

**QUESTIONS AND ANSWERS
ABOUT THE
SEC's
NEW MUNICIPAL
DISCLOSURE RULES**

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This memorandum provides an overview of the obligations imposed on municipal issuers as a result of the Securities and Exchange Commission's adoption and recent amendment of [Rule 15c2-12](#). The questions and answers contained herein have been designed to provide a working understanding of the Rule. This memorandum can not answer all of the questions that our issuer clients will have, and we urge you to call your usual contact at Jones Hall or a member of our Municipal Securities and Disclosure Group with specific questions. Numerous details and exceptions, which could be crucial to a given issuer or bond issue, have been omitted for the sake of general readability. Therefore, this memorandum is not meant to be, nor should it be construed to be, legal advice, which may only be given directly to a client following consideration of a specific factual situation.

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We have used our best efforts to compile and provide only the most accurate information available in the subject matter areas which are covered herein. However, we make no warranty or representation as to the accuracy or completeness thereof. The reader is encouraged to conduct his or her own independent research on any topic dealt with herein before relying upon such information.

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GENERAL OVERVIEW OF THE RULE

On November 10, 1994, the Securities and Exchange Commission adopted amendments (the "Amendments") to existing federal regulations ("Rule 15c2-12" or the "Rule"), beginning a whole new era for municipal securities. Historically, municipal securities have been relatively free from federal regulation; but beginning July 3, 1995, that will no longer be true. For each issue of municipal securities sold on or after July 3, 1995, issuers will be required to do each of the following (subject to the exemptions described herein):

1. Prepare official statements meeting the content requirements of the Rule.
2. File certain financial information and operating data with national and state repositories each year.
3. Prepare announcements of the significant events enumerated in the Rule (including payment defaults, defeasances and draws on a reserve fund) as the events occur.

This memorandum of questions and answers is designed to orient municipal issuers to the new world of Securities and Exchange Commission ("SEC") regulation under the Rule. The full text of the Rule is set forth in Appendix A.

1. What is Rule 15c2-12?

Rule 15c2-12 is a federal regulation which was originally adopted by the SEC in 1989 in response to a perceived need to improve then existing disclosure practices in the municipal marketplace. The Rule, as originally adopted, requires underwriters to review a preliminary official statement "deemed final" by the issuer prior to offering or purchasing municipal securities. Thus, although the Rule technically applies to underwriters, the effect of the Rule is to impose obligations on municipal issuers. By requiring underwriters to review a preliminary official statement deemed final by the issuer, the SEC believed that both the content of the disclosure and the timely dissemination of the preliminary official statement would improve.

The Amendments relate to an additional perceived problem, namely, the lack of reliable information in the secondary market. The SEC's solution, as embodied in the Rule, is to require issuers to provide continuing disclosure throughout the life of each of their bond issues.

In addition to the obvious investor benefits, continuing disclosure can be beneficial to issuers as well. To the extent that investors perceive reliable continuing information as a factor which enhances the liquidity of a security in the secondary market, they may accept a lower interest rate at the time of issuance. The resulting interest savings would directly accrue to the issuer. Additionally, as discussed in [Question 28](#), reliable continuing disclosure could avoid potential issuer liability resulting from incomplete publicly available information about the issuer, or from uneven access to reliable and complete information by all market participants.

2. From an issuer's standpoint, what are the actual requirements of the Rule which have been in effect since its original effective date in 1989?

The principal requirements for issuers which have been applicable since 1989 are as follows:

The issuer is required to deem the preliminary official statement "final as of its date" prior to the time it is distributed.

This portion of the Rule is typically satisfied by either a certificate of the issuer, in the case of a negotiated sale, or by a certification in the notice of sale, in the case of a public sale. By signing the certificate or distributing the notice of public sale, the issuer certifies to the underwriter or potential bidders that, except for certain enumerated items which will be determined in the pricing process (such as interest rates, maturity amounts and prices), the preliminary official statement is complete. This portion of the Rule was designed to end the practice of marketing securities with an incomplete preliminary official statement and taking comfort in the fact that investors would ultimately be provided with a complete final official statement.

The issuer must contract with the underwriter to provide, within seven business days of signing the purchase contract, or acceptance of the winning bid in the case of a public sale, copies of the final official statement in sufficient quantity to allow the underwriter to comply with its delivery requirements under the Rule and rules of the Municipal Securities Rulemaking Board.

