National Federation of Municipal Analysts White Paper on Federal Securities Law Relating to Municipal Securities

The National Federation of Municipal Analysts (the "NFMA") was chartered in 1983. It is a not-for-profit association with the goals of promoting professionalism in municipal credit analysis and furthering the skill level of its members through educational programs and industry communication, providing an informed perspective in the formulation of legal and regulatory matters relating to the municipal finance industry, and facilitating the flow of information between investors and issuing entities. NFMA membership includes approximately 1,000 members, primarily research analysts, who evaluate credit and other risks of municipal securities. These individuals represent, among others, mutual funds, insurance companies, broker/dealers, bond insurers, and rating agencies.

One of the primary initiatives of the NFMA is to provide educational programs and materials to its membership through its annual meeting and advanced seminars as well as through publication of educational materials useful to the membership. The NFMA's efforts have ranged from global disclosure-related issues to more detailed, sector-specific work. For further information on the NFMA's continuing work in the area of disclosure, please see the "Disclosure Guidelines" and "Position Statements" on the NFMA's web site at www.nfma.org.

This white paper includes four components: (1) a comprehensive article summarizing federal securities law relating to municipal securities, (2) a glossary containing definitions of securities terms including all such terms used elsewhere in the white paper, (3) a frequently asked questions presenting straightforward answers to analysts' concerns relating to securities laws in the municipal marketplace, and (4) a timeline showing graphically how the regulatory regime affects the municipal market at each phase of the deal, presented from both the "buy-side" and "sell-side" perspectives.

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Federal Securities Law Relating to Municipal Securities

OVERVIEW

Federal Securities Law Generally

The federal government closely regulates disclosure in connection with the issuance of most securities. Federal securities law is aimed at concerns raised by the fact that the issuers of securities (including conduit borrowers[1]) have more information about the source of repayment of securities than potential investors, and that there may be incentives for issuers not to disclose significant information about the securities if it would preclude issuance or adversely affect pricing. The federal securities laws frequently have been adopted in response to scandals or crises and are designed to provide disincentives to bad acts, as well as to provide guidelines to those wishing to act properly.

The primary federal securities laws are the Securities Act of 1933 (the “1933 Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”). The basic objectives of the 1933 Act and the Exchange Act are: (1) requiring disclosure of material information about securities to allow investors to make informed decisions; and (2) prohibiting misrepresentation or other fraudulent conduct in connection with the purchase and sale of securities.

The 1933 Act governs the primary offering of securities, requires registration of the securities with the Securities and Exchange Commission (the “SEC”), and contains provisions to prevent fraud in connection with the offering of the securities. The 1933 Act and related regulations mandate very specific types of disclosure in the offering statement for registered securities, which disclosure must be reviewed and cleared by the SEC prior to being released to

[1] Conduit borrower refers to the obligor on a loan, installment sale or lease from a governmental issuer to the obligor from the proceeds of municipal securities issued by the governmental issuer.

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the public. There are civil and criminal penalties for failing to do so. Certain types of securities and securities issued under particular circumstances are exempt from registration under the 1933 Act. For example, most municipal securities are exempt from registration as described below.

In addition to its registration requirements, the 1933 Act provides civil liability for participants in the issuance process who make false statements or omit certain information in the disclosure at the time of issuance, or who fail to register a security that is subject to the registration requirements. Violation of such provisions provides a right of rescission to the purchaser of the security. The issuer or conduit borrower is strictly liable for failing to register a security that is not exempt from such requirement and for any false statements or omissions made in connection with the offering, while underwriters may exercise a due diligence defense. The civil liability provisions of the 1933 Act are not applicable to municipal securities to the extent such securities are exempt from registration.

Section 17 of the 1933 Act contains provisions to prevent fraud in an offering of securities. These antifraud provisions, unlike the registration requirements and civil liability provisions, apply broadly enough to include municipal securities offerings, as discussed below.

The Exchange Act creates a regulatory scheme governing broker-dealers in the securities markets and establishes requirements for periodic, on-going disclosure in the secondary market. The Exchange Act also contains antifraud provisions related to disclosure, whether in the primary or secondary market. Since 1975, the Exchange Act applies directly to municipal broker-dealers, and the antifraud provisions therein apply expressly to municipal issuers.

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Federal Securities Law Applicable to Municipal Securities

The 1933 Act and the Exchange Act did not expressly apply to municipal securities until the 1970s. The omission of municipal securities from the original versions of the federal securities laws may be attributable to the belief of Congress that the municipal market did not require federal securities regulation or that the federal Constitution prohibited such regulation as an infringement on states' rights (the Constitutional premise has been almost completely undermined by the courts).

In the early 1970s, Congress held a series of hearings concerning questionable activities of dealers that sold only municipal securities and were therefore exempt from the Exchange Act as in effect at that time (which did not include municipal securities). The hearings also addressed concerns about disclosure made in connection with offerings in the City of New York during its fiscal crisis. The Securities Acts Amendments of 1975, among other things, amended the Exchange Act to make municipal broker-dealers subject to the law and created the Municipal Securities Rulemaking Board (the "MSRB") to govern municipal broker-dealers. The 1975 law included provisions commonly referred to as the "Tower Amendments" which expressly precluded the SEC and the MSRB from requiring municipal issuers to make filings with the SEC or the MSRB prior to the sale of municipal securities and precluded the MSRB from requiring municipal issuers to deliver information to the MSRB or bond purchasers. The 1975 law, however, made municipal issuers subject to the antifraud provisions of Section 10(b) of the Exchange Act.

Following the default by the Washington Public Power Supply System on its bonds (the so-called WPPSS or "whoops" default), and in response to general concerns about the adequacy and timeliness of disclosure, the SEC promulgated Rule 15c2-12 of the Exchange Act in 1989.

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Because of the limitations of the Tower Amendments municipal issuers and conduit borrowers are not directly subject to Rule 15c2-12 and the MSRB rules, but they are indirectly impacted by Rule 15c2-12 because that rule requires underwriters of most public offerings of municipal securities to obtain certain contractual agreements from municipal issuers or conduit borrowers prior to the sale of such bonds. For transactions that are not exempted from its application, Rule 15c2-12 effectively requires that the issuer or the conduit borrower agree to specified primary and continuing disclosure requirements as a condition to use of an underwriter to conduct a public offering of their securities.

