer transactions in the program and to collect the time of trade; in Phase III, to include retail customer transactions; and in Phase IV, to collect and disseminate transaction information on trade date.

The Board has designed the transaction reporting pilot program to provide the public with price and volume information in a way that reflects the unique aspects of the municipal securities market. In Phase I, the pilot program will make information available in the form of a daily, public report containing volume and price information about the inter-dealer market on the previous business day ("daily report"). The issues that will be reported individually each day will be those that traded at or above a threshold number of times on the previous business day. Initially the threshold will be four trades per day. As trading in an issue increases, it will be reported; as an issue's trading frequency decreases, it will be replaced by others that are trading frequently. In this way, the daily report will reflect the changing patterns of trading activity in the universe of some 1.2 million municipal securities. The Phase I pilot program also will make information on all inter-dealer trades in municipal securities available to the Commission and other regulatory agencies to assist in the inspection for compliance with and the enforcement of Board rules.

### Requirement to Report

Before the approval of the amendment to rule G-14, there was no affirmative requirement for public reporting of transactions in municipal securities. In its previous form,

**Questions about dealer transaction reporting procedures under rule G-14 may be directed to Judith A. Somerville, Uniform Practice Specialist. General questions about the pilot program for dissemination of transaction information may be directed to Larry M. Lawrence, Policy and Technology Advisor. Persons interested in subscribing to the pilot program to obtain transaction information may direct questions to Thomas A. Hutton, Director of the Municipal Securities Information Library.**

[1] *See* Securities and Exchange Act Release No. 34-34955 (November 9, 1994).

which remains unchanged under this amendment, rule G-14 required that any report by a dealer of a transaction in municipal securities represent a legitimate trade. The rule continues to require a dealer which distributes or publishes a report of a transaction in a municipal security to know or have reason to believe that the transaction was actually effected and to have no reason to believe that the transaction was fictitious or in furtherance of any fraudulent, misleading or deceptive purpose.

The rule, as amended, imposes a duty upon dealers to report inter-dealer transaction information to the Board or its designee. The rule states that such information will be used to make public reports and will be provided to the Commission, the National Association of Securities Dealers, and bank regulatory organizations charged with enforcing Board rules, *i.e.*, the Comptroller of the Currency in the case of national banks, the Board of Governors of the Federal Reserve System in the case of state member banks of the Federal Reserve System, and the Federal Deposit Insurance Corporation (FDIC) in the case of other banks insured by the FDIC.

### Reporting Procedures

Brokers, dealers and municipal securities dealers will report transactions under Rule G-14 Transaction Reporting Procedures, which are incorporated into the rule. The transaction reporting procedures designate National Securities Clearing Corporation (NSCC) as the Board's agent to receive inter-dealer transaction information. The Board and NSCC are working as partners in the collection and processing of this transaction information. NSCC is a clearing agency registered with the Commission under Section 17A of the Securities and Exchange Act (Act) and is the central facility for automated comparison processing for inter-dealer municipal securities transactions. Automated comparison is the process by which each party to an inter-dealer trade ensures that its contra-party knows the terms of the trade and will be ready to settle, on those terms, on settlement date. In general, the automated comparison process requires each dealer in a transaction to submit information on a trade (*e.g.*, price, quantity, contra-party) to a comparison system operated by a clearing agency registered with the Commission. This information is then matched (compared) by computer in the comparison system and the results reported back to each dealer.[2]

Currently, pursuant to the Board's rule G-12(f)(i), dealers must use the facilities of a registered clearing agency to compare all inter-dealer transactions in securities with CUSIP numbers. Since NSCC and all other registered clearing agencies offering municipal securities comparison services are linked by automated interfaces, it will be possible to submit transactions to NSCC for the purpose of reporting by submitting them to any such clearing agency. Accordingly, the transaction reporting procedures state that dealers may provide transaction information to NSCC or any other registered clearing agency linked with NSCC for the purpose of automated comparison. Dealers may submit transaction information directly or through an agent that is a member of the registered clearing agency.[3] Thus, under the rule as amended, dealers are not required to submit transaction data to a separate reporting system and thus should not incur additional operational costs to fulfill their reporting obligations.

With one exception, automated comparison procedures require both the purchasing and selling dealers to submit information about the trade. Thus, the reporting procedures require transaction information to be submitted by both parties. However, for transactions involving the distribution of new issue securities from a syndicate manager to syndicate members, comparison procedures require only a submission from the syndicate manager. The reporting procedures allow for the same "one-sided" submission of information for purposes of rule G-14.

The information about a transaction that is required to be reported to the Board under rule G-14 is essentially is the same information that dealers already are required to provide as part of the automated comparison process required under rule G-12(f)(i). However, historically the accrued interest on a transaction has not been required for automated comparison, but rather has been an optional data element, *i.e.*, it can be submitted, but is not required for comparison. Under the Rule G-14 Transaction Reporting Procedures, however, accrued interest becomes a mandatory submission item for all trades for which a settlement date is known. Submission of accrued interest is necessary for the Board to compute the dollar price of transactions.

### Timing and Accuracy

The Rule G-14 Transaction Reporting Procedures require dealers to submit transaction information in a manner that will produce a compared trade for the transaction *in the initial comparison cycle on the night of trade date.* In the current comparison environment, dealers generally submit required information to a registered clearing agency by the night of trade date (T). NSCC, as the central facilities provider for the comparison system, accepts this submitted data, compares the submissions of the parties on the night of T and reports the results back to the dealers on T+1. Trades that are successfully compared on T will be the basis of the daily report produced by the Board's program.[4] However, trades that are not successfully compared on the night of the trade because a dealer failed properly to submit transaction information to a registered clearing agency will not be reported on T+1, and will subject the dealer who failed to submit the transaction information to possible enforcement action for violating rule G-14. Even though an intermediary may be involved in submitting transaction information to a registered clearing agency, the primary responsibility for timely and accurate submission to produce compared trades in the initial comparison cycle continues to rest with the dealer that executed the transaction.

---

[2] For a recent discussion of the comparison system, see "Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market," *MSRB Reports,* Vol. 14, No. 2 (March 1994) (hereafter *T+3 Report)* at 7.

[3] These are the same procedures used currently to submit information for automated comparison.

[4] As noted above, both comparison procedures and reporting procedures allow for "one-sided" submission of certain transaction information. Although such submissions are technically not "compared," they will be subject to reporting.

In addition to meeting the above timeframe, the data submitted must be in the format specified by NSCC and must be accurate in all characteristics required by NSCC for matching or comparison. As an indication of the reliability of the data in the daily report, the percentage of submissions that were successfully compared in the initial cycle ("comparison rate") will be shown in each day's report. The Board has previously stated its concern about the need to increase the comparison rate to obtain improvements as a prerequisite to implementing T+3 settlement for municipal securities.[5] Toward this goal, the Board has undertaken a number of educational efforts, has facilitated a major enforcement effort with respect to rule G-12(f)(i),[6] and is taking additional steps.[7]

### Facility for Reporting

#### The Daily Report

The pilot program will make information available in the form of a daily, public report containing volume and pricing information for the inter-dealer market on the previous business day (the "daily report"). For each day of trading the daily report will include the following aggregate information about the market:

(i) total par value traded;

(ii) total number of compared transactions; and

(iii) total number of issues traded (*i.e.*, the number of different CUSIP numbers that were involved in compared transactions on that day)

The frequently traded issues to be reported individually each day will be those that traded at or above a threshold number of times on the previous business day. Initially, the threshold will be four trades per day. For each of these issues, the daily report will provide the high, low and average prices of transactions in the issue, along with total par value traded and the number of trades in the issue.[8] The pilot program also will make information on all inter-dealer trades in municipal securities available to the Commission and other regulatory agencies to assist in the inspection for compliance with, and the enforcement of, Board rules.

#### Pilot Program Subscriptions, Fees and Schedule

The Board has been working with news organizations, information vendors and others to provide the daily report information in electronic format, which these organizations would disseminate more broadly to the public, possibly with additional information that will enhance the value to information "end users." The daily public report will be available by subscription to any person, by means of a computerized "bulletin board," at an annual fee of $15,000 per year.[9] The report will also be available on paper for examination at no charge in the Board's Public Access Facility in Alexandria, Virginia.

The Board plans to make the Phase I pilot program operational for trades effected after January 1, 1995. The Board will solicit comments from subscribers to the daily report, dealers and others regarding possible enhancements to the content and format of the report.[10]

### Board Plans for Subsequent Phases of Transaction Reporting

As noted, the pilot program described above is the first of four planned phases of the transaction reporting program designed to increase transparency in the municipal securities market. During Phase I, the Board will evaluate expansion of the pilot program as experience is gained and comments on program operations are received from information users and the industry. The Board's first consideration will be how the daily report and surveillance mechanisms could be improved in Phase II by including institutional customer transaction data and information on the time of trade. During this evaluation, the Board's goal will be not only to enhance the information contained in the daily report, but also to find cost-effective methods for providing even greater levels of transparency to the market in Phases III and IV. In Phase III, the Board plans to explore ways to include retail customer transactions in the scope of transaction reporting. Finally, in Phase IV, the Board will seek to disseminate transaction price information on a more contemporaneous basis than is possible today. The Board plans to complete Phase II by the end of 1995, Phase III by the end of 1996, and Phase IV in the first part of 1997.

**December 6, 1994**

## Text of Amendment and Procedures*

### Rule G-14 Reports of Sales or Purchases

(a) No ~~municipal securities~~ broker, dealer or municipal securities dealer or person associated with a ~~municipal securities~~ broker, dealer or municipal securities dealer shall distribute or publish, or cause to be distributed or published, any report of a purchase or sale of municipal securities, unless such ~~municipal securities~~ broker, dealer or municipal securities dealer or associated person knows or has reason to believe that the purchase or sale was actually effected and has no reason to believe that the reported transaction is fictitious or in furtherance of any fraudulent, deceptive or manipulative purpose. For purposes of this rule, the terms

[5] *See T+3 Report* at 7-8.

[6] *See* "Enforcement Initiative: Rule G-12," *MSRB Reports,* Vol. 14, No. 2 (March 1994) at 19 and "Enforcement Initiative," *MSRB Reports,* Vol. 14, No. 3 (June 1994) at 35.

[7] For example, the Board held a meeting on December 5, 1994 with representatives of dealers in the New York City area to discuss rule G-14 and the need for more timely submission of transaction data to the clearance and settlement systems to accommodate rule G-14 and the movement to T+3 settlement.

[8] The average prices (but not the high and low prices) will be calculated based upon those trades in a "band" of $100,000 to $1 million par value. The prices and par values of individual transactions will not be included in the daily report.

[9] The Board has filed the fee schedule for the pilot program with the Commission (File No. SR-MSRB-94-18).

[10] A Transaction Reporting Users Group has been established, which will provide its views to the Board about technical program operations and other potential program enhancements.

* Underlining indicates additions; strikethrough indicates deletions.

"distributed" or "published" shall mean the dissemination of a report by any means of communication.

(b) Each broker, dealer or municipal securities dealer shall report to the Board or its designee information about its transactions in municipal securities with other brokers, dealers or municipal securities dealers using the formats and within the timeframes specified in Rule G-14 Transaction Reporting Procedures. Transaction information collected by the Board under this rule will be used to make public reports of market activity and prices and will be made available by the Board to the Commission, securities associations registered under Section 15A of the Act and other appropriate regulatory agencies defined in Section 3(a)(34)(A) of the Act to assist in the inspection for compliance with and the enforcement of Board rules.

**Rule G-14 Transaction Reporting Procedures**

(a) *Inter-Dealer Transactions.*

(i) Except as described in paragraph (ii) of this section (a), each broker, dealer and municipal securities dealer shall report all transactions with other brokers, dealers or municipal securities dealers to the Board's designee for receiving such transaction information. The Board has designated National Securities Clearing Corporation (NSCC) for this purpose. A broker, dealer or municipal securities dealer shall report a transaction by submitting or causing to be submitted to NSCC information in such format and within such timeframe as required by NSCC to produce a compared trade for the transaction in the initial comparison cycle on the night of trade date in the automated comparison system operated by NSCC. Such transaction information may be submitted to NSCC directly or to another registered clearing agency linked for the purpose of automated comparison with NSCC. The broker, dealer or municipal securities dealer may employ an agent that is a member of NSCC or a registered clearing agency for the purpose of submitting transaction information; however, the primary responsibility for timely and accurate submission continues to rest with the broker, dealer or municipal securities dealer that executed the transaction. If the settlement date of a transaction is known by the broker, dealer or municipal securities dealer, the report made to NSCC also shall include a value for accrued interest in the format prescribed by NSCC.

(ii) A transaction that is not eligible to be compared in the automated comparison system operated by NSCC (because of the lack of a CUSIP number for the security or other reasons) shall not be required to be reported under this section (a). A transaction that is subject to a "one-sided" submission procedure in the automated comparison system operated by NSCC shall be reported only by the broker, dealer or municipal securities dealer that is required to submit the transaction information under the one-sided submission procedure.


**Route to:**

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

# Political Contributions and Prohibitions on Municipal Securities Business: Rule G-37

## Board Withdraws from SEC Certain Amendment and Publishes Additional Questions and Answers

**The Board has withdrawn the proposed amendment to rule G-37 which would have exempted retail sales persons from the definition of municipal finance professional. In addition, the Board is publishing additional answers to frequently asked questions concerning rule G-37.**

On August 18, 1994, the Board filed with the SEC for approval amendments to rule G-37 on political contributions and prohibitions on municipal securities business (the "August 1994 amendments"). The amendments would: (i) revise the definition of municipal finance professional to exclude retail sales persons and to clarify which supervisors are subject to the rule; (ii) state a period of time for retaining the designation as a municipal finance professional; (iii) revise the reporting requirements with respect to political parties to require disclosure of all payments (including contributions) to political parties; and (iv) revise the definition of issuer to delete issuers of separate securities.[1] On November 9, the Board withdrew the proposed amendment which would have exempted retail sales persons from the definition of municipal finance professional. The remaining amendments are still pending before the SEC. The Board also has determined to publish a third set of questions and answers (Q's & A's) in order to facilitate dealer compliance with rule G-37.

### Description of Proposed Exemption of Retail Sales Persons from Definition of Municipal Finance Professional

Rule G-37(g)(iv)(A) currently defines municipal finance professional to include any associated person primarily engaged in municipal securities representative activities (as that term is defined in rule G-3(a)(i)). The proposed amendment would have exempted from this definition those sales representatives primarily engaged in retail sales. The Board adopted this amendment in response to many dealers who expressed confusion over which sales representatives fall within the definition of "municipal finance professional" based upon whether they were "primarily engaged in" municipal securities representative activities.

### Basis for Board's Withdrawal of Proposed Exemption

In light of concerns expressed by the dealer community, including letters received by the SEC in response to its request for comment on the Board's August 1994 amendments, the Board has determined to withdraw the proposed exemption of retail sales persons from the definition of municipal finance professional. Certain dealers believe that retail sales persons often are used to solicit municipal business and make contributions on behalf of their firms. These dealers are concerned that the proposed exemption would create an opportunity for circumvention of rule G-37, whereby firms could use retail sales persons as conduits to make unrestricted and unreportable contributions. The Board does not believe that the proposed exemption would have created an opportunity for circumvention of the rule; rule G-37(d) prohibits dealers and municipal finance professionals from using other people or entities as conduits to circumvent or otherwise violate the rule. Also, rule G-37(g)(iv)(B) provides that the definition of "municipal finance professional" includes any associated person who solicits municipal securities business. However, the Board was concerned that effective compliance with rule G-37 could have been undermined by the perception that the exemption would have created an opportunity for circumvention of the letter or spirit of the rule.

Certain dealers, while expressing support for the exemption, also asked the Board to offer additional guidance on rule G-37, including providing a definition of the term "primarily engaged in" municipal securities representative activities. The Board has determined not to provide a specific definition of this term. The Board believes that, pursuant to the definition of municipal finance professional set forth in rule G-37(g)(iv)(A), dealers should be able to determine whether any of their associated persons are primarily engaged in

**Questions about this notice may be directed to Jill C. Finder, Assistant General Counsel.**

[1] File No. SR-MSRB-94-14. For a complete description of these amendments, refer to the filing or *MSRB Reports*, Vol. 14, No. 4 (August 1994) at 27-31.

municipal representative activities and thus qualify as municipal finance professionals.[2] The Board also has determined to provide further guidance on rule G-37 by publishing Q's & A's which focus on those provisions of the rule relating to solicitation of municipal business and the proscription of indirect activities that may result in violations of the rule.

### Additional Rule G-37 Questions & Answers[3]

**1.**

***Q: Many retail sales persons in larger firms may not be "primarily engaged in" municipal securities representative activities and thus may not fall within that portion of the definition of municipal finance professional. However, if these sales persons solicit municipal securities business, would they be subject to rule G-37?***

**A:** Yes. Rule G-37(g)(iv) defines a municipal finance professional to include, among others, any associated person who solicits municipal securities business. If a retail sales person solicits municipal securities business, then that person becomes a municipal finance professional. Any contributions by such persons made to an issuer official may subject the dealer to the two-year prohibition on business with that issuer.

**2.**

***Q: What constitutes "solicitation" of municipal securities business?***

**A:** Solicitation activities may include, but are not limited to, responding to issuer Requests for Proposals, making presentations of public finance and/or municipal securities marketing capabilities to issuer officials, and engaging in other activities calculated to appeal to issuer officials for municipal securities business, or which effectively do so.

**3.**

***Q: Has a "solicitation" occurred if a retail sales person receives a "finder's fee" for bringing municipal securities business to the dealer?***

**A:** If a retail sales person receives a "finder's fee" for bringing municipal securities business to the dealer, then there should be a presumption that the sales person solicited municipal business from an issuer official. In such situations, the sales person becomes a municipal finance professional and any contributions made by that person to an issuer official may subject the dealer to the two-year prohibition on business with that issuer.

**4.**

***Q: Is a "finder's fee" solely cash compensation?***

**A:** No. Such compensation, for example, may take the form of: (i) an unusually large allocation of bonds to a particular sales person; (ii) sales credits; or (iii) any other kind of remuneration.