This portion of the Rule is also typically satisfied by either a provision in the purchase contract or the notice of public sale. The seven business day requirement was designed to ensure that final official statements would be available to investors at or prior to the closing.

3. What new requirements do the Amendments add?

The Amendments add significant new obligations, including the following:

The issuer must undertake in a written agreement or contract for the benefit of holders of the securities being issued to file with national and state repositories:

1. *Certain annual financial information (see [Question 5](#)).*
2. *Audited financial statements, when and if available (see [Question 18](#)).*
3. *Notice of certain enumerated events (see [Question 22](#)).*
4. *Notice of any failure to provide such annual financial information as agreed.*

These requirements are the heart of the Amendments and are generally applicable to any issue sold on or after July 3, 1995 (see [Question 4](#)), subject to certain exemptions for small issuers (see [Question 46](#)) and short term issues such as TRANS (see [Question 45](#)).

The required undertakings by the issuer must be contained in a "written agreement or contract for the benefit of holders of the

the required arrangements by the issuer must be contained in a written agreement or contract for the benefit of holders of the securities." The most likely places are the indenture, trust agreement or resolution of issuance, a separate agreement between the issuer and the trustee or an undertaking by the issuer which specifically recites that it is for the benefit of securities holders. Since the official statement is not a contract for the benefit of securities holders, an undertaking in the official statement will not satisfy the Rule.

The written agreement or contract for the benefit of holders of the securities must also identify each person or entity for whom annual financial information and notices of material events will be provided, and for each such person must specify the following:

1. The type of financial information and operating data to be provided as part of the annual financial information.
2. The accounting principles pursuant to which financial statements will be prepared, and whether the financial statements will be audited.
3. The date on which the annual financial information for the preceding fiscal year will be provided, and to whom.

As discussed below, the entities required to file annual financial information and operating data, and the type to be filed, will be determined by the participants in the offering as they prepare the official statement.

4. What is the effective date of the Amendments?

The Amendments are generally applicable to municipal securities sold on and after July 3, 1995. However, the requirements with respect to filing annual financial information and operating data and audited financial statements only apply with respect to fiscal years ending after December 31, 1995. Thus, if an issuer with a July 1 fiscal year enters into a purchase agreement for a new issue on July 3, 1995, the first annual financial information, operating data and audited financial statements to be filed would be those relating to the fiscal year ending June 30, 1996.

Portions of the small issuer exemption have a January 1, 1996 effective date (see [Question 46](#)).

THE ANNUAL DISCLOSURE REQUIREMENT

The Rule requires municipal issuers to file certain annual financial information and operating data with national and state repositories. The following Questions describe the annual filing requirements.

5. What annual financial information does the Rule require issuers to file?

The Rule states that the term "annual financial information" means "financial information or operating data, provided at least annually, of the type included in the final official statement." Therefore, rather than provide a list applicable to all issues, the Rule uses the final official statement as a guide. The SEC took this approach because the varied nature of municipal issuers and the numerous types of municipal securities make uniform, specific requirements somewhat problematic. In the release adopting the Amendments the SEC stated:

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. Exchange Act Release No. 34961, 59 Fed. Reg. (the "Amendment Release") at 59592 (1994).

6. Must information in the official statement other than financial information and operating data be updated annually?

The annual updating requirement of the Rule relates only to "financial information and operating data." The phrase "financial information and operating data" was carefully chosen to generally limit the scope of the Rule's requirement to quantitative data. In the release adopting the Amendments, the SEC stated:

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. To clarify the intended *quantitative* focus of the rule, as adopted, the rule uses the term "financial information and operating data." Amendment Release at 59593, emphasis added.

Thus, in a city general fund lease financing, for example, the city could undertake in the trust agreement or continuing disclosure agreement to file on an annual basis its adopted budget, audited financial statements and updates of certain enumerated tables and charts in the final official statement. In the adopting release the SEC provided the following example:

If financial information or operating data . . . 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 . . . are not subject to the rule's dissemination provisions. Amendment Release at 59598.

7. Where must the annual financial information be filed?

Annual financial information is required to be filed with *each nationally recognized municipal securities information repository ("NRMSIR")*, and with the appropriate *state information depository*, if any (both described in [Question 8](#)).