The antifraud provisions of the Exchange Act (promulgated through Rule 10b-5 under the Exchange Act) are enforced via private lawsuits as well as by the SEC and federal prosecutors. Private enforcement lawsuits have been rare in the case of municipal securities. There are several hurdles to recovery in a Rule 10b-5 action, even if the falseness or omission of material information is established. The plaintiff must show that the defendant had "scienter," a state of mind consistent with an intent to deceive, manipulate or defraud. In addition, the plaintiff must sue before the statute of limitations runs out, and must prove that the false information was relied on in connection with the decision to purchase or sell, that the false information was material (discussed in detail below), and that there were damages. Furthermore, Rule 10b-5 limits liability to acts "in connection with the purchase or sale of any security." Any action for money damages must be brought by a purchaser or a seller of a security. As a result, a holder who does not sell (or a potential purchaser who does not buy) on the basis of false information does not have standing to sue under the antifraud provisions of Rule 10b-5 even if the value of the holder's

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security is impaired by the false information or if a potential purchase opportunity is lost by false information.[2]

Given the difficulty in bringing such private lawsuits, SEC enforcement actions are more common than private suits in the municipal market, particularly since the creation of the Office of Municipal Securities within the SEC in 1994. The SEC has broader authority to enforce Rule 10b-5 than private plaintiffs; among other distinctions, the SEC does not have to prove damages as a result of a misrepresentation or omission.

SEC enforcement actions are generally preceded by an investigation, which may be formal or informal. Formal investigation requires entry of an order by the SEC directing staff to conduct an inquiry and authorizing the staff to issue subpoenas and administer oaths. Informal investigation may be initiated by the SEC staff without specific authorization from the Commission. At the end of the investigation, staff may recommend an enforcement action under the securities laws. For example, the SEC has the power to initiate an administrative proceeding. If the target of the investigation is a person who is subject to registration or regulation by the SEC (e.g., a broker-dealer), the SEC may impose monetary penalties, remedial sanctions, a temporary cease-and-desist order, or a permanent cease-and-desist order. For any other person, such as an issuer or conduit borrower, the SEC may impose a permanent cease-and-desist order. The SEC can order an accounting and disgorgement of profits obtained illegally in either case. The SEC also may commence a civil proceeding in federal district court or make a criminal referral to the Department of Justice or to other federal, state, or self-regulatory authorities. Short of such actions, the SEC may deliver a so-called 21(a) Report which permits the SEC to make

[2] However, a bond trustee who has been expressly authorized in the indenture to enforce remedies and bring suit will have standing to sue on behalf of purchasers or sellers of securities.

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statements without bringing an action. Some of the theories for liability and findings in recent SEC enforcement actions are described below, under the heading "Materiality."

MUNICIPAL SECURITIES EXEMPT FROM REGISTRATION REQUIREMENTS

As described above, all securities are subject to the registration requirements of the 1933 Act unless specifically exempt. The definition of "securities" is very broad and includes, among other things, bonds, notes, certificates of participation, and investment contracts. Also subject to registration are so-called "separate securities," a concept included in Rule 131, adopted by the SEC in the late 1960s in response to the proliferation of industrial development bonds. Rule 131 identified certain instruments in a municipal securities offering, such as loans or leases to a conduit borrower with respect to property or money used by a commercial or industrial enterprise, as "separate securities" for registration purposes.

Most municipal securities are not registered because they are "exempt securities" under the 1933 Act. The securities exemptions apply to all securities issued by the entities meeting the requirements of the exemption. Exempt securities include any security issued or guaranteed by a state or political subdivision or public instrumentality thereof. This includes all state issuers and most public authorities. Exempt securities also include securities of not-for-profit entities and most exempt facility bonds. This exemption includes most conduit borrowers. For separate securities involving a private entity as a conduit borrower, such as multi-family housing bonds, exemption from registration is based on an exception from separate security registration by virtue of a governmental agency's (e.g., the multi-family housing issuer) ownership or control of the separate security. This theory has been applied more recently in connection with the issuance of Liberty Bonds and Gulf Zone Opportunity Bonds. Even if the bond issue involves a non-exempt conduit borrower, the separate security can be made exempt by using a bank letter of

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credit to back the non-exempt borrower's obligations, based on a separate exemption for securities backed by a bank.

If the securities do not qualify as exempt securities under the 1933 Act, they may be offered and sold as "exempt transactions" under the 1933 Act and still not be subject to the registration requirements. The transaction exemption is based on the details of how the security is offered and who the purchasers are and is applied on a deal-by-deal basis, unlike the exempt securities exception which applies based on the type of security involved, without regard to how it is offered and sold. Distinct transactional exemptions apply separately to issuers, conduit borrowers and underwriters, i.e., each needs a transactional exemption to avoid registration. The most common exempt transaction is a private placement. There are several types of private placements provided by SEC rules: Regulation D, which applies only to issuers and conduit borrowers; Rule 144; and Rule 144A (which applies only to underwriters).[3]

Regulation D provides an issuer or conduit borrower with one of three safe harbors from the registration requirements for a transaction based upon the size of the offering and number of potential investors. Generally, issuers or conduit borrowers are limited to offering the securities to accredited investors and a limited number of non-accredited investors and the offering may not involve any form of general solicitation or advertising. The exemption is limited to the issuer or conduit borrower and requires the purchaser's certification that the purchaser is buying the security for its own account and not for distribution, which means the securities cannot be sold to an underwriter. In addition, such securities are "restricted securities" and cannot be resold

[3] The term "private placement" (or sometimes "limited offering") is sometimes used in the municipal securities market to refer to offerings that are exempt securities and therefore do not need to be structured within the strict requirements of exempt transactions. Such securities may be marketed and sold to a limited number of investors, with investor letters under which the investors contractually commit to certain terms. In such cases, the terms of the investor letter are driven by contract negotiations, not the legal requirements of a private placement within the meaning of the Securities Act. Footnote 4, below, further addresses the distinction between a "private placement" or "limited offering" and a truly rule-based, exempt offering.

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without registration or an exemption from registration. In order to resell, purchasers may rely on a Rule 144 or 144A transactional exemption.

Rule 144 provides that restricted securities may be sold after a one-year holding period, provided that certain current financial information about the issuer or conduit borrower is available, the amount sold during any three-month period does not exceed certain prescribed amounts, the sale is effectuated in an unsolicited transaction or to a market maker, and, for certain sales, notice is filed with the SEC. After two years, such securities cease to be restricted and the requirement for updated disclosure required by Rule 144 is no longer applicable.