**5.**

***Q: If a municipal finance professional directs a retail sales person (who is not a municipal finance professional) to make a political contribution to an issuer official, would this trigger the rule's two-year prohibition on business with that issuer?***

**A:** Yes. Section (d) of the rule prohibits municipal finance professionals (and dealers) from using any person or means to do, directly or indirectly, any act which would violate the rule. In other words, a municipal finance professional is prohibited from using a sales person (or any other person not otherwise subject to the rule) as a conduit to circumvent the rule. Thus, contributions made, directly or indirectly, by a municipal finance professional (or a dealer) to an issuer official will subject the dealer to the rule's two-year prohibition on municipal securities business with that issuer. In addition to triggering the prohibition, the municipal finance professional in this case has violated section (d) of the rule.

**6.**

***Q: If a dealer hires an individual as a retail sales person, would the contributions made by that person prior to being hired subject the dealer to the two-year prohibition on municipal securities business?***

**A:** The rule's two-year prohibition is triggered by contributions by dealers, municipal finance professionals, and political action committees controlled by a dealer or a municipal finance professional. If a retail sales person is not a municipal finance professional and does not become a municipal finance professional within two years after making a contribution to an issuer official, then such contributions will not trigger the ban on business. However, if the retail sales person is, or within two years becomes, a municipal finance professional, then contributions made by that person will subject the hiring dealer to the two-year ban on business. For additional guidance in this area, please refer to the Q's & A's numbered 14 through 16 published in the June 1994 issue of *MSRB Reports*.

**7.**

***Q: Rule G-8 requires dealers to record all issuers with which the dealer has engaged in municipal securities business. The term "issuer" includes the issuer of a separate security as defined in SEC Rule 3b-5(a) under the Act. In the context of industrial revenue bond issues, for example, the issuer of a separate security is a private corporation, not a government entity. Must we record these "issuers"?***

**A:** No. Such private corporations, which are not an agency or instrumentality of a state or any political subdivision, need not be recorded. Of course, dealers are required to record the governmental issuer in these situations, for both taxable and tax-exempt municipal securities.

**December 7, 1994**

---

[2] Dealers should be aware that an associated person who is not "primarily engaged in" municipal representative activities still could be a municipal finance professional under rule G-37(g)(iv)(B), (C) or (D).

[3] The Board published two previous notices containing answers to frequently asked questions to rule G-37. These notices are contained in *MSRB Reports*, Vol. 14, No. 3 (June 1994) at 11-16, and Vol. 14, No. 4 (August 1994) at 27-31.

**Notice of Approval**


**Route to:**

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

# Underwriting Assessment: Rule A-13

### Amendment Approved

**The amendment prohibits dealers from charging or otherwise passing through to issuers the fees required under rule A-13.**

On October 13, 1994, the Securities and Exchange Commission (SEC) approved an amendment to rule A-13, on underwriting assessments.[1] The amendment prohibits dealers from charging or otherwise passing through to issuers the fees required under that rule. The amendment will become effective on November 21, 1994 and it will apply to contracts that are concluded on or after that date.

### Background and Summary of Amendments

To provide revenues for its operation and administration, the Board imposes three types of fees on brokers, dealers and municipal securities dealers (dealers). The Board charges an initial fee of $100 and an annual fee of $100 under rules A-12 and A-14, respectively. In addition, rule A-13 requires each dealer to pay to the Board a fee based upon the dealer's participation in "primary offerings" of municipal securities (A-13 fees)[2] and rule A-13 fees provide the bulk of Board revenues.

The amount of rule A-13 fees owed is based upon the par value of the dealer's participation in primary offerings.[3] No obligation to pay a rule A-13 fee is generated by participation in the following types of primary offerings: (i) those composed exclusively of securities less than nine months in maturity; (ii) offerings under $1 million in par value; and (iii) "limited placement" offerings, as described in subsection (c)(1) of Exchange Act Rule 15c2-12.[4]

Rule A-13 states that, if a syndicate or similar account is formed for the purpose of purchasing securities from an issuer, the managing underwriter is responsible to pay the assessment fee on behalf of each participant in the syndicate. Payment by the managing underwriter, rather than by individual syndicate members, is solely an administrative convenience for underwriters and the Board. The Board invoices managing underwriters monthly for rule A-13 fees, based upon information filed with the Board under rule G-36 on delivery of official statements to the Board.

Rule A-13 is intended to provide a dealer assessment that roughly reflects each dealer's involvement in the municipal securities market. In adopting rule A-13 in 1976, the Board recognized that participation in new issue offerings was not a perfect means to measure a dealer's involvement in the market because the assessment would not, among other things, reflect secondary market transactions and activity.[5] However, after looking at alternative assessment mechanisms and methods of establishing accounts receivable available at that time, the Board concluded that a fee based

**Questions about the amendment may be directed to Christopher A. Taylor, Executive Director.**

---

[1] SEC Release No. 34-34840.

[2] As used in rule A-13, "primary offering" is defined as in Exchange Act Rule 15c2-12 on municipal securities disclosure. Thus, a dealer's obligation under rule A-13 is triggered by its participation in the offering of municipal securities by or on behalf of an issuer, whether the dealer is purchasing the securities directly (*i.e.*, is acting as underwriter) or is acting as an agent in placing the securities with investors. The obligation of a dealer to deliver an official statement to the Board under Board rule G-36 also is based upon the dealer's participation in a "primary offering." Consistent use of the concept of "primary offering" in rules A-13 and G-36 has created substantial administrative efficiencies for the Board by allowing A-13 fee invoicing to be accomplished in an automated manner with data collected under rule G-36.

[3] Currently, the assessment under rule A-13 is $.03 per $1,000 par value for offerings containing securities two years or more in maturity. If the longest maturity in an offering is over nine months but less than two years, the assessment is $.01 per $1,000 par value of the issue. For purposes of calculating the assessment, a put option date is treated the same as a maturity date, *e.g.*, a primary offering of a security with a put option of one year would generate an assessment at the $.01 rate.

[4] These kinds of primary offerings are defined as those that are sold to no more than 35 persons each of whom the underwriter reasonably believes (i) has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the prospective investment and (ii) is not purchasing for more than one account or with a view to distributing the securities.

[5] This point was discussed in the Board's December 12, 1975, exposure draft of rule A-13.

on underwriting participation was the best available means to create verifiable assessments generally reflecting a dealer's involvement in the market.

The Board is aware that, in negotiated underwritings, the subject of rule A-13 fees sometimes is raised in the context of discussions of expenses to be paid by the issuer of the securities. The Board believes that it is misleading for underwriters to characterize rule A-13 fees in this fashion. Since rule A-13 fees are assessments on dealers for the operation of the Board, the Board believes that a dealer's obligation under rule A-13 should not be charged or otherwise passed through to an issuer as an expense to the issuer of bringing a new issue to market. In this respect, the fees paid to the Board by dealers under rule A-13 should be characterized by dealers to issuers no differently than the annual fees paid to the Board under rule A-14 and any other "overhead" expenses that are incurred by virtue of the dealer engaging in municipal securities business. The amendment states that dealers may not charge or otherwise pass through rule A-13 fees to issuers.

**October 13, 1994**

## Text of Amendment*

**Rule A-13. Underwriting Assessment for Brokers, Dealers and Municipal Securities Dealers**

(a) - (d) No change.

(e) *Prohibition on Charging Fees Required Under this Rule To Issuers.* No broker, dealer or municipal securities dealer shall charge or otherwise pass through the fee required under this rule to an issuer of municipal securities.

* Underlining indicates new language.

Volume 14, Number 5

MSRB REPORTS

December 1994


**Route to:**

- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☐ Public Finance
- ☒ Compliance
- ☒ Training
- ☐ Other

# Continuing Education Requirements: Rule G-3

### Amendment Filed

**The Board has filed an amendment to rule G-3 on professional qualifications to adopt enabling rules for the implementation of a continuing education program for the securities industry.**

On December 9, 1994, the Board filed with the Securities and Exchange Commission (SEC) an amendment to rule G-3 on professional qualifications.[1] The purpose of the amendment is to adopt enabling rules for the implementation of a continuing education program for the securities industry. The Board requested that the requirements of the Regulatory Element become effective on July 1, 1995, and the requirements of the Firm Element be implemented in two steps under which dealers will be required to have completed their Firm Element plans by July, 1995, with actual implementation of the plans no later than January, 1996.

### Background

In May 1993, a task force was formed by the Board and five other self-regulatory organizations (*i.e.*, the American Stock Exchange, the Chicago Board Options Exchange, the National Association of Securities Dealers, the New York Stock Exchange and the Philadelphia Stock Exchange (collectively, the "SROs")) which included twelve representatives from a wide range of broker-dealers to study the continuing education needs of the securities industry. In September 1993, the Task Force issued a report recommending a formal two part continuing education program which would require uniform industry-wide periodic training in regulatory matters, and ongoing training programs conducted by firms to keep their employees updated on job and product-related subjects. The Task Force also recommended that a permanent Council on Continuing Education composed of broker-dealer and SRO representatives be formed to develop the content and provide ongoing maintenance of the continuing education program. The Securities Industry/Regulatory Council on Continuing Education (the "Council") was formed in September, 1993 with representatives from six SROs and thirteen broker-dealers.

The proposed amendment codifies the Task Force's recommendations, enables implementation of the continuing education program and provides a means for the Board to monitor and the enforcement agencies to enforce the program's requirements.

### Summary of Amendment

The proposed amendment is divided into two parts: one for the Regulatory Element; the other, for the Firm Element. The Regulatory Element proposal defines the need for registered persons to comply with the requirement, the persons subject to the requirement and when the computer-based training sessions must be attended during the first 10 years of a person's registration. It establishes a grandfather provision for those persons who have been registered for more than 10 years, including those persons who go through the program and achieve 10 years of experience in the industry. The proposed amendment also establishes the consequences of failure to complete a required computer-based training session. In that event, a person's registration becomes inactive and such person cannot conduct a securities business on behalf of the dealer until the requirement is met. The proposed amendment further establishes the conditions under which a person, who would otherwise be exempt from the Regulatory Element, would be required to re-enter the program for another 10 year period. Such re-entry would be occasioned by a person becoming subject to a statutory disqualification as defined by the Securities Exchange Act of 1934; if an individual's registration is suspended by an SRO or other securities regulator; or if a securities regulatory authority imposes a fine of $5,000 or more for a securities violation. For a person registered less than 10 years, any of these events would also result in the re-initiation of the 10 year Regulatory Element requirement. Finally, the proposed rule change provides the

**Questions about the proposed amendment may be directed to Ronald W. Smith, Legal Associate, or Loretta J. Rollins, Professional Qualifications Administrator.**

[1] File No. SR-MSRB-94-17. Comments filed with the SEC should refer to the file number.

option to the SEC, an SRO, the appropriate enforcement authority or any state securities regulator to require re-entry into the program as a condition of continued registration. The proposed amendment also contains definitional language regarding a "registered person" and the interaction between the continuing education cycle and the termination period of up to two years during which individuals may re-enter the industry without the need to requalify by examination.

The Firm Element proposal identifies the persons subject to the requirement. Unlike the Regulatory Element, where all persons registered during their first 10 years are covered, the Firm Element is limited to those persons who have direct contact with customers, be they institutional, retail or investment banking customers of the dealer. In addition, the immediate supervisors of such persons are also covered by the Firm Element. The Firm Element requires dealers to establish a training process and identifies certain minimum requirements associated with that process. First, at least annually, the dealer must develop a training plan after a detailed analysis of its training needs. The proposed rule change contains a number of factors which dealers must take into consideration when conducting their analyses and in developing their training plans. The proposed rule change requires dealers to implement their training plans and to maintain records showing both the content of the training programs and the completion of the programs by the covered associated persons targeted in the training plan. Persons in the firm who are subject to the training plan are required by the proposed rule change to participate in the programs identified by the dealer. The proposed amendment also establishes certain minimum standards for the training programs that are utilized in the plan. Such programs, when dealing with investment products and strategies, must identify their investment features and associated risk factors, their suitability in various investment situations and applicable regulatory requirements that directly affect the product or strategy. Finally, the proposed amendment provides authority to the SROs to require dealers either individually or as part of a group to provide specific training to cover associated persons in any area the SROs deem necessary in the public interest. Depending on the issue of concern, these requirements could be targeted at specific individuals or portions of a dealer, a specific dealer or group of dealers, or across the entire industry. As the program evolves, the Council and the SROs intend to develop curricula for the content for various product and service training programs.

Examiners from the enforcement agencies, during the course of regular field examinations, will review dealers' continuing education programs for compliance with the rules.

**Summary of Comments and Discussion**

In August 1994, the Board solicited comments on the amendments in an exposure draft and received five comment letters.[2]

One commentator stated that its dealer department is a two-person operation and the proposed Firm Element is an unreasonable burden to be placed on such a small operation. The Firm Element Committee of the Council is developing materials for dealers' use in devising and carrying out training programs to meet the requirements of the Firm Element. The Committee intends to incorporate "samples" of how different firms might approach the requirements (*e.g.*, firms that deal with one product, small firms, and firms with large numbers of very small offices or solo representatives). The Board believes this future guidance will assuage the concerns of smaller firms as to the burden of compliance with this requirement.

One commentator, a municipal securities broker's broker, asked whether it will be subject to the Firm Element requirements. The Firm Element is applicable to all persons who conduct business with retail, institutional or investment banking customers of the dealer and the immediate supervisors of such persons. The Firm Element is not applicable to dealers who deal only with other brokers and dealers.

One commentator stated that the Board has not shown that a continuing education program is needed in the industry. Another commentator expressed similar concerns. The Task Force formed by the securities industry to study the issue of continuing education and develop recommendations concluded that the industry would be well served by a uniform continuing education program. The Board believes that a formal industry-wide continuing education program to keep professionals up to date on products, markets, and rules will be beneficial to the municipal securities industry.

Another commentator raised the following issues: (i) the status of "inactive" personnel when they have not completed the Regulatory Element; (ii) the ability of the SEC, SROs, bank regulatory agencies or state securities agencies to direct an individual to re-enter the Regulatory Element; (iii) the need for information concerning the performance of registered persons in the Regulatory Element; and (iv) recordkeeping and record retention with regard to the administration of the Firm Element. The proposed amendment has been revised to clarify the consequences of a registration becoming inactive for a period in excess of two years. Essentially, a registered person who allows this to happen would have the registration administratively terminated and such person would be required to requalify on an entry level examination before the registration could be reactivated. In addition, the proposed amendment has been revised to clarify that re-entry into the Regulatory Element could be triggered as a result of an order by the SEC, any securities SRO, the appropriate enforcement authority or any state securities agency only as a result of a sanction in a formal disciplinary action. This change should address concern about the potential for due process issues to arise if such orders were issued arbitrarily by the regulatory authorities. The remaining issues are not specific to the Board or the municipal securities industry and will be reviewed by the Council in its ongoing discussions and evaluations of the program.

The Board also received two inquiries from bank dealers concerning the planned procedure for the NASD's Central Registration Depository (CRD) system to track and

[2] *MSRB Reports*, Vol. 14, No. 4 (August 1994) at 11-13. The comment letters are available for inspection at the Board's offices.

communicate an individual's registration anniversary date for use with the Regulatory Element.[3] Bank dealer personnel are not registered on the CRD system. The staff has discussed this notification matter on an informal basis with the bank regulatory agencies and they have stated that they will probably require banks to put procedures into place for internal tracking of anniversary dates.

**December 9, 1994**

## Text of Proposed Amendment*

**Rule G-3. Classification of Principals and Representatives; Numerical Requirements; Testing; Continuing Education Requirements**

No broker, dealer or municipal securities dealer or person who is a municipal securities representative, municipal securities principal, municipal securities sales principal or financial and operations principal (as hereafter defined) shall be qualified for purposes of rule G-2 unless such broker, dealer or municipal securities dealer or person meets the requirements of this rule.

(a) - (g) No change.

(h) Continuing Education Requirements

This section (h) prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with a registered securities association with respect to a person associated with a member of such association, or the appropriate regulatory agency as defined in section 3(a)(34) of the Act with respect to a person associated with any other broker, dealer or municipal securities dealer ("the appropriate enforcement authority"). The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

(i) Regulatory Element

(A) Requirements—No broker, dealer or municipal securities dealer shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person, unless such person has complied with the requirements of section (i) hereof.

(1) Each registered person shall complete the Regulatory Element on three occasions, after the occurrence of their second, fifth and tenth registration anniversary dates, or as otherwise prescribed by the Board. On each of the three occasions, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. The content of the Regulatory Element shall be prescribed by the Board.

(2) Registered persons who have been continuously registered for more than 10 years as of the effective date of this section shall be exempt from participation in the Regulatory Element, provided such persons have not been subject to any disciplinary action within the last 10 years as enumerated in paragraphs (i)(C)(1)-(2) of this section. In the event of such disciplinary action, a person will be required to satisfy the requirements of the Regulatory Element by participation for the period from the effective date of this section to 10 years after the occurrence of the disciplinary action.

(3) Persons who have been currently registered for 10 years or less as of the effective date of this section shall initially participate in the Regulatory Element within 120 days after the occurrence of the second, fifth or tenth registration anniversary date, whichever anniversary date first applies, and on the applicable registration anniversary date(s) thereafter. Such persons will have satisfied the requirements of the Regulatory Element after participation on the tenth registration anniversary.

(4) All registered persons who have satisfied the requirements of the Regulatory Element shall be exempt from further participation in the Regulatory Element, subject to re-entry into the program as set forth in paragraph (i)(C) of this section.

(B) Failure to Complete—Unless otherwise determined by the Board, any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive until such time as the requirements of the program have been satisfied. Any person whose registration has been deemed inactive under this section shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration. A registration that is inactive for a period of two years will be administratively terminated. A person whose registration is so terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of this rule. The appropriate enforcement authority may, upon application and a showing of good cause, allow for additional time for a registered person to satisfy the program requirements.