8. What is a NRMSIR and an appropriate state information depository?

A NRMSIR is a repository for municipal securities information which has been acknowledged as a nationally recognized municipal securities information repository by the SEC. Prior to the Amendments, there were three such repositories: Bloomberg Financial Markets Repository, Kenny Alert and The Bond Buyer. When the SEC adopted the Amendments, it required each of the existing NRMSIRs to reapply for NRMSIR status.

The existing NRMSIRs, as well as other repositories, are likely to be certified as NRMSIRs under the Rule. Note that the annual financial information must be filed with *each* NRMSIR. The Rule also permits states to establish, or contract for, state depositories. At this time California has not established a state depository, but State officials are considering the matter.

9. Must the issuer make the filings itself?

No. The Rule specifically states that the annual filings may be made "either directly or indirectly through an indenture trustee or a designated agent." Trustees or other public finance professionals which deal with numerous issues and issuers may ultimately prove to be the most efficient means for making the required filings, especially since NRMSIRs, their addresses and filing mechanics, may change over the life of the issue. Thus, the indenture or continuing disclosure agreement might provide that the agreed upon annual disclosure materials would be filed by the issuer with the trustee or another designated agent, which would in turn make the actual filings with the NRMSIRs and state depository, if any.

10. About whom is annual financial information required?

Annual financial information is required for each "obligated person" for whom financial information or operating data is presented in the final official statement, or, for each "obligated person" meeting objective criteria specified in the undertaking. Objective criteria would be used, for example, in a pooled offering where the issuer might undertake to require annual financial information to be provided for any borrower that is responsible for 10% or more of the debt service on the pooled bonds.

11. Generally, who is an "obligated person"?

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

12. Will the governmental issuer of the municipal securities always be an "obligated person"?

The government issuer will be an "obligated person" except with respect to issues, such as a private activity conduit issue, where it has no payment obligation on the securities.

13. Would a major taxpayer be an "obligated person" in a general obligation or tax allocation financing?

No, unless it were also committed by contract or other arrangement to support payment of all or part of the payment obligation on the municipal securities. The fact that a major taxpayer is responsible for a significant amount of the property tax revenue supporting a bond issue does not of itself make such person an "obligated person" under the Rule. Note, however, that good disclosure practices might dictate that some information about such a major taxpayer be included in the official statement.

14. Would the developer in a single developer assessment district or Mello-Roos financing be an "obligated person" subject to the Rule?

The SEC left this question to be answered by the participants in the underwriting. In a footnote to the Release adopting the Amendments, the SEC stated that "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." Amendment Release at 59596, nt. 74.

15. If an issue is payable solely from an enterprise fund (e.g., water or wastewater) of an issuer, is the issuer an "obligated person"?

The issuer would be an "obligated person" since it is committed through an "enterprise, fund, or account" to the support payment on the securities.

16. The Rule requires financial information, both in the official statement and annually. What constitutes adequate financial information?

The goal of all good disclosure, whether in an official statement or otherwise, is to present clearly and concisely all "material" information; that is, the information a reasonable person would want to know in order to independently evaluate whether to purchase the securities. A leading United States Supreme Court case (*TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438,449 (1976)) stated that "an omitted fact is material if there is a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor]. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

Thus, the scope and extent of the financial information to be included in an official statement, and in the annual financial information filing, will depend on the facts and circumstances of the particular issue. In its March 1994 release entitled "Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others" the SEC stated:

of the Commission regarding Disclosure Obligations of Municipal Securities Issuers and Others, the SEC stated:

Financial information beyond that contained in the financial statements -- provided in tabular and narrative format, footnotes, supplemental tables, schedules and discussions of operations and financial position -- is essential to the fair presentation of an issuer's financial performance and position. As reflected in industry guidelines, the type of information needed (e.g., tax revenue base, budget, demographics, project revenues and operations) varies depending on the type of issuer, the type of security sold, and the sources for repayment of the bond obligations. Securities Act Release No. 7049, Exchange Act Release No. 33741, 59 Fed. Reg. (the "Issuer Disclosure Obligations Release") at 12752-53 (1994).

The SEC and courts have emphasized that good disclosure is designed to inform the potential investor. Pages of information which is all technically true but fails to clearly tell the essential story is *not* good disclosure. Good disclosure clearly presents the relevant facts that an investor will need to know to evaluate the offered security and the underlying credit.