Rule 144A allows for sales or resales by a person other than the issuer to a "qualified institutional buyer," a particular type of entity listed in Rule 144A. Such list includes, in part, an investment company that is part of a family of investment companies with at least $100 million of securities, certain banks that invest at least $100 million and have an audited net worth of at lease $25 million, insurance companies, and certain broker-dealers. The seller must ensure that the subsequent purchaser is a qualified institutional buyer and is aware of the transfer restrictions. In addition, the holder of the securities and the purchaser must have the right to obtain certain financial disclosure from the issuer or conduit borrower, including a brief statement about the issuer's or conduit borrower's business, the most recent balance sheet, statement of profit and loss and retained earnings statement, and similar financial information for the two years that are "reasonably current." This means that the balance sheet must be less than 16 months old, and if older than 6 months it will be supplemented with more current information.[4]

[4] Some securities that are exempt municipal securities under the 1933 Act nevertheless include a restriction (usually on the face of the security and in the related indenture) that the securities can only be sold to a "qualified institutional buyer" or "QIB." The text of this type of restriction usually contains a reference to Rule 144A for the definition of a QIB. Such a Rule 144A reference in an otherwise exempt municipal security does not mean that the

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Similar to the exemption from registration under federal securities laws, most municipal securities are exempt from state "blue sky" requirements, with certain exceptions, most notably for notice filings and for offers and sales in the state in which the issuer is located.

A VOLUNTARY DISCLOSURE MARKET

Because the registration requirements are generally inapplicable, the municipal securities market is characterized by the absence of any formal administrative framework for required content of primary offering disclosure. This is in marked contrast to the corporate securities market, where the content of registration statements is specifically prescribed by detailed regulation under the 1933 Act. In the absence of specifically described disclosure requirements, industry groups such as the NFMA, the Government Finance Officers Association (GFOA), the Healthcare Financial Management Association (HFMA), the National Association of State Auditors, Comptrollers and Treasurers (NASACT), the National Council of State Housing Agencies (NCSHA), the National Association of Local Housing Finance Agencies (NALHFA) and the Securities Industry and Financial Markets Association (or its predecessors) (SIFMA) have issued recommended guidelines to help establish market standards for the content and timing of disclosure. Furthermore, market demand has frequently mandated certain disclosures.

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security relies on the transactional exemption in Rule 144A for its exemption from registration. Instead, the QIB transfer restriction is a contractual limitation, usually imposed by an issuer who wants to limit holdings to sophisticated institutions, and who uses the QIB definition in Rule 144A because it is the industry-accepted benchmark for identifying those permitted holders. In some cases the contractual restriction is time-limited, and generally the contractual restriction requires each seller to get a representation from its buyer that the buyer is a QIB.

The inclusion of contractual restrictions in exempt municipal securities complicates the determination of whether a particular security is "restricted" for purposes of many mutual funds. Whether a security is considered "restricted" for purposes of a particular fund depends in part on the provisions of the fund's prospectus and other governing documents. Many mutual funds have self-imposed limits on "restricted" securities, and the analysis of whether a particular security is restricted is done on a case-by-case basis, according to the fund's internal policies. In general, a security that actually depends on Rule 144A for an exemption from registration will be considered restricted, while a security that does not actually depend on Rule 144A may or may not be considered restricted. Many funds consider any limitation on the ability to trade a security, including purely contractual limitations, to cause the security to be restricted for internal purposes.

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For example, in order to facilitate the sale and liquidity of their bonds, healthcare, housing, and student loan issuers have often agreed to provide quarterly financial statements.

Municipal securities market participants have worked together to make improvements in the dissemination of disclosure pursuant to the requirements of Rule 15c2-12 or voluntarily. The Muni Council, comprising an informal group of 18 municipal market participants including the NFMA, helped develop the central post office, www.DisclosureUSA.org, a conduit for issuers and borrowers to file secondary market disclosure more easily.

MATERIALITY

In the absence of a statutory scheme for municipal securities registration and reporting, disclosure by municipal issuers is governed by the demands of market participants and the antifraud requirements. Thus, the legal test applied to the content of a disclosure document is that it contain all material information and have no material omissions. Materiality is an objective standard as described in the SEC's 1994 interpretive release on Rule 15c2-12 and the antifraud provisions (the "1994 Interpretive Release"): "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."

The obligation to meet this materiality standard falls upon the direct participants in a municipal financing, calling for their active involvement and their advisors' professional judgment. Generally, counsel to one of the participants will

Materiality is a facts and circumstances test. Examples of information that the SEC has determined to be material:

- failure to disclose intended use of bond proceeds;

- failure to accurately disclose financial condition;

- failure to disclose financial interest in transaction; and

- failure to disclose potential taxability of bonds.

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assume the initial responsibility of coordinating an entire disclosure document, with other participants and counsel being assigned appropriate roles respecting particular portions.

The SEC has developed a body of cases, litigation releases, Commission orders, and reports that reflect areas in which the SEC has found disclosure to be deficient. This body of decisions, releases and reports is the only formal guidance from the SEC with respect to materiality of disclosure in municipal bond offerings.

For example, in *In re Maricopa County* the SEC found that the use of bond proceeds to alleviate the issuer's cash flow deficit "was an undisclosed use of investor funds, which an investor would have considered important in deciding whether or not to purchase the Bonds."[5] Similarly, in *SEC v. Matthews & Wright Group, Inc.* the SEC brought an action related to the sale of bonds by Matthews & Wright Group in which the disclosure stated that the bonds were issued to finance the construction of various projects. Instead, substantially all of the proceeds of the offerings were intended to be used to purchase investment contracts to serve as credit enhancement instruments for the bonds and not for the projects.[6]

A number of SEC enforcement actions arose in connection with a failure to disclose financial conditions of the issuer or conduit borrower. For example, the SEC brought an enforcement action against the City of Miami, its city manager and a finance director for omissions and misstatements in the city's comprehensive annual financial report (CAFR) and in three official statements.[7] Although the city's rating was downgraded and its financial condition had steadily worsened after the close of its CAFR, the city (i) made representations that no

[5] *See Release Nos. 7345, 37748 (September 30, 1996); Release Nos. 7354, 37779 (October 3, 1996); see also, In re City of Miami, Florida, Cesar Odio and Manohar Surana, Initial Decision Release No. 185 (June 22, 2001).*

[6] *See Litigation Release No. 12072 (April 27, 1989) (settled final orders); Release No. 34-26841 (May 19, 1989); see also, SEC v. Matthews & Wright Group, Inc., Matthews & Wright Inc., George W. Benoit, Arthur Abba Goldberg, Rodger J. Burns and Bernard M. Althoff, Litigation Release Nos. 12072 (April 27, 1989) (complaint) and 12950 (August 22, 1991) (settled final order).*

[7] *In re City of Miami, Florida, Cesar Odio and Manohar Surana, Initial Decision Release No. 185 (June 22, 2001). See also In re City of Miami, Florida, Releases 8213, 47552 (March 21, 2003).*