(C) Re-entry into Program—Unless otherwise determined by the appropriate enforcement authority, a registered person will be required to re-enter the Regulatory Element and satisfy the program's requirements in their entirety commencing with initial participation within 120 days of a disciplinary action becoming final, and on three additional occasions thereafter, at two, five and 10 years after re-entry, notwithstanding that such person has completed all or part of the program requirements

[3] Under the proposed amendment, every person registered for 10 years or less will be covered by the Regulatory Element and will be required to participate in computer-based training on regulatory matters within 120 calendar days after their second, fifth and tenth anniversaries of initial registration as a securities professional.

* Underlining indicates new language.

based on length of time as a registered person or completion of 10 years of participation in the program, whenever the registered person has been:

(1) subject to any statutory disqualification as defined in Section 3(a)(39) of the Securities Exchange Act of 1934;

(2) subject to suspension or to the imposition of a fine of $5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, the appropriate enforcement authority, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(3) ordered as a sanction in a disciplinary action to re-enter the continuing education program by the Securities and Exchange Commission, any securities self-regulatory organization, the appropriate enforcement authority or any state securities agency.

(D) Any registered person who has terminated association with a broker, dealer or municipal securities dealer and who has, within two years of the date of termination, become reassociated in a registered capacity with a broker, dealer or municipal securities dealer shall participate in the Regulatory Element at such intervals (two, five and 10 years) that may apply based on the initial registration anniversary date rather than based on the date of reassociation in a registered capacity.

(E) Definition of registered person—For purposes of this section, the term "registered person" means any person registered with the appropriate enforcement authority as a municipal securities representative, municipal securities principal, municipal securities sales principal or financial and operations principal pursuant to this rule.

(ii) Firm Element

(A) Persons Subject to the Firm Element—The requirements of this section shall apply to any person registered with a broker, dealer or municipal securities dealer who has direct contact with customers in the conduct of the broker, dealer or municipal securities dealer's securities sales, trading and investment banking activities, and to the immediate supervisors of such persons (collectively, "covered registered persons"). "Customer" shall mean any natural person and any organization, other than another broker, dealer or municipal securities dealer, executing securities transactions with or through or receiving investment banking services from a broker, dealer or municipal securities dealer.

(B) Standards for the Firm Element

(1) Each broker, dealer and municipal securities dealer must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. At a minimum, each broker, dealer and municipal securities dealer shall at least annually evaluate and prioritize its training needs and develop a written training plan. The plan must take into consideration the broker, dealer and municipal securities dealer's size, organizational structure, and scope of business activities, as well as regulatory developments and the performance of covered registered persons in the Regulatory Element.

(2) Minimum Standards for Training Programs—Programs used to implement a broker, dealer or municipal securities dealer's training plan must be appropriate for the business of the broker, dealer or municipal securities dealer and, at a minimum must cover the following matters concerning securities products, services and strategies offered by the broker, dealer or municipal securities dealer:

(a) General investment features and associated risk factors;

(b) Suitability and sales practice considerations;

(c) Applicable regulatory requirements.

(3) Administration of Continuing Education Program—A broker, dealer or municipal securities dealer must administer its continuing education programs in accordance with its annual evaluation and written plan and must maintain records documenting the content of the programs and completion of the programs by covered registered persons.

(C) Participation in the Firm Element—Covered registered persons included in a broker, dealer or municipal securities dealer's plan must take all appropriate and reasonable steps to participate in continuing education programs as required by the broker, dealer or municipal securities dealer.

(D) Specific Training Requirements—The appropriate enforcement authority may require a broker, dealer or municipal securities dealer, individually or as part of a larger group, to provide specific training to its covered registered persons in such areas the appropriate enforcement authority deems appropriate. Such a requirement may stipulate the class of covered registered persons for which it is applicable, the time period in which the requirement must be satisfied and, where appropriate, the actual training content.

**Notice of Approval**


**Route to:**

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☒ Trading
- ☒ Sales
- ☒ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

# Requiring Underwriters to Apply for Depository Eligibility of New Issues: Rule G-34

**Amendment Approved**

**The amendment requires dealers to apply for depository eligibility within one business day of the date of sale of a new issue municipal security.**

On December 9, 1994 the Securities and Exchange Commission (Commission) approved an amendment to rule G-34 on depository eligibility.[1] The amendment requires dealers to apply for depository eligibility within one business day of the date of sale of a new issue municipal security.[2] The amendment exempts from its requirements: (i) issues not meeting the eligibility criteria of a securities depository; and (ii) issues maturing in 60 days or less. It also provides a temporary exemption, until July 1, 1996, for issues under $1 million in par value. The effective date of the amendment has been set for February 7, 1995.

In October 1993, the Commission adopted Securities Exchange Act Rule 15c6-1 which mandates three business days as the regular-way settlement cycle effective June 1, 1995. The Commission at that time asked the Board to develop a plan for implementing T+3 settlement within the municipal securities market to maintain consistency in the settlement cycle for municipal and corporate securities. In March of this year the Board provided the Commission with its *Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market* (T+3 Report). The T+3 Report detailed changes in operational practices and regulatory actions that would be needed in a T+3 environment for municipal securities. The T+3 Report noted the Board's belief that to ensure timely settlements of institutional customer and inter-dealer transactions in a T+3 environment, it would be necessary to minimize the use of physical securities certificates to settle such transactions.

In 1993, the Board amended rules G-12(f)(ii) and G-15(d)(iii) to require essentially all inter-dealer and institutional customer transactions to be settled by book-entry when the securities involved in the transactions are listed as eligible for deposit in a depository. The amendment to rule G-34 will help to ensure that new issue securities are made depository eligible at the time of issuance by ensuring that underwriters apply to depositories to establish eligibility as soon as possible in the underwriting process. Once the depository makes a new issue eligible, it will be subject to the book-entry delivery requirements of rules G-12(f)(ii) and G-15(d)(iii).

**December 9, 1994**

## Text of Amendment*

**G-34. CUSIP Numbers, ~~and~~ Dissemination of Initial Trade Date Information and Depository Eligibility**

(a) New Issue Securities.

(i)-(ii) No change.

(iii) Application for Depository Eligibility.

(A) Except as otherwise provided in this subparagraph (iii), each broker, dealer or municipal securities dealer who acquires, whether as principal or agent, a new issue of municipal securities from the issuer of such securities for the purpose of distributing such new issue shall apply to a securities depository registered with the Securities and Exchange Commission, in accordance with the rules and procedures of such depository, to make such new issue depository-eligible. The application required by this subparagraph (A) shall be made as promptly as possible, but in no event later than one business day after award from the issuer (in the case of a competitive sale) or one business day after the execution of the contract to purchase the securities from the issuer (in the case of a negotiated sale). In the event that the full documentation and information

**Questions about the amendment may be directed to Judith A. Somerville, Uniform Practice Specialist.**

[1] SEC Release 34-35079.

[2] For competitively sold issues, the date of award from the issuer is considered the date of sale. For negotiated issues, the date of execution of the contract to purchase the securities from the issuer is considered the date of sale.

* Underlining indicates new language; strikethrough denotes deletions.

required to establish depository eligibility is not available at the time the initial application is submitted to the depository, the broker, dealer or municipal securities dealer shall forward such documentation as soon as it is available.

(B) Subparagraph (iii)(A) of this rule shall not apply to an issue of municipal securities that fails to meet the criteria for depository eligibility at all depositories that accept municipal securities for deposit.

(C) Subparagraph (iii)(A) of this rule shall not apply to any new issue maturing in 60 days or less.

(D) Subparagraph (iii)(A) of this rule, shall not apply to any new issue that is less than $1 million in par value, *provided however,* that this exemption shall expire July 1, 1996.

(iv) Underwriting Syndicate. In the event a syndicate or similar account has been formed for the purchase of a new issue of municipal securities, the managing underwriter shall take the actions required under the provisions of this rule.

(b)-(c) No Change.

(d) CUSIP Number Eligibility. The provisions of this rule shall not apply to an issue of municipal securities (or for the purposes of section (b) any part of an outstanding maturity of an issue) which does not meet the eligibility criteria for CUSIP number assignment.


**Route to:**

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

## Letter of Interpretation

**Rule G-37. Political contributions and prohibitions on municipal securities business**

This is in response to your letter dated September 29, 1994 regarding rule G-37, on political contributions and prohibitions on municipal securities business. You review a situation regarding a municipal finance professional's participation in a fundraising event for a certain state official. You seek guidance on two matters. First, you inquire whether the activities of the municipal finance professional in connection with this fundraiser constitute a violation of the solicitation prohibition in rule G-37(c). Second, you inquire that, if a violation of rule G-37(c) occurred, would such violation subject your firm to a two-year ban on municipal securities business with the state. The Board has reviewed your letter and authorized this response.

Rule G-37 (b) prohibits dealers from engaging in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (i) the dealer; (ii) any municipal finance professional associated with such dealer; or (iii) any political action committee controlled by the dealer or municipal finance professional.[1] Rule G-37(c) provides that no dealer or any municipal finance professional shall solicit any person or political action committee to make any contribution, or shall coordinate any contributions, to an official of an issuer with which the dealer is engaging or is seeking to engage in municipal securities business.

With regard to your first inquiry, the Board is not the appropriate authority to determine whether in this instance the municipal finance professional's activities amounted to a solicitation of contributions in violation of rule G-37(c). While the Board has authority to adopt rules concerning transactions in municipal securities effected by brokers, dealers and municipal securities dealers, it has no enforcement authority over dealers; that authority is vested with the National Association of Securities Dealers, Inc. (NASD) for securities firms. Whether a particular activity should be characterized as a solicitation of a contribution and a violation of the rule is fact specific, and further inquiry and investigation may be appropriate prior to a determination of violation. The Board believes that it is more appropriate for the NASD to make such inquiries and determinations. Your letter has been forwarded to the NASD for its review.

The Board believes, however, that if a dealer's or a municipal finance professional's name appears on fundraising literature for an issuer official for which the dealer is engaging or seeking to engage in municipal securities business, there is a presumption that such activity is a solicitation by the named party.

With regard to your second inquiry, a violation of rule G-37(c) does not trigger a two-year ban on engaging in municipal securities business with an issuer. If the NASD finds a violation of rule G-37(c) has occurred, the NASD will determine the appropriate sanction.

Finally, rule G-27, on supervision, requires each dealer to adopt, maintain and enforce written supervisory procedures reasonably designed to ensure compliance with Board rules, including rule G-37. In view of the significant penalties associated with rule G-37, including a two-year ban on municipal securities business with an issuer in certain cases, effective compliance procedures are essential. We recognize that some dealers may focus their compliance procedures on the areas in the rule concerning certain political contributions. Rule G-37 has other important provisions, however, such as the prohibition against certain solicitations and the recordkeeping and reporting requirements. Given the situation presented in your letter, your firm may wish to review its procedures to determine whether they are sufficient to ensure compliance with all provisions of rule G-37.

*MSRB Interpretation of November 7, 1994.*

[1] The prohibition does not apply if the only contributions to officials of issuers are made by municipal finance professionals entitled to vote for such officials, and provided, such contributions, in total, are not in excess of $250 by each such municipal finance professional to each official of such issuer, per election.


**Route to:**

- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☐ Trading
- ☐ Sales
- ☐ Operations
- ☐ Public Finance
- ☐ Compliance
- ☐ Training
- ☐ Other

# Recommendations Requested for Board Nominations

The 1995 Nominating Committee requests recommendations of persons to be considered for five Board positions opening on October 1, 1995.

## Membership Requirements

The Board, established by Congress in 1975 to act as the primary rulemaking body for the municipal securities industry, consists of 15 members—five representatives of bank dealers, five representatives of securities firms and five public members. One public member must represent issuers and one investors. Public members may not be associated with a securities firm or bank dealer other than by reason of being under common control with, or directly controlling, any broker or dealer which is not a municipal securities broker or municipal securities dealer.

When making recommendations, keep these Board membership requirements in mind:

- One securities firm representative, two public representatives and two bank dealer representatives must be elected this year to ensure equal representation in each category;
- Municipal securities dealers of diverse size and type must be represented; and
- Wide geographic representation must be maintained.

## Procedure for Recommending Candidates

1. Complete the form printed on page 21 or a photocopy of that form. (Additional forms may be obtained from the Board's offices). The following information must be included on the form:
   - The name, business affiliation, business address and telephone number, home address and telephone number and category (bank dealer, securities firm or public representative) of the individual recommended. (Item 1)
   - The educational and professional background of the individual recommended. (Item 2)
   - The proposer's name, business address, telephone number and professional relationship (if any) to the individual recommended. (Item 3)
   - The affiliation (if any) of the individual with any broker, dealer or municipal securities dealer. (Item 4)
2. Determine in advance that the individual recommended is willing to serve on the Board.
3. Submit recommendations no later than March 17, 1995 to:

Phillip E. Peters
Chairman, Nominating Committee
Municipal Securities Rulemaking Board
1150 18th Street, NW Suite 400
Washington, DC 20036

# Terms of Present Board Members

## Terms Expire September 30, 1995

**David C. Clapp**, Partner
Goldman, Sachs & Co.
New York, New York

**Robert H. Drysdale**, President and Chief Executive Officer
PNC Securities Corp.
Pittsburgh, Pennsylvania

**Frederick W. Gaertner**, Vice President
The Chubb Corporation
Warren, New Jersey

**Walter K. Knorr**, City Comptroller
City of Chicago
Chicago, Illinois

**Phillip E. Peters**, Chief Investment Officer
Boatmen's Bancshares, Inc.
St. Louis, Missouri

## Terms Expire September 30, 1996

**Alan Appelbaum**, Partner
Cleary, Gottlieb, Steen & Hamilton
New York, New York

**Alice W. Handy**, Treasurer
University of Virginia
Charlottesville, Virginia

**Edward J. Reinoso**, President
Reinoso & Company, Incorporated
New York, New York

**Andrew F. Rowley**, Managing Director
Morgan Stanley & Co., Inc.
New York, New York

**Anthony J. Taddey**, Senior Vice President and Director
Municipal Securities Group
BA Securities, Inc.
Los Angeles, California

## Terms Expire September 30, 1997

**Aimee S. Brown**, Principal
Artemis Capital Group, Inc.
San Francisco, California

**Roger G. Hayes**, Managing Director
NationsBanc Capital Markets, Inc.
Charlotte, North Carolina

**John S. McCune,** President
Norwest Investment Services, Inc.
Minneapolis, Minnesota

**Charles D. Mires,** Assistant Vice President, Manager
Municipal Bond Division
Allstate Insurance Company
Northbrook, Illinois

**Robert A. Vanosky,** Executive Vice President and
Co-Manager, Fixed Income Department
Rauscher Pierce Refsnes, Inc.
Dallas, Texas

# Recommendation Form

1. Individual Recommended: _____

Business Address: _____

_____

_____

Telephone Number: _____

Home Address: _____

_____

_____

Telephone Number: _____

Category: ☐ Bank Dealer Representative ☐ Securities Firm Representative ☐ Public Member

2. Educational and Professional Background

Professional: _____

_____

_____

Educational: _____

_____

_____

Associations: _____

_____

_____

3. Proposer: _____

_____

_____

4. Associated Person under Securities Exchange Act of 1934: _____

_____

_____


**Route to:**

- ☒ Manager, Muni Dept.
- ☐ Underwriting
- ☒ Trading
- ☒ Sales
- ☒ Operations
- ☐ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

## T+3 Brochure Available

As outlined in the *Report of the Municipal Securities Rulemaking Board on T+3 Settlement for the Municipal Securities Market,* the Board believes that dealers should concentrate on educational outreach to retail customers to prepare for the move to T+3 settlement in June 1995.[1] The Board understands that the Securities Industry Association (SIA) has designed a T+3 brochure that discusses the compression of the settlement cycle from five to three business days. The brochure explains that customers will need to pay for securities transactions purchases in this shorter time frame. Customers also are encouraged to contact their account representative to inquire about how this change will affect the way they purchase and sell securities.

The SIA has agreed to make their T+3 brochure, entitled *Shortening of the Settlement Cycle,* available to municipal securities dealers. The brochure is designed in a one-page flyer format which may be included as a statement stuffer. Interested dealers may contact Phyllis Cassar of the SIA at (212) 618-0570 for information on how to receive a supply of the brochures.

[1] *See MSRB Reports*, Vol. 14, No. 2 (March 1994) at 13.


**Route to:**

- ☒ Manager, Muni Dept.
- ☒ Underwriting
- ☒ Trading
- ☒ Sales
- ☒ Operations
- ☒ Public Finance
- ☒ Compliance
- ☐ Training
- ☐ Other

# SEC Adopts Amendments to Rules Relating to Municipal Securities Disclosure and Confirmation of Transactions

On November 10, 1994, the SEC adopted amendments to SEC Rules 15c2-12, on municipal securities disclosure, and 10b-10, on confirmation of transactions. The Board is reprinting the adopting release of the SEC Rule 15c2-12 amendments and portions of the adopting release of the SEC Rule 10b-10 amendments.

The amendments to SEC Rule 15c2-12 prohibit a dealer ("Participating Underwriter") from purchasing or selling municipal securities unless the Participating Underwriter has reasonably determined that an issuer of municipal securities or an obligated person has undertaken in a written agreement or contract for the benefit of holders of such securities to provide certain annual financial information and event notices to various information repositories; and prohibit a dealer from recommending the purchase or sale of a municipal security unless it has procedures in place that provide reasonable assurance that it will receive promptly any event notices with respect to that security.

Dealers should note the various effective and compliance dates of the amendments to SEC Rule 15c2-12 stated in the release.

The amendments to SEC Rule 10b-10 require dealers to provide customers written notification of certain information relevant to their securities transactions. While Rule 10b-10 does not apply to transactions in municipal securities, the Board is reprinting certain portions of the notice dealing with SEC action regarding its proposed Rule 15c2-13 regarding disclosure of mark-ups in riskless principal municipal securities transactions and whether a municipal security is not rated by a nationally recognized statistical rating organization.

