

Bill Introduced To Implement 2012 SEC Recommendations; Would Authorize Direct Regulation of Municipal Bond Disclosure

Just prior to adjournment of the 114th Congress, Rep. Gwen Moore (D-Wisconsin) introduced a bill¹ to implement recommendations made in the Securities and Exchange Commission (the “SEC”) Report on the Municipal Securities Market issued in July 2012 (the “2012 Report”). Among other things, the bill would give the SEC authority to regulate directly municipal bond disclosure and would repeal the exemption from registration for certain private activity bonds.

Whether or not the bill is reintroduced and adopted in a future Congress, the bill may provide some insight into the type of and scope of municipal bond disclosure regulation the SEC is seeking. The bill reinforces that issuers would be well served to implement written disclosure policies and procedures, and to review proactively, from a big picture perspective, the content of their official statement disclosure.

Note that municipal issuers already are subject to the antifraud requirements of the federal securities laws, and therefore must be materially accurate and complete in disclosures to the municipal bond market. Under current law, the SEC enforces the antifraud requirements through proceedings against entities and individuals, rather than by rule. The bill would add rulemaking

authority to the SEC’s toolbox to address concerns regarding the quality and timing of municipal bond disclosure.

No Repeal of Tower Amendment. The 2012 Report did not call for a repeal of the Tower Amendment (Section 15B(d)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)), which has long prohibited the SEC from requiring municipal bond issuers to register prior to the sale of municipal bonds. The 2012 Report did 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. The bill likewise would leave the Tower Amendment intact and would not require registration of municipal bond issuers.

Disclosure Requirements. Although stopping short of requiring registration by municipal bond issuers the bill, consistent with the 2012 Report recommendations, would authorize the SEC to regulate the form, content and timing of municipal bond disclosure as described below, as necessary or appropriate in the public interest or for the protection of investors.

- *Continuing Disclosure.* The bill would require issuers and obligated persons – with outstanding municipal securities above a dollar amount to be specified by

¹ H.R. 6488

rule – to prepare annual periodic reports and timely report enumerated events, in the form, in the time periods and before the deadlines prescribed by the SEC. This rule could replace corresponding requirements currently applicable to underwriters (and indirectly to issuers and obligated persons) under Rule 15c2-12.

- *Initial Disclosure.* The bill would make it unlawful for issuers and obligated persons to offer or sell municipal securities – again above an aggregate principal amount to be specified by rule – in a public offering, unless the issuer or other obligated person, prior to the offer or sale, prepares and disseminates an official statement in accordance with rules and regulations as the SEC may prescribe.

The bill provides the SEC with discretion by rule or regulation to prescribe the information to be included in official statements. The bill outlines the information that could be required in official statements, including information regarding the following topics. This list may provide some insight into the type of information the bill sponsor (and to the extent the bill implements the 2012 Report, the SEC) views as material for bond offering documents.

- the issuer
- the debt and debt structure

- legal debts limits and limits on the issuer’s taxing authority
- the nature and extent of material contingent liabilities or commitments that could affect timely repayment
- a 10-year history of any payment defaults or delays
- for tax-supported debt, a five-year history of tax levy rates, valuations, collections and delinquencies for tax-supported debt as well as information regarding estimated future tax revenues for taxes not yet levied and major tax payers
- audited financial statements, if material
- a description of the offering
- a description of the security for the debt, including the priority and rights of bondholders to bring suit
- events of default
- a description of any project or enterprise to be financed with the proceeds of the bonds including:
 - a description of the competitive environment for the project or enterprise, including any major changes in the competitive environment in the prior 10 years,
 - any engineering or financial feasibility reports or studies on the construction and operation of the project or enterprise, and
 - a description of any additional financing required to complete the project or enterprise

- a description of the intended use of the proceeds of the offering
- a statement of counsel’s opinion as to the legality, validity, and enforceability of the debt
- a description of material conflicts of interest, and
- other similar and specific information as the SEC may by rule or regulation require.

Accounting Methods. The bill also authorizes the SEC to prescribe, for continuing disclosure and official statements, the form of the required information, including financial statements, as well as the accounting methods to be followed.

Alternatively, the bill would authorize the SEC to recognize forms for information and accounting methods for financial statements established by a standard setting body, such as the Governmental Accounting Standards Board (“GASB”), although GASB is not named in the bill.

Disclosure Procedures. Consistent with the SEC’s focus in recent enforcement proceedings and in the Municipalities Continuing Disclosure Cooperation Initiative, the bill emphasizes the importance of written disclosure policies and procedures. The bill would require any issuer of, or obligated person with respect to, municipal securities in the aggregate principal amount above \$10 million to adopt internal controls and systems, including written disclosure policies and procedures.

At a minimum the controls should:

- clearly identify responsible officers,
- state the process for drafting and review of official statements, and
- provide for checks and balances to ensure adequate supervision and reasonable disbursement of responsibilities.

Under the bill, the SEC would be permitted to allow issuers and obligated persons to satisfy this requirement via a state-wide system of disclosure controls and education.

Non-Municipal Conduit Borrowers. As noted above, the bill does not repeal the exemption from registration for municipal issuers.

The bill does, however, repeal the exemption for certain private activity bonds. Consistent with the 2012 Report’s recommendations, the bill would 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 501(c)(3) or private placement exemptions – or be subject to registration and reporting with the SEC. If the bill is reintroduced and adopted, for-profit borrowers may favor bank private placements or other limited offerings over publicly offered conduit bond issues.

Safe Harbor for Forward Looking Statements. Consistent with the 2012 Report, the bill clarifies the availability to municipal bond issuers of a safe harbor for forward-looking information (such as projections and trend information), so that these issuers are protected from fraud claims by private litigants.

Conclusion. We will continue to watch whether the bill will be reintroduced and adopted in a future Congress, whether the 2012 Report’s legislative recommendations will be pursued and adopted in another form, or whether municipal bond disclosure will continue to be governed by the general antifraud provision and the indirectly applied requirements of Rule 15c2-12.

In the meantime, the bill is instructive in terms of its emphasis on the importance of issuers adopting written disclosure policies and procedures. The following linked article provides a summary of the key elements of

written disclosure policies and procedures.

<http://www.pacificalawgroup.com/wp-content/uploads/2016/07/Disclosure-Policies-and-Procedures1.pdf>

The bill’s outline of the type of information to be included, as a baseline, in official statements may also be instructive. The list generally tracks with standard disclosure currently provided in official statements. To the extent that information currently is not included in an issuer’s official statement, it may be helpful to consider proactively the information’s applicability and materiality to that issuer and its credit.

If you have any questions regarding the bill, the 2012 Report or municipal bond disclosure requirements, please contact any of our public finance attorneys. Contact information is provided below.

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