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material adverse changes occurred subsequent to the issuance of the CAFR and the related financial statements, (ii) failed to disclose that S&P downgraded the city after the close of such fiscal year, (iii) failed to disclose its cash flow crisis in the official statements in the next year, and (iv) in certain official statements, failed to disclose that bond proceeds would be used to finance operating expenditures. The administrative law judge affirmed the SEC's use of a "snapshot" methodology (i.e. where attention is focused on the financial condition of the issuer when the securities are offered, as opposed to the issuer's most recent year-end results) in determining whether the city committed securities fraud. The administrative law judge concluded the city apparently limited its disclosure because the bonds were insured. The City Manager stated in the record that "most people don't read [the Official Statement], nobody reads this. They go by what the raters, that is Moody's, Standard & Poor's, saying that these bonds are safe to buy. By rating them AAA, they're a very good buy. Therefore, they wouldn't go reading this. Nobody does." This attitude impacted the judge's decision to impose a "cease and desist" order against the city. "The city's attitude that disclosure was not important because no one reads the Official Statement when the bonds are insured, and that regardless of what the financial statements showed, 'people in the business' understood what was going on does not engender confidence in the city's future conduct." Upon appeal of the city, the SEC affirmed the administrative law judge's decision and held "it is in the public interest to order [the City] to cease and desist from committing or causing any violation or future violation of the antifraud provisions of the federal security law."

The SEC brought actions against the issuer and the underwriter based on the omission of a material fact in connection with the sale of bonds by the Dauphin County General Authority to fund the acquisition of an office building in Harrisburg, Pennsylvania. The bonds were secured

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solely by revenues received from office space leases and parking. While the disclosure contained information about the terms of existing leases and the fact that they expired prior to the maturity of the bonds, it was not disclosed that the largest tenant intended to vacate the building following reconstruction of another building.[8]

The SEC also brought an action based on false and misleading disclosure in a continuing disclosure annual filing. The borrower's annual financial statements and annual information disseminated pursuant to Rule 15c2-12 undertakings: (i) overstated a subsidiary's 1996 net income by approximately $40 million by failing to adjust the subsidiary's bad debt reserves to account for uncollectible accounts receivable; (ii) overstated a subsidiary's and the organization's 1997 net income through the inappropriate transfers of approximately $99.6 million in reserves that were utilized to address the bad debt reserve shortfall not addressed in 1996, as well as an additional shortfall in 1997; and (iii) overstated its 1997 net income by misclassifying certain restricted trust funds. Both the borrower and its subsidiary would have posted substantial net losses for fiscal year 1997 without the fraudulent activity. The organization declared bankruptcy in 1998, after the 1997 continuing disclosure report was disseminated.[9]

More recently (and somewhat controversially), the SEC commenced actions based on the failure to disclose potential tax risks in a transaction. For example, in connection with the financial difficulties experienced by Orange County, California, the SEC concluded that certain tax and revenue anticipation notes were not sized properly for federal tax purposes and that failure to disclose that risk was materially misleading to investors.

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[8] *In the Matter of Dauphin County General Authority, Release No. 8415 (April 26, 2004); In the Matter of Dolphin and Bradbury, Incorporated and Robert J. Bradbury, Release Nos. 8721, 54143 (July 13, 2006).*
[9] *In re Allegheny Health, Education and Research Foundation ("AHERF")*, Re*lease Nos. 1283, 42992 (June 30, 2000) (settled final order); see related actions In re Spargo, Release Nos. 1252, 42742 (May 2, 2000) (settled final order) and SEC v. McConnell, Litigation Release No. 16534 (May 2, 2000) (settled final order).*

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SEC RULE 15c2-12

The SEC promulgated Rule 15c2-12 (the “Rule” or "Rule 15c2-12") in 1989 and amended the Rule in 1994 to include continuing disclosure requirements. The Rule was initially proposed in 1988 by the SEC as part of a package accompanying release of its report on the WPPSS default. The Rule came in response to concerns that in connection with primary offerings of securities sufficient information was not always made available to potential investors in a timely manner. In 1994, the SEC adopted amendments to the Rule in response to market concerns that on-going disclosure about municipal securities was not available. Direct regulation of issuers would have required repeal of the Tower Amendments, so the Rule instead applies to municipal broker-dealers and generally applies to financings where the principal amount offered is $1 million or greater. The Rule applies indirectly to issuers, effectively denying their access to the market unless the Rule’s requirements are satisfied. The Rule contains primary disclosure requirements and continuing disclosure requirements.

> ***15c2-12 Primary Disclosure***
>
> ***Does not require specific disclosure, just the inclusion of material information.***

With respect to new issue disclosure at the time of issuance of municipal securities, the Rule provides the only regulatory definition of “final official statement,” setting forth certain categories of information that must be contained in the disclosure document. (However, the information is not prescribed with specificity; the Rule essentially requires the inclusion of material information.) The Rule also establishes timing constraints on the drafting and review of preliminary official statements and final official statements.

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With respect to continuing disclosure, the Rule prohibits the purchase and sale of municipal securities by an underwriter in a public offering unless the issuer or an "obligated person" undertakes to provide continuing disclosure. Continuing disclosure obligations include both periodic reporting of financial and operating information and disclosure of the occurrence of any of a specified list of 11 events, if material. The annual information is required to include audited financial statements when available and material financial information and operating data of the type included in the official statement for the securities. The 11 events, which are listed to the right, are by no means a comprehensive list of those subsequently occurring events that might be material to investors. Further, the qualification that these 11 events be disclosed only if *material* leaves much room for debate. A notable example is the varying views of municipal market participants on whether a tax audit needs to be disclosed. While the Rule does not provide for a specific deadline by which the updated annual disclosure is to be provided, the 1994 Interpretive Release suggests that it be provided within 6 months of the end of the fiscal year. Furthermore, the 1994 Interpretive Release indicates that in some circumstances annual information may not be sufficient and that investors may need more frequent periodic financial information. For example, where an issuer or conduit borrower makes frequent public statements and such statements are a principal source of current information about the

15c2-12 Continuing Disclosure
11 Events to be disclosed, 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 statutes 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.

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issuer or conduit borrower, ongoing disclosure provides the context for the public statements. The SEC also stated that for an issuer or conduit borrower with a primary offering document containing forward looking statements, such as projections, without updated disclosure such forward looking statements could be misleading in the event of a change in circumstances.