---

**SECURITIES AND EXCHANGE COMMISSION**
**17 CFR Part 240**
**Release No. 34-34961; File No. S7-5-94**
**RIN 3235-AG13**
**Municipal Securities Disclosure**

**AGENCY**: Securities and Exchange Commission.

**ACTION**: Final Rule.

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

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

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

**FOR FURTHER INFORMATION CONTACT**: Catherine McGuire, Chief Counsel, Janet W. Russell-Hunter, Attorney, or Paula R. Jenson, Senior Counsel (concerning the rule and release generally), (202) 942-0073, Office of Chief Counsel, Division of Market Regulation, Mail Stop 7-10; Gautam S. Gujral, Attorney (concerning information repositories) (202) 942-0175, Office of Market Supervision, Division of Market Regulation, Mail Stop 5-1, and David A. Sirignano, Senior Legal Adviser to the Director (202) 942-2870, or Amy Meltzer Starr, Attorney (concerning annual financial information, obligated persons, and material events generally), (202) 942-1875, Division of Corporation Finance, Mail Stop 7-6 Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

**SUPPLEMENTARY INFORMATION:**

**I. Introduction and Summary**

The Commission has long been concerned with disclosure in both the primary and secondary markets for municipal securities.[1] As part of the Securities Acts Amendments of 1975, Congress established a limited regulatory scheme for the municipal securities market. This limited regulatory scheme included mandatory registration of municipal securities brokers and dealers, and the creation of the Municipal Securities Rulemaking Board ("MSRB"). In 1989, acting in response to consistently slow dissemination of information in connection with primary offerings of municipal securities, the Commission, pursuant to its authority under Exchange Act Section 15(c)(2),[2] adopted Rule 15c2-12[3] and an accompanying interpretation concerning the due diligence obligations of underwriters of municipal securities.[4] In 1993, the Commission's Division of Market Regulation conducted a comprehensive review of many aspects of the municipal securities market, including secondary market disclosure.[5] Findings in the September, 1993 *Staff Report on the Municipal Securities Market* ("*Staff Report*") regarding the growing participation of individual investors, who may not be sophisticated in financial matters, as well as the proliferation of complex derivative municipal securities, underscored the need for improved disclosure practices in both the primary and secondary municipal securities markets.[6] Information about the issuer and other obligated persons is as critical to the secondary market,[7] where little information about municipal issuers and obligated persons is regularly disseminated, as it is in primary offerings, where, as a general matter, good disclosure practices exist. As one industry group testified, today "secondary market information is difficult to come by even for professional municipal analysts, to say nothing of retail investors."[8]

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

---

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

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

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

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

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

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

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

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

*Others* ("Interpretive Release"),[9] which outlined its views with respect to the disclosure obligations of market participants under the antifraud provisions of the federal securities laws in connection with both primary and secondary market disclosure.

Concurrent with the publication of the Interpretive Release, the Commission published Securities Exchange Act Release No. 33742 ("Proposing Release"),[10] which requested comment on amendments to Rule 15c2-12 ("Proposed Amendments") designed to enhance the quality, timing, and dissemination of disclosure in the municipal securities market by placing certain requirements on brokers, dealers, and municipal securities dealers. In proposing the amendments, the Commission intended to further deter fraud by preventing the underwriting and recommendation of transactions in municipal securities about which little or no current information exists. Brokers, dealers, and municipal securities dealers serve as the link between the issuers whose securities they sell and the investors to whom they recommend securities. Investors, especially individual investors, place their reliance on these securities professionals for their recommendations of municipal securities.

The amendments to Rule 15c2-12 ensure that brokers, dealers, and municipal securities dealers will review the secondary market disclosure practices of issuers and other obligated persons at the time of an offering of municipal securities.[13] This scrutiny at the time of initial issuance of municipal securities will result in the dissemination of important information by issuers and other obligated persons throughout the term of the municipal securities. As a result of the amendments, brokers, dealers, and municipal securities dealers will be better able to satisfy their obligation under the federal securities laws to have a reasonable basis on which to recommend municipal securities, as well as their obligations under the rules of the MSRB.

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

In the Proposing Release, comment was requested on each aspect of the Proposed Amendments, as well as on standards for recognition of nationally recognized municipal securities information repositories ("NRMSIRs"). In response to the request for comments, the Commission received over 390 comment letters representing over 475 groups and individuals. The commenters represented all types of participants in the municipal securities market, including issuers, underwriters, investors, counsel, analysts, financial advisers, banks, insurance providers, disclosure services, and the MSRB.[14] The comment letters presented a variety of thoughtful views on the issues raised by the Proposing Release.[15] The Commission has determined to adopt amendments to Rule 15c2-12, with certain modifications that are designed to address concerns expressed by commenters.[16] In addition, the suggestions of a group of industry participants that cooperated to assist the Commission in its efforts to improve disclosure in the municipal securities market have been valuable.[17]

Commenters across a broad range of market participants supported the goal of improved secondary market disclosure for the municipal securities market, but emphasized that flexibility is necessary, given the diversity that exists in the municipal securities market.[18] As adopted, the amendments to Rule 15c2-12 will further that goal by prohibiting underwritings unless there are commitments to provide ongoing disclosure, while, at the same time, providing issuers with significant flexibility to determine the appropriate nature of that disclosure. The amendments retain the requirement that a Participating Underwriter ascertain that an issuer or obligated person has undertaken to provide secondary market disclosure, including notices of material events, to

---

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

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

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

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

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

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

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

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

information repositories, but rely on the parties to the transaction to establish who will provide secondary market disclosure, and what information is material to an understanding of the security being offered.

The amendments build upon and reinforce current market practices that have provided, as a general matter, good quality disclosure in official statements, and extend those practices to the secondary market. As is currently the practice, under the amendments, the participants in an underwriting would continue to determine which persons are material to an understanding of the Offering. Information concerning those persons would be included in the final official statement. Financial information and operating data that is material to an offering at the outset generally remains material throughout the life of the securities. Under the amendments, that information would be provided on an annual basis. Put simply, the amendments reflect the belief that purchasers in the secondary market need the same level of financial information and operating data in making investment decisions as purchasers in the underwritten offering.

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

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

## II. Description of Amendments to Rule 15c2-12

### A. Amendments with Respect to the Underwriting of Municipal Securities

Under the amendments to Rule 15c2-12, a broker, dealer, or municipal securities dealer ("Participating Underwriter")[19] will be prohibited, subject to certain exemptions, from purchasing or selling municipal securities in connection with a primary offering of municipal securities with an aggregate principal amount of $1,000,000 or more ("Offering"),[20] unless the Participating Underwriter has made certain determinations.[21] Specifically, the Participating Underwriter must reasonably determine that an issuer of municipal securities or an obligated person, either individually or in combination with other issuers of such municipal securities or other obligated persons,[22] has undertaken in a written agreement or contract for the benefit of holders of such securities, to provide, either directly or indirectly through an indenture trustee or a designated agent, certain annual financial information and event notices to various information repositories.[23]

The "reasonable determination" required by the amendments to Rule 15c2-12 must be made by the Participating Underwriter prior to its purchasing or selling municipal securities in connection with an Offering. A Participating Underwriter would, therefore, need to receive assurances from the issuer or obligated persons that such undertakings would be made before agreeing to act as an underwriter. A dealer could look to provisions in the underwriting agreement or bond purchase agreement that describe the undertakings for the benefit of bondholders made elsewhere, such as in a trust indenture, bond resolution, or separate written agreement.[24] In a competitively bid offering, such assurances also might be found in a notice of sale. Of course, representations concerning commitments to provide secondary market disclosure, like any other key representations by an issuer, are subject to specific verification, such that a Participating Underwriter has a reasonable basis to believe that such representations are true and accurate. Thus, investigation of an issuer's or obligated person's undertakings to provide secondary market disclosure would be an element of the Participating Underwriter's professional review of offering documents.[25]

Because the amendments prohibit Participating Underwriters from purchasing or selling securities in the absence of undertakings in a written agreement or contract, such agreement or contract would have to be in place at the time the issuer delivers the securities to the Participating Underwriter.[26] As discussed below, in conditioning the closing of an Offering on the

---

[19] *See* Rule 15c2-12(a).

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

[21] Rule 15c2-12(b)(5)(i).

[22] These concepts are discussed in Section II.A.1.b., *infra*.

[23] Information repositories are discussed in Section II.C., *infra*.

[24] *See* Letter of Merrill Lynch, Pierce, Fenner & Smith ("Merrill Lynch").

[25] As noted in the 1988 Release, the obligations of managing underwriters and underwriters participating in an offering differ. An underwriter participating in an offering need not duplicate the efforts of the managing underwriter, but must satisfy itself that the managing underwriter reviewed the accuracy of the information in the official statement in a professional manner and therefore had a reasonable basis for its recommendation. Underwriters participating in offerings, however, have a duty to notify the managing underwriter of any factors that suggest inaccuracies in disclosure, or signal the need for additional investigation. *See* 1988 Release at n. 87.

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

existence of an agreement or contract, this provision of the amendments permits flexibility as to where undertakings for continuing disclosure are memorialized.[27]

The amendments to the definition of final official statement will affect the obligations of Participating Underwriters under Rule 15c2-12. Rule 15c2-12(b)(1) requires that a Participating Underwriter, prior to bidding for, purchasing, offering, or selling municipal securities, obtain and review a DFOS.[28] The Commission expects that Participating Underwriters will review the DFOS with a view to ascertaining that it contains information satisfying the definition of final official statement in Rule 15c2-12.[29] The Commission further expects that the quality of disclosure in the DFOS will improve in a manner that is commensurate with the changes in final official statement disclosure.[30]

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

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

Under the amendments as adopted, the financial information and operational data to be provided on an annual basis pursuant to the undertaking will mirror the financial information and operating data contained in the final official statement with respect to both the issuers and obligated persons that will be the subject of the ongoing disclosure, and the type of information provided. The amendments govern the core financial and operational data to be provided. It does not address the textual disclosure typically provided in annual reports, leaving the scope of that disclosure to market practice.[31] To clarify the intended quantitative focus of the rule, as adopted, the rule uses the term "financial information and operating data."

**a. The Starting Point — Definition of Final Official Statement**

**(1) Information Concerning Persons Material to an Evaluation of the Offering**

The Proposed Amendments would have revised the definition of final official statement to require that financial and operating information, including audited annual financial statements, regarding the issuer and any significant obligor be included in order to provide a fair presentation of the issuer's and significant obligor's financial condition, results of operations, and cash flow.

Commenters objected to various aspects of the proposed definition, including the general requirement that financial and operating information be presented in the final official statement.[32] Commenters also objected that the use of the term "the issuer," in specifying whose financial information should be included in the final official statement, failed to take into account a variety of situations in which the governmental issuer does not have any repayment obligations on the municipal securities (as with conduit issuers), as well as other situations (such as revenue bonds) in which the payments will be derived from entities, enterprises, funds and accounts that do not prepare separate financial statements. Some commenters took the position that in certain instances, inclusion of the financial statements of the general municipal issuer of which the enterprise is a part may be misleading.[33]

---

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

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

[29] Whether information is in fact known or not reasonably ascertainable at the time the Participating Underwriter must obtain and review the DFOS pursuant to the rule is best determined in the context of each offering by the issuer, the Participating Underwriter, and their respective counsel. *See* Public Securities Association (May 29, 1992)

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

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

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

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

In view of these comments, the definition of final official statement has been revised to require that financial information and operating data be provided for those persons, entities, enterprises, funds, and accounts that are material to an evaluation of the offering.[34] Thus, the definition eliminates the reference to "the" issuer. In addition, the definition no longer requires that the official statement provide information about specific "significant obligors." It leaves to the parties (including the issuer and Participating Underwriters) the determination of whose financial information is material to the offering (including, without limitation, the credit supporting the securities being offered).

The definition does not set its own form and content requirements on the financial information and operating data to be included; in particular, the proposed requirement for audited financial statements has not been adopted. Instead, it provides the flexibility that many commenters asserted is necessary in determining the content and scope of the disclosed financial information and operating data, given the diversity among types of issuers, types of issues, and sources of repayment.[35]

The fact that the amendments rely on the final official statement to set the standard for ongoing disclosure should not serve as an incentive for issuers to reduce existing disclosure practices in the preparation of the final official statement. Market discipline and regulatory requirements should ensure that those practices continue at current or improved levels. While issuers remain primarily responsible for the content and accuracy of their disclosures,[36] as noted, Participating Underwriters must review the DFOS in a manner consistent with their obligations.

As the Commission recognized in the Interpretive Release,[37] the extensive voluntary guidelines issued by the Government Finance Officers' Association, and the industry specific guidelines published by industry groups such as the National Federation of Municipal Analysts, are followed widely in the preparation of official statements.[38] The Commission anticipates that such sound practices will continue and develop beyond that mandated by the amendments. Although those guidelines are not mandatory, the Commission encourages market participants to continue to refer to those voluntary guidelines and the Commission's Interpretive Release in preparing disclosure documents. In addition, as noted in the Interpretive Release,[39] final official statements are subject to the prohibition against false or misleading statements of material facts, including the omission of material facts necessary to make the statements made, in light of the circumstances in which they are made, not misleading.

**(2) Use of Cross References to Publicly Available Information**

The Proposing Release requested comment on the appropriateness of satisfying disclosure needs through a reference to other externally prepared and located documents. In response, a number of commenters stated that the concept of incorporation of information should be explicitly included in the rule,[40] and that the ability to incorporate information should not be conditioned on a minimum dollar amount of securities in the hands of the public—commonly known as "public float."[41] Some commenters also suggested that any limitation of this practice to "seasoned issuers" should include all investment grade issuers.[42] Some commenters further noted that the final official statement should not have to set forth information that has been filed with the Commission in accordance with its periodic reporting requirements.[43] The commenters suggested one significant prerequisite for permitting cross referencing—the availability of the information in some public repository.[44]

The definition of final official statement has been revised to make explicit[45] that a final official statement may include financial information and operating data either by setting forth the information in the document or set of documents composing the final official statement, or by including a specific reference to documents already prepared and previously made publicly available.[46] For purposes of the amendments, documents will be considered to be publicly available if they have been submitted to each NRMSIR and to the appropriate state information depository or, if the information concerns a reporting company, filed with the Commission. If the document is a final official statement, it must be available from the MSRB.

If cross referencing is used, for purposes of determining the appropriate scope of the ongoing information undertaking, the

---

[34] *See* Rule 15c2-12(f)(3).

[35] *See, e.g.*, Letter of Association of Local Housing Financing Agencies ("ALHFA"); Letter of Treasurer, State of Connecticut Office of the Treasurer ("Treasurer of the State of Connecticut"); Letter of Council of Development Finance Agencies ("CDFA"); Joint Response; Letter of Securities Industry Association ("SIA"); Letter of Morgan Stanley & Co., Inc. ("Morgan Stanley").

[36] *See* 1989 Release.

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

[38] *See* note 31, *supra*.

[39] *See* Interpretive Release at Section III.A.

[40] *See* Joint Response.

[41] *See* Letter of ABA Urban Law Section; Letter of Bose McKinney & Evans; Joint Response; Letter of Mudge Rose Guthrie Alexander & Ferdon ("Mudge Rose"); Letter of Dormitory Authority of the State of New York ("New York Dormitory Authority").

[42] *See* Letter of Mudge Rose; Letter of New York Dormitory Authority.

[43] *See* Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of Texas Public Finance Authority.

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

[45] *See* 1989 Release (discussing the definition of "final official statement" in Rule 15c2-12 as originally adopted, and stating that the definition recognizes that the issuer's final official statement may be composed of one or more documents).

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

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

final official statement will be deemed to include all information and documents that have been cross referenced.[47] The amendment does not place limitations on the type of issuer that may use cross referencing. This approach is consistent with the goal of making the repositories the principal source of information concerning municipal securities. Once received by a repository, the referenced information should be readily available regardless of the nature of the issuer.

As commenters noted, permitting cross referencing to other externally prepared and available information should result in official statements that are clear and concise, yet provide information material to the Offering.[48] Moreover, the use of cross referencing also should ease some expressed apprehension about the ability of some issuers to obtain information about parties not within their control, to the extent that information about these parties is made available to the repositories or, if a reporting company, filed with the Commission.[49]

**(3) Description of Information Undertakings**

The definition of final official statement also has been changed from the Proposed Amendments to include a requirement that the undertakings provided pursuant to the rule be described in the final official statement.[50] As the Commission recognized in the Interpretive Release[51] and a number of commenters echoed,[52] it is important for investors and the market to know the scope of any ongoing disclosure. By including a description of the undertaking in the final official statement, market participants will know the identity of the entities about which information will be provided, and the type of information to be provided. By reviewing the final official statement, investors in the secondary market will be able to ascertain the scope of that undertaking and whether it has been satisfied.

Critical to any evaluation of a covenant is the likelihood that the issuer or obligated person will abide by the undertaking. The definition of final official statement thus has been modified to require disclosure of all instances in the previous five years in which any person providing an undertaking failed to comply in all material respects with any previous informational undertakings called for by the amendments.[53] This information is important to the market, and should, therefore, be disclosed in the final official statement. The requirement should provide an additional incentive for issuers and obligated persons to comply with their undertakings to provide secondary market disclosure, and will ensure that Participating Underwriters and others are able to assess the reliability of disclosure representations.[54]

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

**b. Entities About Which Information Must be Provided to the Secondary Market**

It is critical that current financial information and operating data is provided to the secondary market about the persons that would be important to investors in evaluating the security. The Proposed Amendments would have required the Participating Underwriter to determine that the issuer had committed to provide, at least annually, current financial information concerning the issuer of the municipal securities and any significant obligor.[55] The identity of persons about which information should be provided to the secondary market was the subject of a substantial number of comment letters.[56] As with the proposed definition of final official statement, a large number of commenters expressed particular concern about the provision of information on a continuing basis for conduit issuers who have no ongoing liability for repayment of municipal securities.[57] There also were a significant number of comments received critiquing the concept of significant obligor.[58]

---

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

[48] *See, e.g.*, Letter of New York Dormitory Authority; Letter of the Treasurer of the State of Connecticut.

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

[50] Rule 15c2-12(f)(3).

[51] *See* Interpretive Release at Section III.C.4.

[52] *See, e.g.*, Letter of Chemical Securities, Inc. ("Chemical Securities"); Letter of Ferris Baker Watts; Letter of National Federation of Municipal Analysts ("NFMA").