Material information is generally what *you* would want to know about the issuer prior to investing in it, presented in a readable and clear format.

17. Will a narrative discussion of financial information be necessary in all cases?

Charts and tables may not always be sufficient to truly explain the financial condition and ability to pay of an issuer or other obligated person. Narrative discussions explaining significant trends, deviations therefrom, and other events or circumstances may be necessary to tell an investor the full story. In its March 1994 Release regarding issuer disclosure obligations the SEC stated:

[I]n addition to financial and operating data, the official statement may need to include a narrative explanation to avoid misunderstanding and assist the reader in understanding the financial presentation. A numerical presentation alone may not be sufficient to permit an investor to judge the financial and operating condition of the issuer or obligor. For example, it may be necessary to explain the presentation of budget information and the relationship of the budget figures to the financial statements. Issuer Disclosure Obligations Release at 12753.

In the case of corporate offerings registered with the SEC, such narrative discussions, referred to as "management's discussion and analysis of financial condition and results of operations" are mandatory.

THE AUDITED FINANCIAL STATEMENTS FILING REQUIREMENT

The Rule contains an audited financial statements filing requirement. The following Questions relate to this aspect of the Rule.

18. What is the requirement for filing audited financial statements?

Each obligated person for whom financial and operating data is presented in the official statement is required to file audited financial statements, *when and if available*, with each NRMSIR and with the appropriate state information depository, if any. As in the case of the annual financial information filings discussed above, the audited financial statements may be filed either directly or indirectly through an indenture trustee or designated agent.

19. What if an obligated person does not have audited financial statements?

Then it is exempt from the requirement. As originally proposed, the Rule would have required audited financial statements in all circumstances; however, this requirement was liberalized during the comment process.

20. When must the audited financial statements be filed?

The SEC realized that there is significant variation from state to state and from issuer to issuer as to when fiscal years end and when financial statements are prepared. Therefore, the SEC required that audited financial statements be filed when and if available, rather than within a specified time period.

21. Would an "obligated person" for whom financial information, but not audited financial statements, is presented in the final official statement, be required to file audited financial statements?

Yes. Even if the participants in the offering believed that such audited financial statements were not material to the offering, such statements must still be filed annually, when and if available.

THE MATERIAL EVENT DISCLOSURE REQUIREMENT

The Rule requires that notification be given of certain events relating to an issue of securities. The following Questions describe the event notice requirements.

22. What events require a filing of notice?

The Rule requires that notice of any of the following events with respect to a given issue of securities be filed, *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;

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; and
11. Rating changes.

23. When is an event material?

The concept of "materiality" is discussed in [Question 16](#). Generally speaking, an event or fact is "material" if it is likely that it will assume actual significance in the deliberations of a reasonable investor.

24. Where must the event disclosure be filed?

The Rule requires that event disclosure be filed with each NRMSIR or the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any. As in the case of the annual disclosure, such filings may be made either directly or indirectly through an indenture trustee or designated agent.

25. How soon after an event occurs is the notice required to be filed?

The Rule requires that the notices be filed "in a timely manner." The meaning of this phrase will be further clarified as issuers and their counsel start to apply the Rule in practice. Clearly, notice should be filed as soon as the facts and their reasonable expected impact is determined. However, even if all the facts and their effects are not known, the issuer should consider disclosing the information and facts that are available, with supplemental filings as further information becomes known and developments arise. With regard to the timing of event disclosure, the SEC stated that:

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. Amendment Release at 59601.

26. What if the same event is applicable to more than one bond issue?

The requirements of the Rule are applicable to each issue separately. Therefore, an issuer would need to make a filing with respect to each issue to which the event relates. Note that since a single event may have different ramifications for different issues, the event disclosure may need to be tailored to each issue.

27. What if a material event occurs which is not on the list set forth in the Rule?

The list in the Rule sets forth the events which, if material, *must* be disclosed. In addition, material events not on the Rule's list may be required to be disclosed under generally applicable securities law principles. For example, assume that a major taxpayer announces that it will be abandoning its plant located in a redevelopment project area and that such closure will have a material impact on the tax increment revenue in the project area. This event, although material, is not on the Rule's list of events which require disclosure. However, if the redevelopment agency is disseminating its tax increment data for the prior year to the investment community (e.g., in its annual financial information filing under the Rule), such data would be misleading without a statement concerning the imminent plant closure and its expected effect on future tax increment revenues. The SEC has clearly stated its position that under the foregoing example, the issuer would have an obligation to disclose the plant closure whether or not its continuing disclosure covenants covered the event.