VOLUNTARY SECONDARY MARKET DISCLOSURE BEYOND RULE 15c2-12

Independent of contractual undertakings made by issuers and conduit borrowers and continuing disclosure obligations under Rule 15c2-12, the SEC maintains that issuers of municipal securities and conduit borrowers have continuing disclosure responsibilities under Section 10(b) of the Exchange Act and Rule 10b-5. While issuers and conduit borrowers have no affirmative duty to disclose information (unless they are engaged in the offering, purchase or sale of securities or unless disclosure is required under a continuing disclosure undertaking), if an issuer or conduit borrower chooses to disclose information to the market it is prohibited from disclosing information that is materially untrue or misleading, or that contains a material omission, "in light of the circumstances" in which such information is disclosed. There are no other limits on the issuer's or the conduit borrower's disclosure. If an issuer or conduit borrower were to limit its primary disclosure to the minimal information necessary to comply with Rule 15c2-12 and the antifraud provisions, there is no affirmative requirement to provide additional types of information in continuing disclosure filings (other than notices of certain events, if material), since the annual disclosure filings consist of audited financial statements and material financial and operating data that generally is based on the disclosure set forth in the original offering document. The only legal exception is if failure to provide additional information would make the provided information materially false and misleading. In the 1994 Interpretive Release, the SEC stated that "[a] municipal issuer may not be subject to the mandated continuous

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reporting requirements of the Exchange Act, but when it releases information to the public that is reasonably expected to reach investors and the trading markets, those disclosures are subject to the antifraud provisions." Significantly, this refers to information reasonably *expected* to reach investors, not information *intended* for investors. That is, even if a disclosure is made other than in an offering documents or a continuing disclosure filing, it still may be subject to the federal securities laws if made in a manner reasonably likely to reach investors, such as in press release given to The Bond Buyer or information included on the investor relations portion of the issuer's or conduit borrower's web page. There has been criticism by some municipal market participants that the factors contained in Rule 15c2-12 have resulted in less disclosure in the market, so as to avoid falling within the antifraud laws and having to provide updated disclosure once expanded primary disclosure is made.

In addition to disclosure mandated by Rule 15c2-12, issuers and conduit borrowers sometimes also contractually commit to providing periodic disclosures in addition to those required by Rule 15c2-12, responding to *ad hoc* inquiries by bondholders, and providing information concerning material events in addition to those required by the Rule. As noted by the National Association of Bond Lawyers in its September 30, 2000 paper entitled "Providing Information to the Secondary Market Regarding Municipal Securities," additional secondary market disclosure beyond what is mandated by the Rule or the antifraud provisions is not required, nor is it prohibited under federal securities laws. While not required as a matter of law, such voluntary secondary market disclosure may be a good practice and policy for several reasons, including investor relations. For example, it may provide more demand and better liquidity for an issuer's or conduit borrower's securities and result in lower costs of borrowing.

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Strengthened investor relations and communications also may result in more readily attainable waivers or consents, if needed from bondholders.

INSIDER TRADING ISSUES IN THE MUNICIPAL MARKET

The issue of voluntary secondary market disclosure has caused some issuers and conduit borrowers to express concern about insider trading liability for making such disclosure. Bondholders have been concerned that such worries, which they feel are unfounded, are chilling the disclosure of current, material information about issuers. Particularly where the municipal market has so little mandated disclosure, anything tending to restrict the flow of information is even more acutely felt.

Insider trading is a court-developed doctrine under which it is unlawful to purchase or sell a security while in possession of material non-public information in breach of a duty or other relationship of trust and confidence.[10]

Material

Information is material if a reasonable investor would deem the disclosure of the information to significantly alter the total mix of information available. This is the same standard applicable in the antifraud and Rule 15c2-12 area, as described above.

Non-Public

Information is non-public if it is not available to a significant number of market participants.

[10] *Chiarella v. United States, 445 U.S. 222 (1980).*

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Breach of a Duty or Other Relationships of Trust

The person providing the information must be breaching a fiduciary duty or a confidence in providing the material, non-public information. A duty of trust or confidence exists when a person agrees to maintain the information in confidence, the parties have a history of sharing confidential information such that the recipient knows, or reasonably should know, that confidentiality is expected, or the information is received from a spouse, parent, child, or sibling.

There is a line of cases related to corporate debt establishing that a corporate issuer's fiduciary duty runs to its shareholders and not to debt holders (debt holders just benefiting from contractual obligations not fiduciary ones), other than when the entity becomes insolvent. Based on this, there are theories that this element cannot be satisfied for insider trading in the municipal market where the issuer may not have "shareholders." Other theories dismiss this limitation.

Motive to Benefit Personally

The person providing the information must be seeking a personal benefit by disclosing the material, non-public information.

Insider trading is an intent-based crime. Further, it requires use of non-public information acquired in breach of a duty. Thus, where an issuer or conduit borrower official is communicating with investors in good faith, in a context that does not involve the disclosure of "market moving" information, it is highly unlikely that a duty is being breached. This is particularly the case where the issuer or conduit borrower has adopted a policy endorsing such investor communications or where the communication is required by the bond documents.

There are certain kinds of information that would tend to have a significant impact on the market price of a security, such as a plan of defeasance or an event of taxability, where selective

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disclosure to a single inquiring analyst is not advisable. But the cases also support the diligent analyst who tries to get "behind the financials" by asking questions about information that it reasonably believes to be generally available. While the line is admittedly not definitive, there is certainly ample room for the issuer that wishes to provide information to its investor base to do so without fear of being accused of "tipping."

Regulation FD

In the corporate market, the SEC promulgated Regulation FD, which mandates fair disclosure practices and promotes equal access to information from issuers to the market. By its terms, Regulation FD is not applicable to issuers of municipal securities and conduit borrowers. Although Regulation FD does not apply to municipal issuers or conduit borrowers, some market participants suggest it has caused municipal issuers and conduit borrowers to limit disclosure, such as by refusing to respond to direct investor inquiries, so as to avoid providing such information to all holders or potential holders of its bonds.

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Glossary of Terms Used in "Federal Securities Law Relating to Municipal Securities"

Analysts refers to professionals specializing in the credit analysis of municipal securities and includes institutional investors, bond rating agencies, bond insurance companies, portfolio managers, investment banking firms and financial advisors.

Blue sky laws are state laws regulating the offer and sale of securities to prevent fraud. Blue sky laws have been described as being designed to prevent securities schemes with no more basis than "so many feet of blue sky." Many of the blue sky legal requirements were preempted by the National Securities Markets Act of 1996, although there remain certain fee, filing and disclosure requirements.