[53] *See* Rule 15c2-12(f)(3).

[54] *See* Letter of PSA.

[55] Paragraph (b)(5)(i)(A) of the Proposed Amendments.

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

[57] *See, e.g.*, Letter of ABA Urban Law Section; Letter of Gilmore & Bell, P.C. ("Gilmore & Bell"); Letter of New York State Housing Finance Agency, State of New York Mortgage Agency, New York State Medical Care Facilities Finance Agency ("New York State Housing Finance Agency"); Letter of Orrick Herrington.

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

Under the amendments as revised, the identity of the persons for which information must be provided on an annual basis is determined by the information included in the final official statement. If the final official statement includes financial information or operating data on a person, information about that person must continue to be provided to the secondary market if the person is committed by contract or other arrangement to support payment of the obligations on the municipal securities.[59] Thus, the obligation to provide ongoing information relates to those persons for which financial information or operating data is included in the final official statement *and* that have a contractual or other connection to repayment of the municipal obligations.

**(1) The Obligated Person Concept**

The Proposed Amendments defined a significant obligor as "any person who, directly or indirectly, is the source of 20 percent or more of the cash flow servicing the obligations on the municipal security." The proposed definition generated a significant amount of comment, including concerns that it could be interpreted to include significant taxpayers and customers,[60] credit enhancers (including banks that are letter of credit providers and insurers providing bond insurance),[61] providers of guaranteed investment contracts,[62] as well as state and federal governments that provide revenue sharing, grant, state and local aid and other cofinancing arrangements.[63] Commenters raised technical concerns as to the appropriate percentage of repayment obligation necessary to trigger inclusion in the definition of significant obligor,[64] and when the percentages were to be measured.[65] Some commenters also expressed concern that, in the bond pool context, the definition of significant obligor may not have permitted sufficient flexibility in determining which obligors in a pool would be the subject of the requirement to provide information on an ongoing basis.[66]

Commenters suggested a number of modifications to the significant obligor concept. First, a number of commenters indicated that the definition of significant obligor should include a requirement that a contractual relationship exist between the obligor and the repayment of the obligation before a continuing information obligation is imposed.[67] Second, commenters recommended modifying the definition to include different percentages of cash flow, ranging from a low of no threshold to a high of 50% of cash flow.[68] Third, some commenters suggested replacing the entire definition of significant obligor with the concept of materiality, in which the issuer and the other offering participants would determine, on a continuing basis, whose information would be provided.[69]

As suggested by a number of commenters, the amendments eliminate the reference to significant obligor.[70] Instead, the amendments include a definition of "obligated person," which means a person (including an issuer of separate securities) that is committed by contract or other arrangement structured to support payment of all or part of the obligations on the municipal securities.[71] By including a nexus to the financing through a commitment that is structured to support the payment obligations, the amendments address concerns raised by many commenters that the term "source of cash flow" in the definition of significant obligor was overbroad and could encompass persons with no relationship to the financing.[72] The requirement for a contractual or other arrangement will assist Participating Underwriters in identifying the persons for which information should be provided pursuant to an undertaking.

Some commenters recommended that the commitment with respect to payment of the obligation on the securities consist of a contractual obligation to and enforceable by bondholders.[73] Instead, the definition includes a broader notion of a contract or arrangement that is structured to "support payment," without specifying that it run to bondholders. The definition is intended to include contracts or arrangements where payments are made either to bondholders, to issuers to be used to pay obligations on

---

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

[60] *See, e.g.*, Letter of American Municipal Power—Ohio, Inc. ("AMP—Ohio"); Letter of Gilmore & Bell; Letter of Treasurer of the State of California.

[61] *See, e.g.*, Letter of Financial Guaranty Insurance Company ("FGIC"); Letter of Goldman Sachs; Letter of Hawkins Delafield & Wood; Letter of Thacher Proffitt & Wood.

[62] *See, e.g.*, Letter of Kutak Rock.

[63] *See, e.g.*, Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of State of Washington, Office of the Treasurer.

[64] *See, e.g.*, Letter of APPA; Letter of George K. Baum & Co.; Letter of CDFA; Letter of Eaton Vance Management; Letter of NCHFFA.

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

[66] *See, e.g.*, Letter of ABA Urban Law Section; Letter of A.G. Edwards & Sons, Inc.; Letter of Council of Infrastructure Financing Authorities ("CIFA"); Letter of Hawkins Delafield & Wood; Letter of Program Administration Services, Inc.

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

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

[69] *See, e.g.*, Letter of ABA Business Law Section; Letter of ALHFA; Letter of PSA.

[70] *See, e.g.*, Letter of FGIC; Joint Response; Letter of NABL; Letter of PSA.

[71] *See* Rule 15c2-12(f)(10).

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

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

municipal securities, or through conduit structures.[74] Similarly, the reference to "obligations on municipal securities" is intended to be broad enough to cover debt obligations, lease payments and any other repayment obligation on or resulting from the municipal securities.

As was the case with the proposed significant obligor concept, the term "obligated persons" includes, but is broader than, the concept of issuers of separate securities under Rule 131 pursuant to the Securities Act of 1933 ("Securities Act")[75] and Exchange Act Rule 3b-5.[76] Also, in response to comments raised that the terms "issuer" or "significant obligor" do not sufficiently address financings in which the source of repayment is not a separate person or entity, but a dedicated revenue stream from a specified project, segregated tax revenues or other enterprise, fund or account,[77] the definition includes persons which are obligated generally, such as with full recourse to the person, or, in a more limited manner, such as through an enterprise, fund or account of such person, including a dedicated revenue stream. As noted above, the obligation to provide information must cover all such enterprises, funds or accounts, whether or not there is a separate entity. In such a case, the information undertaking could be provided by the governmental unit or financing authority of which the enterprise, fund or account is a part.[78] For example, a Participating Underwriter could accept an information undertaking from a state issuing bonds secured solely by funds collected under a special tax, to report financial information relating to the special tax; for issues supported both by contracts of assistance of separate authorities or funds in addition to the issuer's own revenues, undertakings from the separate authorities, as well as the issuer could be provided. Accordingly, although the definition of significant obligor has been eliminated, that modification does not reflect a change in the Commission's assessment of the importance of ongoing information concerning the ultimate sources of payment on the securities.

Unlike the significant obligor concept in the Proposed Amendments, there is no need to include a specified percentage of payment in the definition of obligated person, because the issuer and other participants will determine at the time of preparation of the final official statement which obligated persons are material to an Offering.[79] In making that materiality determination, the parties to a financing will evaluate the facts of the Offering.[80]

Determining the obligated persons in pooled financings requires more flexibility, because the composition of the pool may vary over time. Rather than identifying the specific persons for which information will be provided on a continuing basis, under the amendments, bond pools must describe in their official statements, and the undertaking, the objective criteria (presumably including percentage of payment support) they will apply consistently, both in the final official statement and on a continuing basis, in determining whether information concerning an obligated person will be provided.[81] The amendments permit, but do not require this approach for non-pooled issuers. The objective criteria approach ensures that financial information and operating data will be provided about those persons that, at the time of disclosure, meet the objective standards described in the undertakings. Obligated persons could commit to the issuer, at the time of initial participation in a pooled financing, through an undertaking to provide information when and if they satisfy that criteria. Obligated persons that no longer meet the objective criteria will no longer need to provide ongoing information. In order to ensure that the selection method is incorporated into the undertaking, the amendments require that Participating Underwriters reasonably determine that the undertakings identify those

---

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

[75] 17 CFR 239.131.

[76] 17 CFR 240.3b-5

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

[78] *See* Rule 15c2-12(b)(5)(i).

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

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

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

persons for which the information will be provided, either by name or by the objective criteria to be used to select such persons.[82]

Commenters were divided on whether providers of bond insurance, letters of credit, and other liquidity facilities, should be excluded from the definition of significant obligor.[83] The concept of "obligated person" encompasses these entities because they are committed, at least conditionally, to support payment of principal and interest obligations. Moreover, these persons normally are material to an understanding of the security, and, therefore, official statements should contain financial information concerning such persons either directly or by reference to publicly available materials. A number of commenters stated, however, that it would be inappropriate to put the onus on the issuer to provide information on such providers on an annual basis, particularly where that information is otherwise available to investors either upon request or in public reports that have been submitted to appropriate regulatory authorities.[84]

Commenters indicated a willingness by providers of bond insurance, letters of credit, and other liquidity facilities to deposit publicly available reports in a repository, or otherwise note where such reports may be easily obtained.[85] The issuer or other obligated person providing the undertaking may then refer to such reports in their annual financial information and indicate the location where any such current annual reports can be obtained. Based upon such representations, providers of bond insurance, letters of credit, and liquidity facilities have been excepted from the definition of obligated person to eliminate the need to separately obtain and disseminate annual information about such providers.

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

**(2) Who Must Undertake**

A related question to whose information must be given is who must provide the information undertaking; the person providing the undertaking may not necessarily be the person about which the information relates. The Proposed Amendments would have required that the continuing information undertaking be provided by the issuer. A significant number of commenters raised concerns about which of potentially several persons that could be considered an issuer of municipal securities[86] would be expected to provide the undertaking and who would make that determination.[87] This was a particular concern in light of the potential liability of the issuer providing the undertaking for the provision and the content of information regarding other issuers and significant obligors—persons not necessarily under their control. Commenters made a number of suggestions to address these perceived ambiguities, including requiring that each issuer of a municipal security and each significant obligor undertake to provide the information only with respect to itself.[88]

In response to these concerns, and consistent with the general approach to affording underwriting participants significant flexibility, the undertaking provision has been revised to provide that the undertaking may be made by any issuer of the municipal securities being offered, or by any obligated person for which information is provided in the final official statement. An issuer of a municipal security may provide the undertaking, regardless of whether it is obligated on the municipal security. In addition, obligated persons may provide the undertaking regardless of whether they are deemed an issuer of municipal securities. These obligated persons may be the main, if not the only, credit source for repayment of the obligations on the municipal securities. This approach should allow the governmental issuer to shift to the obligated person the responsibility to provide information on a continuing basis.

---

[82] *See* Rule 15c2-12(b)(5)(ii).

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

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

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

[86] The term "issuer of municipal securities," as defined in Rule 15c2-12, includes issuers of separate securities as well.

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

[88] *See, e.g.*, Letter of ABA Urban Law Section; Letter of ALHFA; Letter of Kutak Rock; Letter of NABL.

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

The amendments have been revised to clarify that dissemination responsibilities may be delegated to designated agents or to indenture trustees. As commenters pointed out, there are circumstances in which third parties may be effective in assisting issuers and obligated persons in disseminating the information.[89] Moreover, indenture trustees have expressed concerns about being considered "designated agents" in performing any dissemination role, based on the scope of, and standards affecting, their responsibilities as indenture trustees.[90] The language has been revised in response to clarify that, in addition to designated agents, issuers or obligated persons may contractually empower indenture trustees to disseminate information that an issuer or obligated person has agreed to provide. The parties may authorize an indenture trustee to provide certain information through specific instruction or on its own initiative upon becoming aware of particular facts.

**c. Scope of Financial Information and Operating Data to be Provided on an Annual Basis**

**(1) Definition of Annual Financial Information**

The amendments provide a definition of the term "annual financial information,"[91] a concept that was used, without definition, in the Proposed Amendments. The definition of annual financial information specifies both the timing of the information—that is, once a year—and, by referring to the final official statement, the type of financial information and operating data that is to be provided to the repositories. If financial information or operating data concerning an obligated person (or category of obligated persons in the case of financings using the objective criteria approach) is included in the final official statement, then annual financial information would consist of the same type of financial information or operating data. For example, if anticipated cash flow information is provided in the final official statement for a revenue bond financing, cash flow data reflecting actual operations must continue to be provided on an annual basis. Only the annual financial information called for by the undertakings need be sent to the repositories; other types of financial information and reports that may be prepared by the issuer or obligated persons are not subject to the rule's dissemination provisions.

Many commenters addressed the issue of whether the rule should specify form and content of the information that should be provided on an annual basis, as well as for event specific information.[92] Some commenters argued that the rule should include specified formats for information to be provided, including financial statements and certain industry reporting formats,[93] while other commenters contended that no form or content should be specified and that the parties should be permitted to make determinations based on materiality alone.[94] As discussed below, the flexibility afforded by the concept of annual financial information addresses these concerns by providing a minimum standard for ongoing disclosure, but allowing the parties to define that standard with respect to each Offering of municipal securities.

**(2) Financial Information**

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

Some commenters indicated that some municipalities were not required by law to have independently audited financial statements, and any such requirement would impose a significant new expense.[95] A number of commenters also expressed doubt as to whether audited financial information could be delivered on an annual basis, because audits may not be completed for a number of years following the close of the fiscal year.[96] Commenters noted that in some cases, financial statements for certain types of entities were audited every year, and in other cases every 2-3 years.[97] Therefore, some of these commenters argued that the requirement for annual audited financial statements would have an adverse impact on an issuer's ability to access the public securities markets or increase its costs of financing.[98]

A number of commenters also raised concerns regarding the availability of full financial statements for certain issuers,

---

[89] *See, e.g.*, Letter of Bond Investors Association; Letter of PSA; Letter of Texas Public Finance Authority.

[90] *See, e.g.*, Letter of Bank One Corporation; Letter of Reliance Trust Company; Letter of State Street Bank and Trust Company.

[91] Rule 15c2-12(f)(9).

[92] *See, e.g.*, Letter of Dean Witter Reynolds, Inc. ("Dean Witter"); Letter of National League of Cities; Letter of NFMA; Joint Response; Letter of PSA; Letter of Tillinghast, Collins & Graham; Letter of the Treasurer of the State of Connecticut.

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

[94] *See, e.g.*, Letter of CDFA; Letter of Chapman and Cutler; Letter of CIFA; Joint Response; Letter of H.M. Quackenbush; Letter of NABL.

[95] *See, e.g.* Letter of Texas Water Development Board; Letter of State of Washington, Office of the Treasurer.

[96] *See, e.g.*, Letter of City of Barling; Letter of Dain Bosworth, Inc.; Letter of Friday, Eldridge & Clark.

[97] *See, e.g.*, Letter of AMP—Ohio; Letter of State of Indiana, State Board of Accounts; Letter of State of Montana, Department of Natural Resources and Conservation; Letter of Washington Finance Officers Association.

[98] *See, e.g.*, Letter of AMP—Ohio; Letter of Washington Finance Officers Association.

whether or not audited.[99] As examples, commenters noted that some issuing entities do not have their own financial statements and may be included in the financial statements of a larger issuer or entity.[100] Commenters from two states indicated that governmental units of the states may be encompassed in the state's comprehensive annual financial report and that there may be only supplemental schedules that described the governmental units.[101]

Some commenters raised the point that financial statements of a general governmental unit may not necessarily be relevant in certain project and structured financings.[102] As an example, one commenter noted that in some asset backed financings, information about the governmental issuer may be relevant only with respect to its experience in managing programs of loan pools.[103]

Commenters proposed a number of alternatives to the requirement to provide annual audited financial statements. Among the alternatives was a suggestion that financial statements be required in the form customarily prepared by the issuer promptly upon becoming available and that audited financial statements be provided to the extent available.[104] Other suggestions included limiting the requirement to those entities required by state or federal law to have audited financial statements.[105]

In view of the comments received, the amendments do not adopt the proposal to mandate audited financial statements on an annual basis with respect to each issuer and significant obligor. Instead, the amendments continue to require annual financial information, which may be unaudited, and may, where appropriate and consistent with the presentation in the final official statement, be other than full financial statements. While it is anticipated that full financial statements will be provided for entities with ongoing revenues and operating expenses, it is possible that in the case of dedicated revenue streams and certain types of structured financings, other types of special purpose financial statements, project operating statements or reports may be used to reflect the financial position of the credit source for the financing. However, if audited financial statements are prepared, then when and if available, such audited financial statements will be subject to the undertaking and must be submitted to the repositories.[106] Thus, as suggested by a number of commenters, the undertaking must include audited financial statements only in those cases where they otherwise are prepared.

The amendments adopt the proposed requirement that the undertaking specify the accounting principles pursuant to which the financial information provided as part of the annual financial information will be prepared.[107] As discussed in the Proposing Release, it is important that financial information be prepared on a consistent basis to enable market participants to evaluate results and perform year to year comparisons.[108] The undertaking also must specify whether audited financial statements will be provided as part of the annual financial information.[109]

The amendments do not establish a standardized format for presentation of financial information, or any specification of the content of the information, other than by reference to the final official statement. The annual financial information may be presented through any disclosure document or set of documents, whatever their form or principal purpose, that include the necessary information. The amendments, as adopted, contemplate that sequential final official statements prepared by frequent issuers may meet the standards of the rule. As in the case of final official statements, annual financial information submitted to a repository also may reference other information already submitted to repositories or the MSRB, or filed with the Commission.[110]

**(3) Operating Data**

The Proposed Amendments[111] would have required that the undertaking call for pertinent operating information, and that the parties specify the pertinent operating information to be provided on an annual basis. The basic concern of commenters regarding this provision, in addition to issues of specification of form and content discussed above, was that the use of the term "pertinent" did not provide sufficient guidance as to who would determine what was pertinent and what independent obligations Participating Underwriters would have with respect to such evaluation.[112]

The amendments have been modified to respond to these comments. The phrase "pertinent" has been deleted from the

---

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

[100] *See, e.g.*, Letter of Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

[101] *See, e.g.*, Letter of the Treasurer of the State of North Carolina; Letter of Texas Office of the State Auditor.

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

[103] *See* Letter of ABA Urban Law Section.

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

[105] *See, e.g.*, Letter of the Treasurer of the State of North Carolina; Letter of Washington Finance Officers Association.

[106] *See* Rule 15c2-12(b)(5)(i)(B).

[107] *See* Rule 15c2-12(b)(5)(ii)(B).

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

[109] *See* Rule 15c2-12(b)(5)(ii)(B).

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

[111] Paragraph (b)(5)(i)(A) of the Proposed Amendments.

[112] *See, e.g.*, Letter of APPA; Letter of Fidelity Management and Research Company; Letter of Hawkins Delafield & Wood.