28. What if the publication of material information is not specifically addressed to the investment community, but is just generally published?

The key is whether it can be reasonably expected that the investing community will rely on the information. To continue with the example of the plant closure in a redevelopment project area, if the Mayor is discussing city and redevelopment agency finances during an election campaign speech, the investing community, even if it is listening, probably would not be justified in assuming that a complete financial picture is being presented. However, when addressing a topic or situation in a format that can reasonably be expected to reach the investing community, issuers should take great care to disclose the full story.

In its 1994 release regarding municipal issuer disclosure responsibilities the SEC stated:

Since access by market participants to current and reliable information is uneven and inefficient, municipal issuers presently face a risk of misleading investors through public statements that may not be intended to be the basis of investment decisions, but nevertheless may reasonably be expected to reach the securities markets. As market participants have urged, in order to minimize the risk of misleading investors, municipal issuers should establish practices and procedures to identify and timely disclose, in a manner designed to inform the trading market, material information reflecting on the creditworthiness of the issuer and obligor and the terms of the security. Issuer Disclosure Obligations Release at 12756.

29. Since the annual financial information required to be filed by the Rule is intended to be relied on by the investing community, must *all* material facts be disclosed at the time of each annual filing?

No. However, if the financial information filed pursuant to the Rule would be misleading unless the material facts were disclosed, then such facts may not be omitted. On the other hand, a material event completely unrelated to the financial information and operating data presented in the annual filing need not be disclosed under the Rule.

The Rule contains specific content requirements for official statements. The following Questions relate to the official statement requirements.

30. What requirements of the Rule relate to Official Statements?

The Amendments contain a definition of "final official statement" which requires that the final official statement set forth:

1. Information concerning the terms of the proposed issue of securities; information, including financial information or operating data, concerning such issuers and those other entities, enterprises, funds, accounts, and other persons material to an evaluation of the offering.
2. A description of the annual updating and events disclosure undertakings made by the issuer and other obligated persons pursuant to the Rule.
3. Any instances in the previous five years in which an obligated person about which financial information is included in the official statement failed to comply in all material respects with its undertakings to provide annual disclosure information.

31. Is financial information about private entities required to be included in a final official statement?

The definition of final official statement requires the inclusion of financial information or operating data concerning any entity or person material to an evaluation of the offering. Therefore, financial information about private entities could be required. For example, if 90% of the property in a redevelopment project area is owned by a single large manufacturing company, a reasonable investor would probably want to be informed about the company's ability to pay its property taxes and about the prospects for the company remaining in the project area. Note that this does not necessarily mean that the company's audited financial statements should be included in the official statement. The participants in the offering would need to decide what information about the company was material to the offering. Such information would be required to be included in the official statement.

32. Will the issuer's complete audited financial statements always be included in the official statement?

Not always. For example, in the case of a city revenue bond issue secured solely by net revenues of its water enterprise, only the portions of the audited financial statements relating to the water enterprise need be included. However, if the participants in the offering were to conclude that information about the city's general finances would for some reason be material to an investor, then the full audit would be included. A central theme of the Rule is that the participants in the offering are responsible for making the determination as to what financial information and operating data is material to the offering and, therefore, needs to be included in the official statement. Note, however, that even if the issuer's complete audited financial statements are not included in the official statement, the Rule still requires that they be filed on an annual basis (see [Question 21](#)).

33. May official statements incorporate by reference information previously filed with information repositories?

Yes. Financial information or operating data may be set forth in the official statement, or may be included by specific reference to documents previously provided to each NRMSIR, and to a state information depository, if any, or filed with the SEC. If the document from which information is being incorporated is an official statement, it must be on file with the Municipal Securities Rulemaking Board.

34. If an issue is insured or backed by a letter of credit, must information about the municipal issuer or other obligated persons be included in the official statement?