Broker-Dealer refers to an individual or firm that is in the business of buying and selling securities for itself or others. Broker-dealers must register with the SEC, are heavily regulated by the SEC and, in the case of municipal securities, the MSRB. Broker-dealers are typically members of the National Association of Securities Dealers.

Committee or Ad Hoc Committee refers to an informal group of purchasers or holders of particular municipal securities organized to negotiate collectively.

Conduit Borrower refers to an Obligor whose obligation runs to a governmental issuer and who receives the proceeds of the municipal securities issued by the governmental issuer.

Conduit Borrowing refers to the issuance of municipal securities by a governmental issuer for the benefit of a Conduit Borrower who is the Obligor on the securities under a loan, installment sale or lease from the governmental issuer to the Obligor.

Continuing Disclosure Agreement, Rule 15c2-12 Agreement **or** ***Rule 15c2-12 Undertaking*** refers to the agreement under which the Obligor on the municipal securities undertakes to comply with the continuing disclosure requirements of Rule 15c2-12.

DisclosureUSA refers to the Internet-based electronic filing system used by issuers and other filers to upload documents for immediate transmission, together with CUSIP numbers and other information, to meet the filing requirements of Rule 15c2-12. Filing through DisclosureUSA eliminates the need to make separate filings with each NRMSIR and SID. As an outgrowth of efforts of the Muni Counsel, DisclosureUSA was created and is operated by the Municipal Advisory Council (MAC) of Texas.

Eleven Material Events are the eleven events expressly listed in Rule 15c2-12 that must be disclosed, if material, in a continuing disclosure filing with the NRMSIRs (and SIDs, where applicable). The events include principal and interest payment delinquencies; non-payment related defaults; unscheduled draws on debt service reserves reflecting financial difficulties; unscheduled draws on credit enhancements reflecting financial difficulties; substitution of credit or liquidity providers, or their failure to perform; adverse tax opinions or events affecting the tax-

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exempt status of the security; modifications to rights of security holders; bond calls; defeasances; release, substitution or sale of property securing repayment of the securities; and rating changes. The Eleven Material Events do not represent an exclusive list of all events that may be material for antifraud and insider trading purposes.

Final official statement is defined in Rule 15c2-12 and consists of a document or set of documents prepared by an issuer of municipal securities or its representatives that sets forth information concerning the terms of the proposed issue of securities, including financial information or operating data. The amendments to Rule 15c2-12 expanded the definition to include a requirement that a final official statement include a description of the continuing disclosure undertaking and disclosure of any failure to comply with prior undertakings in the last five years.

Exchange Act or ***1934 Act*** is the Securities Exchange Act of 1934, which created the SEC. The Exchange Act empowers the SEC with broad authority over all aspects of the securities industry, including the power to register, regulate, and oversee broker-dealers and self regulatory agencies, such as the MSRB, the New York Stock Exchange, the American Stock Exchange and the National Association of Securities Dealers. The Exchange Act identifies and prohibits certain types of conduct in the markets and provides the SEC with disciplinary powers over regulated entities and persons associated with them. The Exchange Act also empowers the SEC to require periodic reporting of information by companies with publicly traded securities.

Indenture/Trust Indenture refers to the written agreement under which municipal securities are issued and includes the terms thereof. Depending on the issuer, the indenture is sometimes calls a trust agreement, ordinance or resolution.

Insider trading refers to the illegal buying or selling of a security while having material, non-public information about the security, in breach of a fiduciary duty or other relationship of trust and confidence. Insider trading may also include “tipping” such information, securities trading by the person “tipped,” and securities trading by persons who misappropriate such information. Insider trading is a felony, and the SEC also can levy large civil penalties for violations.

Interpretative Release or ***1994 Interpretive Release*** refers to a report published by the SEC in 1994 to provide guidance on Rule 15c2-12, as originally promulgated. The Interpretive Release was issued at about the same time as the release proposing the amendments to Rule 15c2-12 to provided for continuing disclosure requirements. The Interpretive Release, in part, was a response to input received by the SEC in connection with development of the Rule 15c2-12 amendments. Some of such input caused the SEC to be concerned whether Rule 15c2-12, as originally promulgated, was being complied with fully. Through the Interpretive Release, the SEC clarified certain matters related to Rule 15c2-12 and disclosure generally. Among other things, the Interpretive Release promoted voluntary disclosure and is cited for this proposition.

GFOA means the Government Finance Officers Association, a professional association of state/provincial and local finance officers in the United States and Canada. It was founded in 1906 and has over 16,800 members and full-time staff with offices in Chicago and Washington D.C. See www.gfoa.org.

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"Market Moving" Information refers to information about municipal securities that is material and the dissemination of which likely would affect the pricing of the municipal securities.

Materiality or ***material*** is referred to frequently in the federal securities laws. There are violations of the antifraud rule only for "material" misstatements or omissions. Rule 15c2-12 requires disclosure of the eleven listed events, if "material." Insider trading occurs only in connection with "material" nonpublic information. Definitions of materiality are not set forth in the 1933 Act or the 1934 Act. There are multiple definitions set forth in case law, one of which is referred to in the Interpretive Release and is a good summary of the definition: "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." There are no bright-line tests for measuring whether a fact is material.

MSRB means the Municipal Securities Rulemaking Board, established in 1975 by Congress to develop rules regulating securities firms and banks in underwriting, trading and selling municipal securities. The MSRB is a self-regulatory agency, subject to oversight by the SEC, which must approve all MSRB Rules. The MSRB is composed of members from the municipal securities dealer community and sets standard for all municipal securities dealers. See www.msrb.org.

Muni Council consisted of a group of 19 municipal market participants created in 2004 to work to improve secondary market disclosure in the municipal markets. Members included: American Bankers Association, American Bar Association - Section of State and Local Government Law, American Institute for Certified Public Accountants, Association of Investment Management and Research, Council of Infrastructure Financing Authorities, GFOA, Healthcare Financial Management Association, Investment Counsel Association of America, Investment Company Institute, Municipal Advisory Council of Texas, National Association of Bond Lawyers, National Association of Independent Public Finance Advisors, National Association of State Auditors, Comptrollers and Treasurers, National Association of State Treasurers, National Council of Health Facilities Finance Authorities, National Council of State Housing Agencies, NFMA, Regional Municipal Operations Association and The Bond Market Association.

Municipal Securities refers to debt securities issued by a governmental issuer on behalf of itself or a Conduit Borrower to fund capital projects.