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

Some commenters expressed concern that the Proposed Amendments were not sufficiently flexible to permit parties to address changing conditions because the undertaking would have to describe the financial and pertinent operating information to be provided in the future.[113] Nonetheless, the requirement that the undertaking specify in reasonable detail the type of data that will be provided on an ongoing basis, including the identity of the persons (or category of persons) about which the information will relate has been retained. As is the case with financial information, the intent of the amendments is to give investors and market participants the ability to evaluate the security through comparisons of the quantitative operating data provided. Contrary to the suggestion of some commenters, the undertaking would be meaningless if issuers and obligated persons could unilaterally determine that certain types of information were no longer necessary or meaningful to investors.

Because the amendments require that the undertaking specify only the general type of information to be supplied, there should be sufficient flexibility to accommodate subsequent developments that may require adjustments in the financial information and operating data that should be provided annually. Of course, nothing in the undertaking will prevent a party from providing additional information, particularly where such disclosure may be necessary to avoid liability under the antifraud provisions of the federal securities laws. Similarly, the amendments make specific provision for adjusting the persons about which information is provided. As required in the case of pooled financings, parties may identify the persons covered by reference to objective selection criteria that will be applied on a consistent basis between the offering statements and with regard to annual financial information. Moreover, the party providing the undertaking need not continue to provide information concerning persons that are no longer obligated persons with respect to the municipal securities.

A new provision has been added to the amendments which permits the written agreement or contract to have a termination provision with respect to any obligated person that is no longer directly or indirectly liable for repayment of any of the obligations on the municipal securities.[114] Once an obligated person no longer has any liability for repayment of the municipal securities, whether through termination or expiration of its commitment to support payment, or as a result of a defeasance of the municipal securities with no remaining liability, then the obligation to provide annual financial information and notices of events may terminate.

**2. Notice of Material Events**

Commenters generally agreed that issuers and obligors should be subject to an undertaking to provide event information to the market.[115] Brokers, dealers and municipal securities dealers supported these provisions of the Proposed Amendments, because the use of a list provides guidance as to what events should be covered.[116] Other commenters, however, felt that the list should be deleted from the rule and that the concept of materiality should be relied upon to determine what events should be the subject of notices.[117] Some commenters believed that the list of eleven events should be expanded to include a provision that would cover any other event that might reasonably be expected to have a material adverse effect on the holders of the bonds.[118]

The list of eleven events has been retained in the amendments.[119] As indicated in the Proposing Release, the list of eleven events was proposed in response to requests for guidance to issuers and other participants in the municipal securities markets as to those events that normally would reflect on the credit supporting the municipal securities, as well as on the terms of the securities that they issue, and thus normally would be considered material. Under the amendments, only the occurrence of one of the specified events will, if material, create an obligation to send a notice to the repository.

The determination of whether other events also should be the subject of notification pursuant to the information undertaking is left to the parties. For example, some commenters requested that the list of events be expanded to address circumstances when the notified events have been cured or rectified, as well as other favorable developments.[120] The parties would be free to

---

[113] *See, e.g.*, Letter of Chapman and Cutler; Joint Response; Letter of Kutak Rock.

[114] *See* Rule 15c2-12(b)(5)(iii).

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

[116] *See, e.g.*, Letter of Chemical Securities; Letter of Goldman Sachs; Letter of George K. Baum; Letter of PSA.

[117] *See, e.g.*, Letter of CDFA; Letter of Gust & Rosenfeld; Joint Response; Letter of Municipal Treasurers Association; Letter of Rauscher Pierce Refsnes, Inc.; Letter of Standish Ayer & Wood, Inc.

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

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

[120] *See, e.g.*, Letter of NAST; Letter of the Treasurer of State of California.

add such matters to the undertaking. Issuers also may wish to send information regarding material developments to the repositories, to ensure equal access to that information by all investors and participants in the market, regardless of whether the particular development is subject to the undertaking.[121]

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

Some commenters expressed concern that the event described as "matters affecting collateral" was too broad.[122] In response to such observations, that reference has been revised to reflect more clearly the types of events relating to collateral that could affect the creditworthiness of the security being offered. For instance, the item was not intended to require disclosure in the event of a drop in revenues or receipts securing payment. Rather, as more clearly indicated in the revised amendments, it is intended to encompass the release, substitution, or sale of property securing repayment of the securities being offered.[123]

Commenters also questioned whether the event relating to adverse tax opinions or events affecting the tax-exempt status of the security would include events not specific to an issuer, such as tax law changes which may affect a multitude of issuances and which are broadly reported.[124] They argued that there is no need for each issuer to make that disclosure, which may overwhelm the repositories. The amendments do not include a uniform requirement for notification of events having widespread impact that are widely reported. Frequently, individual issuer disclosure may not affect the total "mix" of information available to investors, for example where Congress amends tax rates or alternative minimum tax rules that could affect an investor's yield. On the other hand, it may not be clear, absent individual disclosure, which classes of outstanding securities are affected by the general events, for example, where the tax law change affects a particular type of municipal security or financing structure.

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

Commenters expressed concern that the party providing the undertaking may not have knowledge of the occurrence of events affecting other parties that might be called for by the provisions of the rule.[125] This concern should be addressed by the revised approach of enabling the parties to the transaction to determine who will provide the undertakings. For example, in the conduit context, the covenant could be provided by the person that is committed by contract or other arrangement to support payment of debt service, rather than the conduit issuer.

The timing for providing the notification has not been changed from the Proposed Amendments, which required that the notice be provided on a "timely" basis. The amendments do not establish a specific time frame as "timely," because of the wide variety of events and issuer circumstances. In general, this determination must take into consideration the time needed to discover the occurrence of the event, assess its materiality, and prepare and disseminate the notice.

A new paragraph has been added to the amendments[126] that would require a Participating Underwriter to reasonably determine that the undertaking includes an agreement to notify the appropriate repository if the annual financial information is not provided in the stated time frame. Given the expressed concerns of some commenters regarding the difficulty that they would face in determining whether an issuer or other person was in compliance with any of its undertakings,[127] this provision will help inform market participants if annual financial information for such persons has not been made available in the agreed upon time frame.

### 3. Location of Undertaking in a Written Agreement or Contract

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

As discussed in the Proposing Release, many offerings of municipal securities are issued pursuant to a trust indenture

---

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

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

[123] *See* Rule 15c2-12(b)(5)(i)(C)(10).

[124] *See, e.g.*, Letter of ABA Urban Law Section; Letter of Kutak Rock; Letter of Orrick Herrington.

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

[126] *See* Rule 15c2-12(b)(5)(i)(D).

[127] *See, e.g.*, Letter of Gust & Rosenfeld.

setting out the covenants of the issuer for the benefit of the holders of the municipal securities. If there is no trust indenture as part of an offering, as is the case with general obligation and certain other types of bonds, there may be a bond resolution, ordinance, or other legislation. Most commenters addressing this issue considered the trust indenture, bond resolution, ordinance, or other legislation to be appropriate for undertakings to provide secondary market disclosure, because they would create a direct obligation by issuers to bondholders.[128] Commenters also suggested the use of a separate written agreement between the issuer and the trustee as an appropriate method of memorializing undertakings.[129]

Several commenters suggested that the inclusion of the undertakings in an underwriting agreement or bond purchase agreement would be sufficient for purposes of Rule 15c2-12,[130] though another commenter suggested that a promise running to the benefit of the underwriter, whether in a bond purchase agreement or in a separate agreement, would be enforceable by existing and future bondholders only on the basis of a third party beneficiary theory, the availability of which may vary from state to state.[131]

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

The Commission also recognizes that an issuer's ability to contract may be limited under state law. To the extent that issuers are restricted by statute from entering into long-term contractual arrangements, the undertaking may include a qualifier to its obligation, such as that it is subject to appropriation.[132]

Commenters generally took the view that, while a statement in the final official statement describing any undertakings to provide secondary market disclosure would be an important addition to undertakings in a written agreement or contract, in order to make clear that the undertaking is an obligation of the issuer or obligated person that is enforceable on behalf of bondholders, the undertaking should be in a writing signed by the issuer or obligated person.[133] Statements regarding an issuer's or obligated person's provision of secondary market disclosure made exclusively in an official statement would not satisfy the terms of Rule 15c2-12(b)(5) because they would not create a contract enforceable on behalf of bondholders.

Commenters addressing the inclusion of undertakings in various documents were concerned that the failure to provide continuing disclosure pursuant to the undertakings could be deemed a potential event of default on the securities.[134] Though a failure to comply with the undertaking would be a breach of contract, the rule does not specify the consequences of an issuer's breach of its undertakings to provide secondary market disclosure. As called for by the Joint Response, as well as other commenters, remedies for breach of any undertaking under applicable state law are a subject for negotiation between the parties to the Offering. To avoid uncertainties of enforcement, the parties to a transaction are encouraged to enumerate the consequences in the undertaking, including the available remedies, for breach of the information undertaking.

**B. Recommendation of Transactions in Municipal Securities**

The Proposed Amendments would have prohibited any broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipal security unless it had specifically reviewed the information the issuer of such municipal security had undertaken to provide.[135] The purpose of this provision of the Proposed Amendments was to assist dealers in satisfying their obligation to have a reasonable basis to recommend municipal securities by requiring them to consider the most current information before making a recommendation.

In view of the importance of secondary market liquidity in municipal issues, the Commission requested comment on

---

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

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

[130] *See e.g.*, Letter of Mudge Rose.

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

[132] Some commenters were concerned that in some jurisdictions, an issuer's ability to agree to provide information beyond a one year period might be restricted by state law. To address such concerns, inclusion of a condition subsequent in the covenant, such as subject to appropriation, might be appropriate. It is anticipated, however, that should funds that would enable the issuer to provide the agreed upon information not be appropriated, disclosure of such fact would be made by notice to the repositories pursuant to Rule 15c2-12(b)(5)(i)(D).

[133] *See, e.g.*, Letter of Chemical Securities; Letter of Dain Bosworth, Inc.; Letter of Dillon, Read & Co., Inc.

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

[135] *See* paragraph (c) of the Proposed Amendments.

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

Many commenters strongly criticized this provision of the Proposed Amendments. The majority of commenters responded that requiring the review of information prior to making a recommendation on the purchase or sale of a municipal security would create substantial compliance burdens for dealers.[136] Commenters also noted that the specific requirement to review information either would impel dealers to hire larger research and analysis staffs,[137] or, more likely, would cause dealers to restrict the issuers whose municipal securities they would trade to a smaller number of large and frequent issuers.[138] Commenters predicted that, as a result, liquidity for all but the largest and most frequent issuers would be reduced.[139]

Commenters proposed alternatives to the recommendation prohibition, including basing the type of review of a municipal security, and disclosure about such review, on whether the investor was an institutional or retail investor,[140] or on the type of municipal security recommended.[141] Other commenters suggested the continued reliance on the reasonable basis standard inherent in the MSRB's suitability rule, G-19, and the antifraud provisions, as discussed by the Commission in the 1988 and 1989 Releases proposing and adopting Rule 15c2-12, as well as the Interpretive Release.[142]

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

In the Commission's view, the recommendation provision, as modified, should substantially reduce the concerns of commenters with respect to compliance burdens and effects on liquidity. It also will help ensure that dealers will consider the material event notices that issuers produce, thus enabling them to have an adequate basis on which to recommend[143] municipal securities.

Moreover, even though the amendments do not require that dealers directly review an issuer's ongoing disclosure before making each recommendation, the Commission agrees with those commenters that said that additional information made available by issuers will be taken into account by dealers making recommendations regarding that security, under the MSRB's fair dealing and suitability rules, and the antifraud provisions.[144] In addition to the Commission's past interpretations of the responsibilities of dealers to have a reasonable basis for their recommendations, the MSRB repeatedly has emphasized that secondary market disclosure information publicized by issuers must be taken into account by dealers to meet the investor protection standards imposed by its investor protection rules. Specifically, MSRB rule G-17 requires dealers to disclose material facts of a transaction to the customer; MSRB rule G-19 requires dealers to ensure that any transaction recommended to the customer is suitable for that customer; and MSRB rule G-30 requires dealers to ensure that the prices set for customer transactions are fair and reasonable. In its comment letter, the MSRB noted that "[i]f a dealer is not aware of major financial and other material developments affecting an issuer's securities, it is difficult or impossible for the dealer to comply with these requirements."[145]

For example, if a dealer reviews an electronic reporting system for material events relating to a security, and finds that an issuer has submitted a notice that it has failed to provide annual financial information on or before the date specified in the written agreement or contract,[146] that fact would be a significant factor to be taken into account when the dealer formulates the basis for a recommendation of such securities. While the dealer would not be prohibited *per se* from recommending such municipal

[136] *See* Letter of PSA (noting that paragraph (c) would require dealers to create records showing that they had reviewed municipal securities).
[137] *See, e.g.*, Letter of Chapman and Cutler (brokers with fewer analysts will be at a competitive disadvantage); Letter of Morgan Stanley (noting that in order to comply with paragraph (c) as proposed, reliance on third-party service providers for information analysis would be required).
[138] *See, e.g.*, Joint Response; Letter of PSA; Letter of Gabriel, Hueglin & Cashman.
[139] *See, e.g.*, Joint Response; Letter of PSA.
[140] Letter of Investment Company Institute ("ICI"). *See also* Letter of MSRB; Letter of NABL. NABL suggested disclosure by dealers as to whether a party has committed to provide secondary market disclosure, and if not, the consequences of investing in the securities.
[141] *See, e.g.*, Letter of Edward D. Jones & Co. (suggesting application of the Proposed Amendments only to non-rated or special assessment bonds); Letter of NABL (suggesting exemptions from the amendments to Rule 15c2-12 for issuers that obtain and maintain an investment grade rating, and for general obligation bonds and revenue bonds issued to finance essential government purposes).
[142] *See, e.g.*, Letter of PSA; Letter of A.G. Edwards & Sons, Inc. (reviewing issuer's disclosure is not the only way to form the basis for a recommendation).
[143] As noted in the Proposing Release, most situations in which a dealer brings a municipal security to the attention of a customer involve an implicit recommendation of the security to the customer.
[144] *See, e.g.*, Letter of MSRB (emphasizing that, in the Board's view, dealers would be responsible for continuing disclosure information available in NRMSIRs even without the specific "review" requirement); Letter of Paine Webber.
[145] Letter of MSRB (noting the requirements of the MSRB's rules in commenting that the Proposed Amendment's requirement to review periodic information is not a practical option for dealers).
[146] *See* Rule 15c2-12(b)(5)(i)(D).

securities, notice that the issuer has failed to provide annual financial information would be the type of material information required to be disclosed to the customer pursuant to MSRB rule G-17.[147] Such a notice also would trigger a further inquiry by the dealer to assure itself that it is cognizant of the condition of the issuer or obligated persons, despite the absence of promised information. This also would be true if a dealer attempts to obtain an issuer's annual financial information, finds that it has not been submitted to any repository, and the dealer had no record of the issuer submitting a notice to this effect. In such cases, further research may be necessary or advisable prior to making a recommendation in the issuer's securities.

### C. Information Repositories

#### 1. Background

Under Rule 15c2-12, as adopted in 1989, NRMSIRs essentially serve the function of disseminators of official statements on behalf of Participating Underwriters.[148] The option of Participating Underwriters to transfer their final official statement delivery obligations to NRMSIRs has encouraged the development of NRMSIRs.[149] The three existing NRMSIRs are private vendors that gather and disseminate final official statements pursuant to Rule 15c2-12. In addition, although not required under existing provisions of the rule, they provide other current information about municipal issuers to the primary and secondary municipal securities markets.[150]

As a result of the amendments, NRMSIRs will play an expanded role in the collection and dissemination of secondary market information. In addition to the collection and dissemination of final official statements, they will collect and disseminate annual financial information, as well as notices of material events. The Commission is sensitive to the need of NRMSIRs for flexibility, especially with respect to the timing requirements for the dissemination of notices of material events. The Commission will monitor developments in the municipal securities market as participants adapt to the changes in Rule 15c2-12, and fully expects that the current and potential NRMSIRs are capable of adjusting to their expanded role. The Commission is of the view that NRMSIRs, as private information vendors, will have sufficient economic incentives to serve their expanded functions resulting from the amendments to Rule 15c2-12, even in the absence of the more specific review requirement of the recommendation prohibition of the Proposed Amendments.[151]

#### 2. Definition of Nationally Recognized Municipal Securities Information Repository

The Commission requested comment on whether the term "NRMSIR" should be defined in Rule 15c2-12, and whether specific standards should be established for NRMSIRs. If standards were to be established in the rule, the Commission requested comment on whether proposed standards set forth in the release were adequate.[152] The majority of state-based information gatherers and disseminators, and other NRMSIRs that addressed the issue of defining the term "NRMSIR" supported maintaining the guidelines already established by the Commission in the 1989 Release.[153] After reviewing the

---

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

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

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

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

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

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

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

comment letters, the Commission has determined that the guidance established in the 1989 Release for NRMSIRs should be modified only as necessary to reflect the amendments to Rule 15c2-12. In determining whether a particular entity is a NRMSIR the Commission will now consider, among other things, whether the repository:

(1) is national in scope;

(2) maintains[154] current, accurate[155] information about municipal offerings in the form of official statements, and annual financial information, notices of material events, and notices of a failure to provide annual financial information undertaken to be provided in accordance with Rule 15c2-12;

(3) has effective retrieval and dissemination systems;

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

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

(6) charges reasonable fees.

While NRMSIRs may charge reasonable fees[156] for the dissemination of information, they may not charge issuers for accepting information provided by issuers in accordance with Rule 15c2-12.[157] In response to concerns raised by commenters, the Commission also notes that giving preferential treatment to certain brokers, dealers, and municipal securities dealers by giving them market information before it is made available to all customers would be wholly inconsistent with recognition as a NRMSIR.[158]

Comment also was requested on the ability and willingness of both potential NRMSIRs, and those presently operating under no-action letters, to meet the dissemination standards discussed in the Proposing Release. NRMSIRs responded that they can meet these standards.[159] In order to implement these standards, the Commission has determined that existing NRMSIRs should reapply for recognition from the Commission under the revised criteria to continue to function as NRMSIRs.