In its July 1989 Release adopting the Rule, the SEC stated that, "In the Commission's view, the presence of credit enhancements generally would not be a substitute for material disclosure concerning the primary obligor on municipal bonds." . . . "Investors in public offerings of securities backed by insurance policies have an interest in information allowing them to assess the financial resources of both the issuer and the insurer." Exchange Act Release No. 26985, 54 Fed. Reg. (the "Adopting Release") at 28812, 28812 nt. 89 (1989). Therefore, material information regarding the issuer or other obligated persons is ordinarily included in the official statement, even though the issue is insured or backed by a letter of credit.

GENERAL MECHANICS APPLICABLE TO THE RULE

The following Questions relate to certain practical and operational provisions of the Rule.

35. When does the obligation to file annual information terminate?

The continuing information requirements last the entire term of the financing. However, the filing requirements for particular obligated persons (including issuers) may terminate earlier. In the release adopting the Rule the SEC stated:

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. Amendment Release at 59600.

36. Who is an "issuer" for purposes of the Rule?

The Rule defines "issuer" to include the governmental issuer and the issuer of any "separate security" under federal securities law. Thus, the "issuer" could include the governmental entity commonly considered to be the issuer and perhaps others as well. In a typical conduit healthcare financing, for example, where a governmental authority issues bonds and loans the proceeds to a private hospital, both the authority (which is the issuer of the bonds) and the hospital (which is considered the issuer of the loan agreement

hospital, both the authority (which is the issuer of the bonds) and the hospital (which is considered the issuer of the loan agreement – a separate security for purposes of federal securities law) are issuers for purposes of the Rule. The same would be true in a Marks–Roos financing where a joint powers authority issues Marks–Roos bonds secured by payments made by a city under a lease. Both the authority (as issuer of the bonds) and the city (as issuer of the lease) are issuers for purposes of the Rule. Since a policy of municipal bond insurance or letter of credit is also considered a "separate security" under federal securities law, bond insurers and letter of credit banks are also "issuers".

Thus, a municipal entity is generally considered to be an issuer for all of its issues, including conduit issues and Mello–Roos issues; but, there may be other "issuers" as well. The professionals involved in the offering will need to determine whether any such additional issuers are involved in a given securities offering.

37. Is the governmental issuer required to make the required undertakings and filings for any additional issuers or obligated persons involved in the offering?

No. The Rule contemplates that issuers and obligated persons, either individually or in combination with each other, will make all of the necessary undertakings and filings. In the release adopting the Amendments the SEC stated:

[T]o 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. Amendment Release at 59597.

For example, in the case of the preceding question where a city financing authority issues healthcare revenue bonds and loans the proceeds to a hospital, the city and the hospital can each independently covenant to provide the annual financial information and operating data applicable to itself. Note that if the bond issue is a true conduit issue where the governmental issuer is not liable for debt service, there may be no financial information and operating data about the city in the official statement and no required annual updates about the city.

38. What is the effect of a late filing or a failure to file?

A failure to make a required filing in a timely manner could lead to a number of consequences. First, such a failure would be a default under the indenture or other agreement containing the continuing disclosure covenant. Various commentators on the Rule have suggested that the remedy for such a default be limited to a suit to compel performance, but it need not be.

Second, the Rule requires that notice of a failure to file the annual financial information on or before the date specified in the written undertaking be filed with each NRMSIR or the Municipal Securities Rulemaking Board, and with the appropriate state depository, if any.

Third, although a delinquent or missing filing will not necessarily prevent a broker/dealer from trading the security in the secondary market, it may inhibit new issues by the issuer since the Rule prohibits an underwriter from participating in a new offering unless it has reasonably determined that all the required continuing information undertakings will be made. As the SEC stated in the release adopting the Amendments, ". . . 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." Amendment Release at 59595.

Finally, the issuer's official statements must disclose material breaches of the continuing disclosure covenants occurring in the previous five years (see [Question 30](#)).

39. What if the issuer has made all of its required filings, but an obligated person over which it has no control (such as a private borrower in an industrial development financing) has not?

The Rule specifically allows a governmental issuer to limit its undertakings to information about itself. If, as should be the case, the obligated person had separately undertaken to provide annual financial information, such a failure would not be a default by the issuer; but rather a default by such obligated person. In such a case, the consequences of a failure to make a required filing, as described above, would apply to the obligated person and not the issuer.

40. Will issuers need to pay filing fees?

Neither NRMSIRs nor the Municipal Securities Rulemaking Board will charge issuers or other obligated persons to make the required filings. Although the Rule does not prohibit state information depositories from charging filing fees, it is not expected that they will do so.

