



SEC Report Recommends that the SEC Be Authorized To Directly Regulate the Form, Content and Timing of Municipal Bond Disclosure

On July 31, 2012, the Securities and Exchange Commission (the “SEC”) released its Report on the Municipal Securities Market (“Report”). A full copy of the Report is available at <http://www.sec.gov/news/studies/2012/munireport073112.pdf>. Generally, the Report recommends that Congress give the SEC authority to directly regulate the form, content and frequency of the disclosure provided by municipal bond issuers, including financial statements. The SEC also seeks access to federal tax return and audit information as well as enforcement authority with respect to continuing disclosure undertakings. Finally, the SEC seeks authority to regulate private, non-municipal borrowers that access financing through municipal conduit issuers. The Report also provides an overview of the municipal securities market and makes additional recommendations regarding pre- and post-trade price transparency and regarding dealer pricing obligations.

No Repeal of Tower Amendment. Notably, the Report does not call for a repeal of the Tower Amendment (Section 15B(d)(1) of the Securities Exchange Act of 1934 (“Exchange Act”). The Tower Amendment has long prohibited the SEC from requiring municipal bond issuers to file or register with the SEC or the Municipal Securities Rulemaking Board (“MSRB”) prior to the sale of municipal bonds. The Report also does not recommend eliminating the exemption for municipal issuers under Section 3(a)(2) of the Securities Act of 1933 (the “Securities Act”) or under the Exchange Act. As a result, the Report does not recommend that municipal bond issuers become subject to the SEC’s registration and periodic filing requirements applicable to corporate issuers.

Disclosure Recommendations. Although stopping short of recommending that municipal bond issuers register and file with the SEC, the Report identifies a number of legislative, regulatory and industry-practice recommendations intended to improve municipal bond disclosure.

- **Legislative Recommendations**

- *Permit SEC Regulation of Municipal Disclosure.* The Report recommends that Congress authorize the SEC to impose requirements on the disclosure that municipal bond issuers provide to the bond market. This legislative change would allow the SEC to regulate:
 - The timeframe for disclosures;
 - The frequency of disclosures; and
 - Minimum disclosure standards.

If implemented, this recommendation could result in more specific and uniform requirements regarding the timing and content of official statements and other disclosure. Note that municipal issuers already are subject to the antifraud requirements of the federal securities laws, and therefore must not include untrue statements or omit material facts in disclosures to the municipal bond market. Many of the disclosure practices that the SEC seeks to regulate directly pursuant to this recommendation – such as using stale financial information in municipal bond disclosure documents and inadequately disclosing pension or other post-employment benefit obligations – implicate the antifraud requirements, and could be the subject of an enforcement action under existing SEC statutory authority.

- *Repeal the Municipal Securities Exemption for Non-Municipal Conduit Borrowers.* The Report recommends that Congress amend the municipal securities exemptions under the Securities Act and Exchange Act so that private, non-municipal borrowers could not avail themselves of the exemptions by borrowing through a municipal conduit issuer. These borrowers would need to rely on other exemptions – such as the exemptions for nonprofit issuers or private placements – or be subject to registration and reporting with the SEC. If this recommendation is implemented, for-profit borrowers may favor bank private placements or other limited offerings over publicly offered conduit bond issues.
- *Permit SEC Regulation of the Form and Content of Financial Statements.* The Report recommends that the SEC be permitted to regulate the form and content of the financial statements of municipal bond issuers, and that the SEC have authority over the body setting the standard for “generally accepted accounting principles” for financial statements used in municipal bond offerings. The Report further recommends that the SEC have authority to require that the financial statements be audited (by an independent auditor or state auditor). To the extent that these recommendations could result in a federally regulated, and presumably more uniform, approach to the preparation and auditing of municipal financial statements, this recommendation could have significant impacts on municipal issuers now subject to state-specific audit regimes.
- *Clarify the Scope of the Safe Harbor for Forward Looking Statements.* The Report recommends providing a safe harbor for municipal issuers that provide forward-looking information (such as projections and trend information) to the municipal bond market, so that these issuers are protected from fraud claims by private litigants. The Report recommends that this safe harbor be available only if the risks and key assumptions underlying the projections or other forward-looking information are disclosed, and only if the issuer complies with its ongoing

disclosure obligations. If this recommendation is implemented, municipal issuers may be encouraged to provide more projection and trend information in official statements but will need to continue to be careful to disclose the risks and assumptions inherent in such information.

- *Allow the Internal Revenue Service to Share Return and Audit Information.* Under current law, tax return information is required to be held confidential under Section 6103 of the Internal Revenue Code. Section 6103 specifically identifies certain limited circumstances under which tax return information may be disclosed, and the safeguards to be followed to protect taxpayer privacy. The Report recommends that Section 6103 be amended to permit the IRS to share return and audit information with the SEC, especially where securities fraud is suspected. This recommendation builds on the March 2, 2010 Memorandum of Understanding between the IRS and the SEC, under which the agencies “agreed to work more closely to monitor and regulate the municipal bond market and industry.”
- *Permit the SEC to Require Trustees and Others to Enforce Continuing Disclosure Undertakings.* SEC Rule 15c2-12 prohibits an underwriter, with certain exceptions, from purchasing or selling municipal securities unless the underwriter has determined that the issuer and certain obligated persons have entered into a written undertaking to provide ongoing disclosure. These undertakings generally provide that bondholders may enforce the continuing disclosure obligation through lawsuits seeking specific performance. The Report recommends that the SEC be permitted to require bond trustees or other entities to enforce the terms of continuing disclosure agreements.
- **Regulatory Recommendations.** The legislative recommendations outlined above are intended to provide the SEC with clear statutory authority to directly regulate municipal bond disclosure, to specify the form and content of the financial statements of municipal issuers, to require that financial statements be audited, to receive return and audit information from the IRS, and to enforce the continuing disclosure obligations of municipal bond issuers. The Report also recommends a number of regulatory steps within the SEC’s existing statutory authority. The list of regulatory recommendations is relatively sparse compared to the list of legislative recommendations, perhaps in an attempt to underscore the SEC’s view that its legislative recommendations are necessary to address the municipal disclosure concerns outlined in the Report.
 - *Host Annual Municipal Securities Conference.* The Report notes that the SEC could host an annual conference among municipal bond market participants.

- *Update Interpretive Guidance.* The Report notes that the SEC could update its 1994 Interpretive Release, providing more up-to-date guidance regarding municipal disclosure practices.
- *Amend Rule 15c2-12.* The Report notes a number of potential amendments to Rule 15c2-12 and notes that these amendments would not be necessary if the SEC receives direct authority to regulate municipal disclosure.
- *Work with the MSRB.* The Report notes the success of EMMA in making municipal bond information more readily accessible, and recommends that the SEC continue to work with the MSRB on these matters.
- **Industry-Practice Recommendations.** The Report also recommends that market participants continue to develop and follow disclosure “best practices” guidelines, and suggests that these guidelines address, among other things:
 - Disclosure procedures (e.g., procedures regarding training, review and approval of official statements and continuing disclosure reports)
 - Timeliness of financial information (e.g., providing annual financial information on a more timely basis, and providing quarterly or interim financial information)
 - Use of websites
 - Use of derivatives in connection with municipal bonds

We will stay tuned to see whether Congress responds to the Report by providing the SEC with its requested authority, or whether municipal bond disclosure will continue to be governed by the general antifraud provision and the indirectly applied requirements of Rule 15c2-12. If you have any questions regarding the Report or municipal bond disclosure requirements, please contact any of our public finance attorneys.