### 3. State Information Depositories

The Commission also requested comment on whether a state-based depository could serve as an effective means to disseminate information to the market for a nationally traded security, thus enabling the appropriate parties to fulfill their disclosure obligations using a state-based depository. Commenters expressed divergent views on this issue.[160] No state responded directly in response to the Commission's request for comment on whether states are willing to make the necessary financial commitment to create a state-based system. The Comptroller of the State of New York pointed out, however, that his office already collects financial data from local governments, and that there "is an appropriate and important function which the states may perform in the secondary market disclosure process."[161] A number of third party state-based information collectors also stated that they were in the process of creating state-based repositories.[162] Other such third party state-based information collectors pointed out that they already had working depositories in place.[163]

Based on these comments, and in light of existing disclosure mechanisms and recent legislation in several states designed to enhance secondary market disclosure,[164] it appears that states can play a beneficial role in enhancing disclosure in

---

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

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

[156] *See* 1989 Release.

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

[158] *See, e.g.*, Letter of Colonial Management Associates, Inc.

[159] Letter of Bloomberg L.P.; Letter of J.J. Kenny Co.; Letter of The Bond Buyer.

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

[161] *See* Letter of the Office of the State Comptroller, State of New York.

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

[163] *See* Letter of Municipal Advisory Council of Texas; Letter of Ohio Municipal Advisory Council.

[164] South Carolina recently enacted legislation requiring issuers to agree in a bond indenture to file an annual independent audit within a specified

(*continued*)

the municipal securities market.[165] State-based depositories will be in a special relationship with filers of disclosure information to provide for convenient and efficient dissemination. The Commission therefore encourages states to develop state-based depositories.

To encourage the development of state-based depositories, the Commission has amended Rule 15c2-12 to require that Participating Underwriters reasonably determine that the information undertaken to be provided, in addition to being submitted to the NRMSIRs, or, in some cases, to the MSRB, will be submitted to a state information depository ("SID"), if an appropriate SID has been established in that state. Further, as discussed below,[166] an exemption conditioned on making annual financial information available upon request or to a SID, and providing notices of material events to each NRMSIR or the MSRB, and to a SID, has been adopted. An appropriate SID would be a depository operated or designated[167] by the state that receives information from all issuers within the state, and makes this information available promptly to the public on a contemporaneous basis.[168] The Commission staff is prepared to provide guidance in particular instances regarding a SID's qualification for purposes of the rule.

**4. Information Delivery Requirements**

The Proposing Release asked to whom the required information should be delivered. It also requested comment on the feasibility of requiring NRMSIRs to inform the MSRB when they receive disclosure information from issuers, and whether such information also should be required to be placed with the MSRB, in addition to or in lieu of a NRMSIR. The NRMSIRs did not address the issue of requiring them to inform the MSRB whenever they received disclosure information from an issuer, although one commenter argued that designating the MSRB as a repository only would add an unnecessary layer to the dissemination process.[169] Other commenters suggested designating a single central repository.[170] Similarly, some commenters suggested imposing a requirement that disclosure information be delivered to all NRMSIRs,[171] while others suggested that NRMSIRs be required to share the information received with other NRMSIRs,[172] and a third group preferred the establishment of a central index.[173] State-based information gatherers and disemminators had diverging views on this issue.[174]

Based on these comments, the Commission has determined to require that annual financial information undertaken to be provided be deposited with each NRMSIR and the appropriate SID in the issuer's state. Any audited financial statements submitted in accordance with the undertakings also must be delivered to each NRMSIR and to the SID in the issuer's state, if such a depository has been established. The requirement to have annual financial information and audited financial statements delivered to all NRMSIRs and the appropriate SID is a modification of the Proposed Amendments. This modification will ensure that all NRMSIRs receive disclosure information directly. It also permits the Commission to adopt the amendments without a delay for the creation of a central index or a system of information sharing among NRMSIRs.[175] The requirement to send information to all NRMSIRs rather than a single NRMSIR of the issuer's or obligated person's choice, should not impose significant burdens or costs, other than duplication and mailing costs. Furthermore, this requirement to deliver disclosure to the NRMSIRs and the appropriate SID also allays the anti-competitive concerns raised by the creation of a single NRMSIR.

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

---

*(footnote continued)*

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

[165] *See, e.g.*, Letter of the Office of the State Comptroller, State of New York.

[166] *See* Section II.D.1. *infra.*

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

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

[169] Letter of Bloomberg L.P.

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

[171] *See, e.g.*, Letter of J.J. Kenny Co.; Letter of National Association of Independent Public Financial Advisers.

[172] *See, e.g.*, Letter of MSRB; Letter of Richard A. Ciccarone.

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

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

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

**5. Timing of Dissemination**

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

NRMSIRs and other information vendors have indicated in their comment letters that under certain circumstances a 15 minute turnaround[176] time for notices of material events, and a 24 hour turnaround period for annual financial information may be feasible, and, in some instances, already is in place.[177] Nonetheless, because the ultimate scope of the information undertakings was not known to the existing and potential NRMSIRs at the time they submitted their comments, the Commission intends to discuss with the NRMSIRs during the recognition process appropriate and practicable turnaround standards for information re-dissemination. Because SIDs are alternative sources of information for every type of disclosure, the Commission does not intend to impose strict turnaround times for SIDs. Instead, SIDs should provide the Commission and users with a clear statement of turnaround times that they will meet consistently.

**6. Technological Considerations**

The Commission also received many suggestions from information gatherers and vendors on streamlining the filing of disclosure information. These suggestions included requiring electronic filing of disclosure information, providing filings on computer disks and providing information to NRMSIRs as images of original source documents rather than exclusively as coded text.[178] Rather than dictate standards, the Commission encourages municipal securities market participants to coordinate their requirements and preferences on an industry-wide basis.

**D. Exemptions**

The Proposed Amendments contained two new exemptions, which are being adopted with certain modifications. A third new exemption from the annual financial information requirement, for short-term securities, also is being adopted. In addition, Rule 15c2-12's limitation to primary offerings of municipal securities with an aggregate principal amount of $1,000,000 or more, and its existing exemptions, also apply to the amendments.[179]

**1. Small Issuer Exemption**

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

A number of commenters discussed the appropriateness of the proposed dollar exemption, with comments ranging from a call for increased thresholds to no thresholds at all.[180] Some commenters believed that the thresholds should be increased, because many small municipalities would exceed these thresholds if they delay their financings in order to issue a greater amount of bonds at one time. The commenters argued that these are small, infrequent issuers with limited trading in the secondary market and the cost of compliance would outweigh the benefits received from improved secondary market disclosure.[181]

Other commenters took exception to the proposed thresholds because they were too high. These commenters argued that the exemption as proposed would exclude from coverage of the rule the types of issuers who have historically had deficient disclosure practices and disproportionate numbers of defaults.[182] A number of commenters also argued that the $3 million/48

---

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

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

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

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

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

[181] *See, e.g.*, Letter of NAST; Letter of SIA.

[182] *See, e.g.* Letter of Chemical Securities; Letter of Eaton Vance Management; Letter of Edward D. Jones & Co.; Letter of Morgan Stanley; Letter of National Association of Independent Public Finance Advisors; Letter of Norwest Investment Services.

month component of the threshold was too complex.[183]

As adopted,[184] the exemption retains the aggregate $10,000,000 limitation, but eliminates the $3,000,000 threshold. Instead, in addition to falling under the $10,000,000 in outstanding securities threshold, the exemption is conditioned upon an issuer or obligated person providing a limited disclosure undertaking. Under this undertaking, financial information and operating data concerning each obligor for which financial information or operating data is presented in the final official statement, must be provided upon request to any person, or be provided at least annually to the appropriate SID. The undertaking would specify the type of financial information and operating data that will be made available annually, which must include financial information and operating data that is customarily prepared by the obligated person and is publicly available. The final official statement must describe where and how the financial information and operating data can be obtained.

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

In addition to providing financial information and operating data annually, notices of material events must be sent to each NRMSIR or to the MSRB, and the appropriate SID. This public information condition has been adopted in response to comments highlighting the need for information regarding small issuers accessing the public debt market.[185]

The threshold of $10,000,000 has been retained, notwithstanding comments that it was too high or too low. According to statistics provided by one commenter,[186] in 1993, 71% of the approximately 52,000 municipal issuers had under $10,000,000 in outstanding municipal securities. Accordingly, the amendments as proposed already provided significant exemptive relief for small issuers. Indeed, the fact that a majority of issuers fall below that threshold supports conditioning the exemption on a commitment to provide a limited amount of secondary market information from exempt issuers. Even with that condition, a significant percentage of offerings would remain totally exempt from the amendments as adopted, because over 20% of the total issuances in 1993 were under $1,000,000.[187] As these statistics demonstrate, the exemption should exclude a large percentage of small infrequent issuers.

Commenters also questioned how the aggregate thresholds were measured, including whose securities would be included and whether the exemption applied only to outstanding securities that were sold in Offerings subject to the rule.[188] Many commenters indicated that the thresholds should be separately applied to each issuer of municipal securities and each underlying obligor.[189] Thus, in the case of conduit issuers that have no liability on the municipal securities, commenters argued that the thresholds should be determined by reference to the persons who are the beneficiaries of the financing.[190] Some commenters argued that those issuers that had different types of financings that relied on separate revenue streams for repayment, such as dedicated tax revenues, should not be foreclosed from relying on the small issuer exemption for each financing.[191]

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

---

[183] *See, e.g.*, Letter of APPA; Letter of The Bank of New York; Joint Response.

[184] *See* Rule 15c2-12(d)(2).

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

[186] *See* Letter of The Bond Buyer.

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

[188] *See, e.g.*, Letter of ABA Urban Law Section; Letter of CIFA; Letter of Colorado Municipal Bond Supervision Advisory Board.

[189] *See, e.g.*, Letter of ALHFA; Letter of CDFA; Letter of Hawkins Delafield & Wood.

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

[191] *See, e.g.*, Letter of ABA Business Law Section; Letter of Chapman and Cutler; Letter of NABL.

With respect to the second concern, however, the amendments require that an obligated person aggregate all its outstanding obligations, even if some are payable from separate dedicated revenue sources. For example, a city or county that issues securities for a number of different purposes could not qualify as a small and infrequent issuer merely because its outstanding securities are payable from separate revenue streams. Thus, while a governmental issuer's outstanding obligations need not be aggregated with that of non-governmental obligated persons, a governmental issuer could not avoid aggregation of its securities by restricting repayment to separate revenue streams.[192]

Commenters also discussed a related issue of what securities would be included in the calculation. Commenters contended that only publicly offered securities should be included in the calculation. Other commenters questioned how short term obligations such as bond anticipation notes, refunded bonds and installment/lease purchase agreements would be treated. Several commenters suggested that the threshold should be measured only against publicly offered, long-term bonds.[193]

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

A number of commenters indicated that an exemption should be available based on the number of holders of the municipal securities.[194] However, in accordance with concerns voiced by other commenters regarding the difficulty in ascertaining the number of holders due to the fact that most municipal securities are held in street name through a very limited number of depositories,[195] the amendments do not adopt any exemption based on the number of holders of the municipal securities.

A variety of other comments were raised relating to exemptions, and a number of alternative exemptions were proposed, including exemptions based on the type of issuer or the existence of an investment grade rating.[196] Commenters also believed that an exemption should be available for securities covered by bond insurance or other credit enhancement, such as bank letters of credit.[197] Except as described above, the exemptions have not been revised to adopt these suggestions. Commenters, including some bond insurance providers,[198] expressed the view that the existence of credit enhancement does not necessarily eliminate the need for information regarding the underlying credit.

A number of commenters also argued that new exemptions should be added that would mirror exemptions under the Securities Act.[199] Some commenters argued that exemptions should be included for non-profit entities that would have their own exemption from registration under the Securities Act.[200] The Commission is not including any exclusion in the amendments for any such issuers. Issuers accessing the tax-exempt public securities markets have obligations to promote the integrity and efficiency of those markets. As the Commission noted in the Interpretive Release, the high level of defaults in sectors such as healthcare, lifecare, retirement homes and multifamily housing, relative to other market sectors,[201] and the past problems with the sufficiency of information in many of these sectors, weighs heavily against adopting such exclusions.

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

A new exemption has been added to exempt from the requirement for an undertaking calling for annual financial information, Offerings of securities with an 18 month or shorter maturity.[202] The new exemption is in response to comments suggesting that the rule not require annual financial information in situations where the securities would mature shortly after, or possibly even before, the annual financial information would be due.[203] The provisions of the amended rule relating to notices of material

---

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

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

[194] *See, e.g.*, Letter of ABA Business Law Section; Letter of Kutak Rock; Letter of Mudge Rose; Letter of National League of Cities.

[195] *See, e.g.*, Letter of Bank One Corporation; Letter of Reliance Trust Company.

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

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

[198] As some commenters indicated, the existence of credit enhancement or other programmatic enhancement features does not eliminate the need for information on underlying obligated persons, particularly where there is a long term guarantee, because of the potential impact of a default on the pricing of the securities. *See* Letter of Kutak Rock on behalf of Financial Guaranty Insurers; Letter of FGIC; Letter of Prudential Investment Corp. *See also* Securities and Exchange Commission, *Report by the Securities and Exchange Commission on the Financial Guaranty Market: The Use of the Exemption In Section 3(a)(2) of the Securities Act for Securities Guaranteed by Banks and the Use of Insurance Policies to Guarantee Debt Securities* (August 28, 1987).

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

[200] *See, e.g.*, Letter of Morgan Stanley; Letter of Mudge Rose; Letter of New York Dormitory Authority.

[201] Interpretive Release at Section III.D. *See also* Letter of The Bond Buyer.

[202] Rule 15c2-12(d)(3).

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

events, however, would apply to these Offerings absent some other Rule 15c2-12 exemption.

**3. Exemptions from the Recommendation Prohibition**

The Proposed Amendments also included a new exemption,[204] which would have permitted the recommendation in the secondary market of securities that were not subject to the underwriting prohibition, either because they were sold in a primary offering[205] of municipal securities with an aggregate principal amount of less than $1,000,000, or came within the existing exemptions for limited placements, short-term securities, and securities with demand features,[206] or within the new exemption for small, infrequent issuers.[207] This exemption has been adopted as proposed,[208] with the exception that securities sold in an exempt Offering that is subject to the limited undertaking condition,[209] are not exempt from the application of the recommendation prohibition. Pursuant to this element of the small issuer exemption, dealers must have in place procedures to receive notices of material events.[210]

**4. Transactional Exemption**

The existing Rule 15c2-12 transactional exemption[211] permits the Commission to exempt any Participating Underwriter from any requirement of the rule. Because Rule 15c2-12, as amended, places requirements on brokers, dealers, and municipal securities dealers in the secondary market, the transactional exemption has been amended to clarify that the Commission has exemptive authority with respect to both Participating Underwriters, in connection with Offerings, and with respect to brokers, dealers, and municipal securities dealers recommending transactions in the secondary market.[212]

**E. Transitional Provision**

The rule as amended contains a transitional provision for the amendments to Rule 15c2-12.[213] The underwriting prohibition applies to a Participating Underwriter that has contractually committed to act as an underwriter in an Offering on or after the effective date of the rule, July 3, 1995; provided that issuers need not undertake to provide annual financial information for fiscal years ending prior to January 1, 1996. The recommendation prohibition will become effective on January 1, 1996. The Commission is of the view that this delay of six months beyond the effective date of the amendment relating to the underwriting of municipal securities is sufficient to permit participants in the municipal securities market to design procedures for compliance with the provisions of Rule 15c2-12. Brokers, dealers and municipal securities dealers must, therefore, have procedures in place to comply with the recommendation prohibition on or before January 1, 1996. Finally, the limited undertaking condition to the small issuer exemption need not be satisfied for offerings commencing prior to January 1, 1996.

**III. Effects on Competition and Regulatory Flexibility Act Considerations**

Section 23(a)(2) of the Exchange Act[214] requires the Commission, in adopting rules under the Act, to consider the anticompetitive effects of those rules, if any, and to balance that impact against the regulatory benefits gained in terms of furthering the purposes of the Exchange Act. The Commission has considered the amendments to Rule 15c2-12 in light of the standard cited in Section 23(a)(2) and believes the adoption of the amendments will not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

In addition, the Commission has prepared a final regulatory flexibility analysis ("FRFA"), pursuant to the requirements of the Regulatory Flexibility Act[215] regarding the proposed amendments to Rule 15c2-12. The Commission requested comment on the extent to which current practice deviates from the requirements of the proposed amendments, and the extent to which additional costs may be imposed on small issuers, brokers, dealers, and municipal securities dealers if the amendments are adopted as proposed. The FRFA indicates that the amendments to the rule could impose some additional costs on small broker-dealers and municipal issuers. Nonetheless, the Commission is of the view that many of the substantive requirements of the amendments already are observed, absent access to the continuing information provided by the amendments, by issuers, brokers, dealers, and municipal securities dealers as a matter of business practice, or to fulfill their existing obligations under the antifraud provisions of the federal securities laws. To the extent that the Proposed Amendments would have imposed additional costs on small issuers, brokers, dealers, and municipal securities dealers, in response to commenters' concerns, the Commission has modified the amendments as described.

A copy of the FRFA may be obtained from Janet W. Russell-Hunter, Attorney, Office of Chief Counsel, Division of Market

---

[204] *See* paragraph (d)(3) of the Proposed Amendments.

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

[206] *See* paragraph (d)(1) of the Proposed Amendments.

[207] *See* paragraph (d)(2) of the Proposed Amendments.

[208] Rule 15c2-12(d)(4).

[209] *See* Rule 15c2-12(d)(2).

[210] *See* Rule 15c2-12(b)(5)(i)(C).

[211] Former paragraph (d) of Rule 15c2-12.

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

[213] *See* Rule 15c2-12(g).

[214] 15 U.S.C. 78w(a)(2).

[215] 5 U.S.C. 604.

Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 7-10, Washington, D.C. 20549, (202) 942-0073.

**List of Subjects in 17 CFR Part 240**

Reporting and recordkeeping requirements, securities.