Rather than charge municipal entities and other persons for filing information, fees will be paid by the users of the information – underwriters, broker/dealers and other market participants which request the filed information.

41. Are remarketings subject to the Rule?

Certain remarketings are subject to the entire Rule, even if the original issue date was before the 1989 effective date of the Rule. Specifically, "primary offerings" subject to the Rule include remarketings that are accompanied by a change in authorized denominations from \$100,000 or more to less than \$100,000, or that are accompanied by a change in the period during which such securities may be tendered for redemption or purchase from a period of nine months or less to a period of more than nine months.

42. How can the SEC adopt continuing disclosure rules regulating California municipal entities?

Technically, the Rule does not apply to issuers, but rather to brokers and dealers, which are regulated by the SEC. Issuers, however, are indirectly regulated since underwriters are prohibited from participating in an underwriting unless they have reasonably determined that the continuing information undertakings required by the Rule will be provided by the issuer, either alone or together with other obligated persons.

It is not surprising that issuers are affected by the SEC's attempt to improve disclosure for municipal securities since, as the SEC and numerous court cases have made clear, *the official statement is the issuer's document*. It is true that the official statement is often actually drafted by the underwriter, underwriter's counsel, or a financial advisor; however, the legal principle remains the same – the issuer is legally responsible for the official statement.

43. Are there any SEC Rules relating to the sale of municipal securities which are *directly* applicable to municipal issuers?

Although municipal securities are specifically exempted from the registration requirements of the federal securities laws, they are not exempted from the so-called "anti-fraud" provisions of such laws. The anti-fraud provisions, of which Rule 10b-5 is the best known, prohibit any person (including a municipal issuer), in connection with the offer or sale of a security, from making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. One of the stated purposes of the Rule and the companion releases published by the SEC is to assist underwriters and issuers in meeting their obligations under the anti-fraud provisions.

In furtherance of such purpose, the SEC included the following footnote in the release originally adopting the Rule: "*Because they are ultimately liable for the content of their disclosure, issuers should insist that any persons retained to assist in the preparation of their disclosure documents have a professional understanding of the disclosure requirements under the federal securities laws.*" Adopting Release at 28811, nt. 84, emphasis added.

EXEMPTIONS FROM THE RULE

The following Questions relate to exemptions from the Rule, some of which are exemptions from the entire Rule, and others of which are exemptions from just the continuing disclosure requirements of the Rule.

44. What are the exemptions from the entire Rule?

The Rule only applies to issues of \$1,000,000 or more. Issues of less than \$1,000,000 need not comply with *any* of the provisions of the Rule.

The Rule also contains three general exemptions for issues otherwise subject to the Rule (i.e., issues meeting the \$1,000,000 threshold): (1) a private placement exemption for securities sold to no more than 35 sophisticated investors who are buying for investment and not distribution, (2) an exemption for certain securities which the holder has a right to tender at a price of at least par at least as frequently as every nine months, and (3) an exemption for securities with a maturity of nine months or less. Each of the above three general exemptions from the entire Rule requires that the securities be in minimum denominations of \$100,000 or more.

45. What about TRANs and other note issues with maturities of greater than nine months?

Although not exempted from the entire Rule, the Amendments to the Rule exempt securities with maturities of 18 months or less from the annual financial information filing requirement (see [Question 5](#)) and audited financial statements filing requirement (see [Question 18](#)). However, the 18 month maturity exemption is *not* an exemption from the event disclosure requirement (see [Question 22](#)). Thus, the typical TRAN issue would be exempt from the annual disclosure provisions but not from event disclosure.

46. Is there a small issuer exemption from the continuing disclosure requirements of the Rule?

The Amendments to the Rule include a limited exemption from the continuing disclosure requirements for certain small issuers and issues. The exemption states that the annual financial information and audited financial statements filing requirements of the Rule do not apply to issues meeting the following requirements:

1. 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, but excluding securities exempted from the Rule through a general exemption from the entire Rule (see [Question 44](#)).
2. Each obligated person undertakes, for the benefit of securities holders, to provide: (a) at a minimum, financial information and operating data which is customarily prepared by such obligated person and is publicly available (see [Question 47](#)), and (b) to each NRMSIR or to the Municipal Securities Rulemaking Board, and to the appropriate state information depository, if any, event disclosure under the Rule (see [Question 22](#)).
3. The final official statement identifies by name, address, and telephone number the persons from whom the foregoing information, data and notices can be obtained.