NFMA refers to the National Federation of Municipal Analysts, a not-for-profit association chartered in 1983 with the goals of promoting professionalism in municipal credit analysis and furthering the skill level of its members through educational programs and industry communication, providing an informed perspective in the formulation of legal and regulatory matters relating to the municipal finance industry, and facilitating the flow of information between investors and issuing entities. NFMA comprises six constituent societies: Boston Municipal Analysts Forum (BMAF), California Society of Municipal Analysts (CSMA), Chicago Municipal Analysts Society (CMAS), Minnesota Society of Municipal Analysts (MSMA), Municipal Analysts Group of New York (MAGNY) and Southern Municipal Finance Society (SMFS). Members of constituent societies are automatically members of the NFMA. In

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addition, individuals not located in proximity to a constituent society may join the NFMA as affiliated individuals.

NFMA's Disclosure Guidelines refers to papers formulated by the NFMA, including Best Practices and White Papers, intended to provide guidance to issuers of municipal securities and intermediaries in providing primary and ongoing financial and operational information to the municipal analyst community (the investors and potential investors).

NRMSIRs means Nationally Recognized Municipal Securities Information Repositories, designated by the SEC to receive the required disclosure filings under Rule 15c2-12. The SEC maintains the current list of NRMSIRs at www.sec.gov.info/municipal/nrmsir.htm. The current NRMSIRs are:

Bloomberg Municipal Repository
(www.bloomberg.com/markets/rates/municontacts.html);

DPC Data Inc.
(www.dpcdate.com);

FT Interactive Data
(www.ftid.com); and

Standard & Poor's Securities Evaluations, Inc.
(www.disclosuredirectory.standardandpoors.com).

1933 Act is the Securities Act of 1933, sometimes referred to as the "truth in securities law." The two objectives of the 1933 Act are to require that investors receive financial and other significant information concerning securities being offered for public sale, and to prohibit deceit, misrepresentations, and other fraud in the sale of securities.

Obligor means the entity primarily responsible for the repayment of debt, such as the issuer or, in a conduit offering, the Conduit Borrower.

Preliminary Official Statement or POS refers to the document or set of documents prepared prior to the pricing of municipal securities which contain the same information as the Final Official Statement, except for certain information that is determined at the time of pricing of the municipal securities. The POS is sometimes referred to as the "red herring" in reference to the disclaimer printed on the front cover of the POS, usually in red, which indicates that the POS is not the formal offer of sale of the securities. The POS often is the "deemed final official statement" as provided in Rule 15c2-12.

Qualified institutional buyer or ***QIB*** is used in Rule 144A and refers to those institutional investors who are generally perceived to possess the expertise and financial muscle to evaluate and invest in the capital markets. A QIB must be a specific type of entity listed in Rule144A, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entity. The list includes without limitation, banks, savings and loans institutions, insurance

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companies, investment companies, employee benefit plans and entities owned entirely by qualified investors. Also included are registered broker-dealers owning and investing, on a discretionary basis, $10 million in securities of non-affiliates.

Regulation D refers to a regulation promulgated by the SEC under the 1993 Act, that provides an issuer or Conduit Borrower three different types of private placement exemptions from the registration requirements. The exemptions, set forth in Rules 504, 505 and 506 under the 1933 Act, are based on the size of the offering and the number and type of potential investors.

Regulation FD refers to the SEC's Regulation on Fair Disclosure, adopted in 2000, which prohibits selective disclosure by requiring public companies and other entities subject to the rule to disclose material, non-public information by certain means designed to achieve broad distribution. Municipal securities are not subject to Regulation FD. Nevertheless, some municipal securities market participants believe Regulation FD has chilled disclosure in the municipal market because some issuers and Obligors point to Regulation FD as a parallel disclosure standard that would not require the disclosure of certain information of interest to investors in the municipal market.

Rule 10b-5 refers to an antifraud Rule promulgated by the SEC under the Exchange Act which prohibits material misstatements or omissions in connection with the purchase or sale of a security. Municipal securities are not exempt from Rule 10b-5. Rule 10b-5 is enforced through private lawsuits for money damages. There are multiple elements of Rule 10b-5 that must be demonstrated in such a cause of action, as described in the accompanying article.

Rule 15c2-12 refers to a Rule promulgated by the SEC under the Exchange Act specifically relating to disclosure in connection with municipal securities. Given the limitations of the Tower Amendment (see definition below), the Rule governs broker-dealers of municipal securities but is applied by contract to Obligors. The Rule, originally promulgated in 1989, addressed perceived flaws in the content and timeliness of receipt of disclosure in connection with the initial offering of municipal securities. Amendments to 15c2-12 in 1994 addressed ongoing disclosure.

Rule 131 refers to a Rule promulgated by the SEC under the 1933 Act that created the concept of a "separate security." Specifically, Rule 131 specifies that any part of a security issued by a governmental unit exempt from registration under Section 3(a)(2) of the 1933 Act, which is or will be used, under a lease, sale or loan arrangement, by or for industrial or commercial enterprise, shall be deemed to be a separate security under the 1933 Act and requires its own exemption. Rule 131 was created, in part, to specify that the loan obligation in a conduit borrowing is a security. There are a few general exceptions in Rule 131, such as if the obligation is payable from the general funds of a governmental unit or it if relates to a public project.

Rule 144 refers to a Rule promulgated by the SEC under the 1933 Act authorizing a type of private placement, which is a means of avoiding the registration requirements of the 1933 Act for a type of security that does not qualify as an exempt security. Rule 144 provides that restricted securities may be sold after a one-year holding period, provided that certain current financial information about the issuer or Conduit Borrower is available, the amount sold during any three-month period does not exceed certain prescribed amounts, the sale is effectuated in an

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unsolicited transaction or to a market maker, and, for certain sales, notice is filed with the SEC. After two years, such securities cease to be restricted and the requirement for updated disclosure required by Rule 144 is no longer applicable.

Rule 144A refers to a Rule promulgated by the SEC under the 1933 Act authorizing a type of private placement, which is a means of avoiding the registration requirements of the 1933 Act for a type of security that does not qualify as an exempt security. Rule 144A allows for sales or resales of a security to a "qualified institutional buyer." Rule 144A mandates the disclosure and ongoing availability of certain financial information about the Obligor.

Section 17(a) refers to Section 17(a) of the 1933 Act, the only substantive provision of the 1933 Act directly applicable to generally exempt municipal securities. Section 17(a) is an antifraud provision that prohibits false or misleading statements in connection with the offer or sale of any security.

Security is broadly defined in the 1933 Act as: "any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." *See Section 2 of the 1933 Act.*

SEC is the United States Securities and Exchange Commission, established in 1934 after the market crash of 1929. The SEC is governed by five Presidential-appointed Commissioners and has four divisions: Corporation Finance, Market Regulation (which governs broker-deals and the MSRB and includes the Office of Municipal Securities), Investment Management and Enforcement.