**Text of Amendments to Rule 15c2-12**

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

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

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

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

* * * * *

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

§ 240.15c2-12 *Municipal securities disclosure.*

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

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

* * * * *

(b) *Requirements.*

* * *

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

(A) To each nationally recognized municipal securities information repository and to the appropriate state information depository, if any, annual financial information for each obligated person for whom financial information or operating data is presented in the final official statement, or, for each obligated person meeting the objective criteria specified in the undertaking and used to select the obligated persons for whom financial information or operating data is presented in the final official statement, except that, in the case of pooled obligations, the undertaking shall specify such objective criteria;

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

(C) In a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any, notice of any of the following events with respect to the securities being offered in the Offering, if material:

(*1*) Principal and interest payment delinquencies;
(*2*) Non-payment related defaults;
(*3*) Unscheduled draws on debt service reserves reflecting financial difficulties;
(*4*) Unscheduled draws on credit enhancements reflecting financial difficulties;
(*5*) Substitution of credit or liquidity providers, or their failure to perform;
(*6*) Adverse tax opinions or events affecting the tax-exempt status of the security;
(*7*) Modifications to rights of security holders;
(*8*) Bond calls;
(*9*) Defeasances;
(*10*) Release, substitution, or sale of property securing repayment of the securities;
(*11*) Rating changes; and

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

(ii) The written agreement or contract for the benefit of holders of such securities also shall identify each person for whom annual financial information and notices of material events will be provided, either by name or by the objective criteria used to select such persons, and, for each such person shall:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(e) *Exemptive Authority.* The Commission, upon written request, or upon its own motion, may exempt any broker, dealer, or municipal securities dealer, whether acting in the capacity of a Participating Underwriter or otherwise, that is a participant in a transaction or class of transactions from any requirement of this section, either unconditionally or on specified terms and conditions, if the Commission determines that such an exemption is consistent with the public interest and the protection of investors.

(f) *Definitions.*

* * *

(3) The term *final official statement* means a document or set of documents prepared by an issuer of municipal securities or its representatives that is complete as of the date delivered to the Participating Underwriter(s) and that sets forth

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

* * * * *

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

(10) The term *obligated person* means any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities).

* * * * *

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

By the Commission.

Jonathan G. Katz
Secretary

Dated: November 10, 1994

---

**SECURITIES AND EXCHANGE COMMISSION**
**17 CFR Part 240**
**Release No. 34-34962; File No. S7-6-94**
**RIN: 3235-AF84**
**Confirmation of Transactions**
**AGENCY:** Securities and Exchange Commission
**ACTION:** Final Rule
**SUMMARY:** The Commission is adopting amendments to Rule 10b-10 under the Securities Exchange Act of 1934 that will require brokers and dealers to provide customers immediate written notification of information relevant to their securities transactions. Consistent with the Commission's investor protection mandate and in keeping with innovations in securities products and markets, the amendments will require brokers and dealers to provide information concerning customer transaction costs in specified Nasdaq and exchange-listed securities, the status of certain unrated debt securities, the status of certain non-SIPC member broker-dealers, and the availability of information regarding asset-backed securities.
**EFFECTIVE DATE:** April 3, 1995
**FOR FURTHER INFORMATION CONTACT:** Catherine McGuire, Chief Counsel, C. Dirk Peterson, Senior Counsel, or Terry R. Young, Attorney (202/942-0073), Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 7-10, Washington, D.C. 20549.
**SUPPLEMENTARY INFORMATION:**
I. *INTRODUCTION AND SUMMARY*

A. *PRICE TRANSPARENCY*

During the past year, the Commission has initiated efforts to further improve the efficiency of, and to protect investors in, the municipal securities and other debt markets. In September 1993, the Commission's Division of Market Regulation published the *Staff Report on the Municipal Securities Market* ("Staff Report"),[1] which contained several recommendations to improve the municipal securities market. The Staff Report recommended, among other things, riskless principal mark-up disclosure as a means of providing greater information to investors purchasing municipal securities.[2] The Staff Report noted that, unlike the equity markets where mark-ups and mark-downs[3] are disclosed to investors in non-market maker riskless principal transactions and principal transactions in "reported securities,"[4] mark-ups are not disclosed in any principal transaction in municipal securities.[5] Thus, investors of municipal securities are constrained in their ability to compare transaction costs among broker-dealers and across markets. The Staff Report identified this ability as one of the benefits of mark-up disclosure.[6]

In addition to enhanced confirmation disclosure, the Staff Report discussed the overall benefits of price transparency and the need for greater transparency in the municipal securities market.[7] Notably, price transparency enhances market liquidity and depth, and fosters investor confidence,[8] while a lack of price information impairs market pricing mechanisms, weakens competition, and prevents investors from monitoring the quality of their executions.[9]

To address some of the recommendations contained in the Staff Report, on March 9, 1994, the Commission published for comment proposed Rule 15c2-13 under the Securities Exchange Act of 1934 ("Exchange Act")[10] to require disclosure of mark-ups in riskless principal transactions in municipal securities. Because the same benefits of mark-up disclosure apply to other debt transactions, the Commission proposed amendments to Rule 10b-10 ("Rule") under the Exchange Act that would require riskless principal mark-up disclosure for debt securities other than municipal securities.[11]

Since the Proposing Release was published for comment on March 9, 1994, municipal market participants have proposed significant new ways of making pricing information more widely available to investors. The Municipal Securities Rulemaking Board ("MSRB") has taken the first step toward a system that will make publicly available price information for municipal securities transactions on a next day basis. Recently, the MSRB stated that its "ultimate goal for the [transparency] program is to collect and make available transaction information in a comprehensive and contemporaneous manner (footnote omitted) . . . [and] wishe[d] to reiterate to the Commission its commitment to these goals."[12] The Public Securities Association ("PSA") also has proposed a system to publicize municipal securities price information. These proposals will create the infrastructure necessary to enhance transparency in the market, and when fully implemented, will provide last sale reporting for virtually all municipal securities transactions.

The Commission is encouraged by these developments, and after careful consideration, has determined to defer the riskless principal mark-up proposal for six months[13] in anticipation of meaningful progress by the industry toward enhanced price transparency in the municipal securities market. The riskless principal mark-up proposals would provide better information only to a certain segment of transactions in the debt markets. The industry's efforts to improve transparency, on the other hand, ultimately will result in enhanced price disclosure for *all* transactions. Moreover, better dissemination of price information will benefit investors by providing them with useful information at the time they are making their investment decision, rather than after-the-fact when the confirmation is received. If, at the end of the six-month period, industry initiatives to improve price transparency have not progressed to the Commission's satisfaction, however, the Commission may reconsider the riskless principal mark-up proposal in light of existing alternatives.

B. *OTHER DISCLOSURES*

In addition to the riskless principal mark-up proposals, the Commission proposed several other amendments designed to

---

[1] *Staff Report on the Municipal Securities Market* (September 1993).

[2] Staff Report, at 16 and 18.

[3] For purposes of this release, references to mark-ups also will apply to mark-downs or commission equivalents.

[4] *See infra* note 71 for a discussion of "reported securities."

[5] Staff Report, at 15-16.

[6] *Id.* at 16.

[7] Staff Report, at 20 and 36.

[8] Testimony of Arthur Levitt, Chairman, U.S. Securities and Exchange Commission, Concerning International Markets and Individuals Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 28, 1994.

[9] *See* Brandon Becker, Director, Division of Market Regulation, Address at 19th International Organization of Securities Commissions Annual Conference (1994).

[10] Securities Exchange Act Release No. 33743 (March 9, 1994), 59 FR 12767 ("Proposing Release").

[11] The Commission previously proposed disclosure requirements of mark-ups in riskless principal transactions on three other occasions. *See* Securities Exchange Act Release No. 15220 (Oct. 6, 1978), 43 FR 47538 (proposing mark-up disclosure for riskless principal transactions in municipal securities); Securities Exchange Act Release No. 13661 (June 23, 1977), 42 FR 33348 (proposing mark-up disclosure by non-market makers in riskless principal equity and debt securities, but not municipal securities); and Securities Exchange Act Release No. 12806 (Sept. 16, 1976), 41 FR 41432 (proposing mark-up disclosure by non-market makers in riskless principal transactions involving equity and debt securities).

[12] Letter from Robert H. Drysdale, Chairman, MSRB, to Arthur Levitt, Chairman, SEC (Nov. 3, 1994), at pp. 1-2. Available in Public Reference File No. S7-6-94.

[13] Recently, the MSRB set forth a tentative schedule for the completion of each of the four phases of its proposal: phase one (inter-dealer transactions, January 1, 1995); phase two (addition of time of trade and institutional customer transactions, December 1995); phase three (addition of retail customer transactions, November 1996); and phase four (more contemporaneous trade reporting, April 1997). *See* Letter from Robert H. Drysdale, Chairman, MSRB, to Arthur Levitt, Chairman, SEC, (Nov. 3, 1994), at pp. 3-7. Available in Public Reference File No. S7-6-94.

improve confirmation disclosure so that customers can better evaluate their securities transactions. Specifically, the Commission proposed amendments to Rule 10b-10 that would require broker-dealers to disclose (1) mark-ups in connection with transactions in certain Nasdaq and regional exchange-listed securities; (2) if they are not members of the Securities Investor Protection Corporation ("SIPC"); (3) information relevant to certain types of collateralized debt instruments; and (4) if a debt security has not been rated by a nationally recognized statistical rating organization ("NRSRO"). Proposed Rule 15c2-13 contained a similar provision requiring broker-dealers to disclose the unrated status of a municipal security.

The Commission also requested comment on the broader issue of whether the shortened settlement period of three days ("T+3 Settlement") will have an effect on the future utility of the confirmation and whether some information currently required in the confirmation could be shifted to an account statement.[14] In addition, the Commission proposed adding a preliminary statement to Rule 10b-10 designed to clarify that the Rule is not intended as a safe harbor from the general antifraud provisions of the federal securities laws.[15]

In response to the request for comment, the Commission received 344 comment letters, the majority of which addressed the mark-up disclosure proposals for riskless principal transactions. Commenters included regional and national broker-dealers, industry associations, financial institutions, law firms, insurance companies, and individual investors.[16] The comments presented a range of views with respect to the proposals and the effects that the proposed disclosure requirements may have on broker-dealers, investors, and markets.

After a review of the comments, the Commission is adopting the proposed amendments to Rule 10b-10 that require disclosure if a debt security is not rated by an NRSRO, with a modification to exclude all government securities from the disclosure requirement; mark-up disclosure in connection with transactions in certain Nasdaq and regional exchange-listed securities; disclosure if a broker-dealer is not a member of SIPC, except for certain transactions in investment company shares by non-SIPC member firms that do not handle customer funds or securities; and disclosure with respect to the availability of information with respect to transactions in collateralized debt securities. The Commission also is adopting the preliminary note to Rule 10b-10. To allow firms the appropriate time to adapt their systems to accommodate these disclosure requirements, the proposals will become effective April 3, 1995.

In addition, that portion of Rule 15c2-13 that would require disclosure if a municipal security was not rated by an NRSRO has been deferred and will be withdrawn if the MSRB acts to adopt similar amendments to its confirmation rule, Rule G-15.[17] The MSRB recently reiterated its willingness to amend Rule G-15 to require disclosure if a municipal security is not rated by an NRSRO.[18]

* * * * *

By the Commission.

Jonathan G. Katz
Secretary

November 10, 1994

[14] *See* Proposing Release, *supra* note 10, at 59 FR 12767-68.
[15] *Id.* at 59 FR 12772.
[16] The comment letters and a summary of comments have been placed in Public Reference File No. S7-6-94, which is available for inspection in the Public Reference Room.
[17] MSRB Rule G-15, MSRB Manual (CCH) ¶ 3571.
[18] Letter from Robert H. Drysdale, Chairman, MSRB, to Arthur Levitt, Chairman, SEC (Nov. 3, 1994). Available in Public Reference File No. S7-6-94.

# Publications List

## *Manuals and Rule Texts*

**MSRB Manual**
Soft-cover edition containing the text of MSRB rules, interpretive notices and letters, samples of forms, texts of the Securities Exchange Act of 1934 and of the Securities Investor Protection Act of 1970, as amended, and other applicable rules and regulations affecting the industry. Reprinted semi-annually.
October 1, 1994 ..... $5.00

**Glossary of Municipal Securities Terms**
Glossary of terms (adapted from the State of Florida's *Glossary of Municipal Bond Terms*) defined according to use in the municipal securities industry.
1985 ..... $1.50

**Instructions for Filing Forms G-36**
This publication is available to assist underwriters in submitting official statements, advance refunding documents and complete and correct Forms G-36.
1994 ..... no charge

**Professional Qualification Handbook**
A guide to the requirements for qualification as a municipal securities representative, principal, sales principal and financial and operations principal, with questions and answers on each category. Includes sections on examination procedures, waivers, disqualification and lapse of qualification, the text of MSRB qualification rules and a glossary of terms.
1990 ..... 5 copies per order ..... no charge
Each additional copy ..... $1.50

**Manual on Close-Out Procedures**
A discussion of the close-out procedures of rule G-12(h)(i) in a question and answer format. Includes the text of rule G-12(h)(i) with each sentence indexed to particular questions, and a glossary of terms.
January 1, 1985 ..... $3.00

**Arbitration Information and Rules**
Based on SICA's *Arbitration Procedures* and edited to conform to the Board's arbitration rules, this pamphlet includes the text of rules G-35 and A-16, a glossary of terms and list of other sponsoring organizations.
1991 ..... no charge

**Instructions for Beginning an Arbitration**
Step-by-step instructions and forms necessary for filing an arbitration claim.
1991 ..... no charge

**The MSRB Arbitrator's Manual**
The Board's guide for arbitrators. Based on SICA's *The Arbitrator's Manual*, it has been edited to conform to the Board's arbitration rules. It also contains relevant portions of the *Code of Ethics for Arbitrators in Commercial Disputes*.
1991 ..... $1.00

## *Reporter and Newsletter*

**MSRB Reports**
The MSRB's reporter and newsletter to the municipal securities industry. Includes notices of rule amendments filed with and/or approved by the SEC, notices of interpretations of MSRB rules, requests for comments from the industry and the public and news items.
Quarterly ..... no charge

## *Examination Study Outlines*

A series of guides outlining subject matter areas a candidate seeking professional qualification is expected to know. Each outline includes a list of reference materials and sample questions.

**Study Outline: Municipal Securities Representative Qualification Examination**
Outline for Test Series 52
July 1992 ..... no charge

**Study Outline: Municipal Securities Principal Qualification Examination**
Outline for Test Series 53
January 1993 ..... no charge

## *Brochure*

**MSRB Information for Municipal Securities Investors**
Investor brochure describing Board rulemaking authority, the rules protecting the investor, arbitration and communication with the industry and investors. Use of this brochure satisfies the requirements of rule G-10.
1 to 500 copies ..... no charge
Over 500 copies ..... $.01 per copy

# Publications Order Form

| Description | Price | Quantity | Amount Due |
|---|---|---|---|
| MSRB Manual (soft-cover edition) | $5.00 | | |
| Glossary of Municipal Securities Terms | $1.50 | | |
| Professional Qualification Handbook | 5 copies per order no charge<br>Each additional copy $1.50 | | |
| Manual on Close-Out Procedures | $3.00 | | |
| Instructions for Filing Forms G-36 | no charge | | |
| Arbitration Information and Rules | no charge | | |
| Instructions for Beginning an Arbitration | no charge | | |
| The MSRB Arbitrator's Manual | $1.00 | | |
| Study Outline: Municipal Securities Representative Qualification Examination | no charge | | |
| Study Outline: Municipal Securities Principal Qualification Examination | no charge | | |
| MSRB Information for Municipal Securities Investors (Investor Brochure) | 1 to 500 copies no charge<br>Over 500 copies $.01 per copy | | |
| | | Subtotal | |
| | | D.C. residents add 5.75% sales tax; Virginia residents add 4.5% sales tax | |
| | | Total amount due | |

☐ Check here if you currently do not have a subscription, but want to receive *MSRB Reports*.

☐ Check here if you want to have *MSRB Reports* sent to additional recipients. (Please list names and addresses of any additional recipients on a separate sheet of paper.)

Requested by: _____ Telephone: (  ) _____ Date: _____

Ship to: _____

Attention: _____

Address: _____
(Street address preferred)

_____

All orders for publications that are priced **must** be submitted by mail along with payment for the full amount due. Requests for priced publications will not be honored until payment is received. Make checks payable to the "Municipal Securities Rulemaking Board" or "MSRB."
Orders should be addressed to the Municipal Securities Rulemaking Board, 1640 King Street, Suite 300, Alexandria, Virginia, 22314-2719, Attention: Publications.

# MSRB Seminar on Recent Initiatives

## January 12, 1995
## Hotel Crescent Court
## 2200 Cedar Springs
## Dallas, Texas

**SEMINAR AGENDA**

| | |
|---|---|
| 10:00–10:15a.m. | **Introduction, MSRB Chairman Robert H. Drysdale,** President and CEO of PNC Securities Corporation |
| 10:15–11:00a.m. | **General Session I.** Christopher A. Taylor, Executive Director and Diane G. Klinke, General Counsel<br>• MSRB Priorities<br>• Political Contributions<br>• Secondary Market Disclosure<br>• Continuing Education |
| 11:15a.m.–Noon | **General Session II.** Harold L. Johnson, Deputy General Counsel and Judith A. Somerville, Uniform Practice Specialist<br>• T+3<br>• Transaction Reporting |
| Noon–1:30p.m. | **Lunch** (on your own) |
| 1:30–2:15p.m. | **Concurrent Workshops Session I.**<br>• Operations and Fair Practice<br>• Political Contributions |
| 2:30–3:15p.m. | **Concurrent Workshops Session II.**<br>• Operations and Fair Practice<br>• Continuing Education |

Those who are interested in attending should contact Pat Hardy, MSRB, 1150 18th Street N.W., Washington, D.C. 20036, telephone (202) 223-9347, fax (202) 872-0347. The per person fee is $50 if paid before January 1, 1995 and $75 thereafter.