47. So, the major advantage of qualifying for the small issuer exemption is that no extra effort is needed to compile annual financial information?

That's true. For issues meeting the small issuer exemption, only "financial information and operating data which is customarily prepared by such obligated person and is publicly available" is required. The obligated persons do not need to annually update and file any specific financial and operating data in the official statement. Another advantage of the small issuer exemption is the filing requirement itself, which is "upon request to any person or at least annually to the appropriate state information depository." There

requirement itself, which is upon request to any person or at least annually to the appropriate state information depository. There is no requirement for filing with NRMSIRs. Note that the small issuer exemption does *not* provide an exemption from the event disclosure portions of the Rule (see [Question 22](#)).

The small issuer exemption also has a later effective date. Specifically, the annual financial information and events disclosure requirements for issues meeting the small issuer exemption do not apply to an offering commencing prior to January 1, 1996.

48. Would the small issuer exemption be available if one obligated person, such as a newly created joint powers authority in a Marks–Roos financing, has less than \$10,000,000 in municipal securities outstanding, but another, such as the city lessee in such financing, has more than \$10,000,000?

For the small issuer exemption to be available, no obligated person may have more than \$10,000,000 of municipal securities outstanding. If any one obligated person fails the test, the whole transaction and all obligated persons (including obligated persons which would have met the test) are subject to the Rule.

49. For purposes of the small issuer exemption, must the governmental issuer aggregate all of its municipal securities, including those payable from different revenue sources?

Yes. The SEC provided the following specific guidance on this question in the release adopting the Amendments:

[T]he 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 payment to separate revenue streams. Amendment Release at 59607.

50. Are defeased securities counted towards the \$10,000,000 small issuer exemption?

No. The SEC also provided specific guidance on this question in the release adopting the Amendments:

[T]o 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. Amendment Release at 59607.

CONCLUSION

The months preceding and following the effective date of the Amendments on July 3, 1995 are likely to be a period of adjustment as market participants, including municipal issuers and underwriters, become accustomed to the new requirements. The attorneys at Jones Hall, whether acting as bond counsel, disclosure counsel or both, look forward to guiding issuers through this transition period and into the era of continuing disclosure beyond. If we may provide further information or answer questions regarding the Rule or this memorandum, please do not hesitate to contact us.

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TEXT OF RULE 15c2-12

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.* (1) Prior to the time the Participating Underwriter bids for, purchases, offers, or sells municipal securities in an Offering, the Participating Underwriter shall obtain and review an official statement that an issuer of such securities deems final as of its date, except for the omission of no more than the following information: The offering price(s), interest rate(s), selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, any other terms or provisions required by an issuer of such securities to be specified in a competitive bid, ratings, other terms of the securities depending on such matters, and the identity of the underwriter(s).

(2) Except in competitively bid offerings, from the time the Participating Underwriter has reached an understanding with an issuer of municipal securities that it will become a Participating Underwriter in an Offering until a final official statement is available, the Participating Underwriter shall send no later than the next business day, by first-class mail or other equally

available, the Participating Underwriter shall send no later than the next business day, by first class mail or other equally prompt means, to any potential customer, on request, a single copy of the most recent preliminary official statement, if any.

(3) The Participating Underwriter shall contract with an issuer of municipal securities or its designated agent to receive, within seven business days after any final agreement to purchase, offer, or sell the municipal securities in an Offering and in sufficient time to accompany any confirmation that requests payment from any customer, copies of a final official statement in sufficient quantity to comply with paragraph (b)(4) of this rule and the rules of the Municipal Securities Rulemaking Board.

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

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

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

(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 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

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

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

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

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

(3) The term "final official statement" means a document or set of documents prepared by an issuer of municipal securities or its representatives 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.

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

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

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

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

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

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

(8) The term "underwriter" means any person who has purchased from an issuer of municipal securities with a view to, or offers or sells for an issuer of municipal securities in connection with, the offering of any municipal security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; except, that such term shall not include a person whose interest is limited to a commission, concession, or allowance from an underwriter, broker, dealer, or municipal securities dealer not in excess of the usual and customary distributors' or sellers' commission, concession, or allowance.

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

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