Selective disclosure refers to an entity disclosing material, non-public information to one person or investor, or a small group of investors, without disclosing it to all investors. The SEC promulgated Regulation FD (see definition above) to address selective disclosure concerns for public companies. Regulation FD is not applicable to municipal securities.

Separate security is discussed in the above definition of Rule 131.

SIDs refers to state information depositories, of which there currently are only three, in Ohio, Texas and Michigan. For securities offerings by issuers in those states, Rule 15c2-12 disclosure filings must be made with the applicable SID in addition to the NRMSIRs.

SIFMA is the Securities Industry and Financial Markets Association, created in 2006 by merger of the Securities Industry Association and The Bond Market Association (formerly PSA). See www.sifma.org.

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"Speaking to the market" refers to any disclosure by an issuer of municipal securities or a Conduit Borrower to the public that is reasonably expected to reach investors and the trading markets (whether or not such disclosure is published for the purpose of providing information to the securities markets).

Tower Amendment refers to a provision in the Securities Act Amendments of 1975 which precludes the then-created MSRB from directly regulating issuers. "The [MSRB] is not authorized under this chapter to require any issuer of municipal securities, directly or indirectly through a municipal securities broker or municipal securities dealer or otherwise, to furnish to the [MSRB] or to a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to such issuer: provided, however, that the [MSRB] may require municipal securities brokers and municipal securities dealers to furnish to the [MSRB] or purchasers or prospective purchasers of municipal securities applications, reports, documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer. Nothing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this chapter." The Tower Amendment supplemented another limitation in the Securities Act Amendments of 1975 on the ability for the SEC and MSRB to regulate issuers of municipal securities directly: "Neither the [SEC] nor the [MSRB] is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the [SEC] or the [MSRB] prior to the sale of such securities by the issuer any application, report or document in connection with the issuance, sale or distribution of such securities." *See Section 15B(d)(1) and (2) of the 1933 Act, as enacted by the Securities Act Amendments of 1975, including the so-called Tower Amendment.*

Trustee refers to a financial institution, usually a trust company or the trust department in a commercial bank, that acts on behalf of the issuer and/or Conduit Borrower and holds collateral for the benefit of the holders of municipal securities. The Trustee's obligations and responsibilities are set forth in the Indenture.

WPPSS refers to the Washington Public Power Supply System. In 1983, WPPSS defaulted on over $2 billion of municipal bonds issued to fund two nuclear power plants. The default is arguably one of the events that lead to the creation of Rule 15c2-12.

Underwriter See definition of Broker-Dealer.

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Frequently-Asked Questions by Analysts About Municipal Bond Disclosure

Problems of No Information

A. If an Obligor cites one or more of the following reasons for not providing <u>any</u> information to an Analyst (perhaps on advice of counsel), how should the Analyst respond?

1. *Obligors cannot provide any information to Analysts generally.*

   This "blanket" answer reflects a misunderstanding of municipal bond disclosure regulation—or at least an aversion to trying to understand the disclosure rules. In fact, there is no general prohibition against Obligors providing information to Analysts. Obligors may try to steer clear of any hypothetical liability under Section 17(a) of the 1933 Act and Rule 10b-5 by avoiding all communications with Analysts, but this strategy is grossly overprotective and does not reflect the narrow potential for liability under those anti-fraud protections.

   Failure of an Obligor to communicate with beneficial holders of municipal bonds may result in a market disadvantage for the Obligor—investors may not price the Obligor's bonds as well as bonds of a more communicative Obligor, and more disclosure leads to better investor relations for an Obligor. Moreover, information is essential for the municipal bond market to function efficiently. For these and other reasons, the Government Finance Officers Association (GFOA) and the National Federation of Municipal Analysts (NFMA) have recommended that Obligors communicate information to beneficial owners of municipal bonds, even where there is no disclosure obligation.

2. *If an Obligor provides information to one Analyst, it must provide the same information at the same time to all Analysts.*

   The concern of "selective disclosure" in the municipal market is not nearly as widespread as the concern in the public equity market. The problem in the municipal market is more often "not enough disclosure" rather than "selective disclosure." Nevertheless, over-cautious Obligors may use the "selective disclosure" regulations, such as Regulation FD (which does not apply to municipal securities), as support-by-analogy that Obligors should not provide information on an analyst-by-analyst basis. Obligors are correct to avoid true "selective disclosure" of material information to "key" Analysts, but the solution should not be a complete shutdown of the flow of information from an Obligor to Analysts.

   It is important to distinguish between an Obligor's communications with Analysts on a one-by-one basis generally (which is permissible and often encouraged) and the "selective disclosure" of material information to certain Analysts. As a general matter, no "selective disclosure" concern will be raised simply because an Obligor

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takes an opportunity to explain its financial statements to a particular Analyst. Most such conversations do not involve the type of "material" information that drives "selective disclosure" concerns (that is, "market-moving" information), and avoiding "selective disclosure" is therefore not a valid reason to avoid communications with Analysts altogether.

That said, to the extent that true "selective disclosure" concerns are implicated, there are several ways for an Obligor to address those concerns without cutting off all communications with Analysts:

- The Obligor can designate a single person to be the sole route for communications between the Obligor and Analysts, following the "investor relations representative" role in public corporations. This will help mitigate some of the risks of "selective disclosure," namely, different levels of information and inconsistent information being disclosed to different Analysts.
- The Obligor can establish open-access communications periods, such as periodic conference calls, so Analysts have an equal opportunity to ask questions and hear answers.
- The Obligor can follow the NFMA's Best Practices for Disclosure in its respective sector (see www.nfma.org).
- The Obligor can provide its secondary market disclosure on the internet, free of charge, to permit Analysts open access to secondary-market information without regard to whether they have paid access to a NRMSIR.

These suggestions should help an Obligor strike a balance between concerns for "selective disclosure" and the need for appropriate disclosure in an efficient market.

3. *Insider trading laws prevent Obligors from communicating with Analysts.*

"Insider trading" is a brand of the "selective disclosure" concern.

Insider trading is the trading of securities while in possession of material non-public information acquired in breach of fiduciary duty, for the purpose of personal benefit. Because this standard is strict, it does not generally foreclose communication between an Obligor and a single Analyst. Provided that the Obligor is communicating in good faith and not disclosing "market-moving" information, the breach of fiduciary duty element of insider trading is not likely to be met, especially where the Obligor has made communication with bondholders a formal policy or is complying with the bond documents. So, for example, an Obligor should be able to answer many inquiries from an Analyst regarding publicly-disclosed financial statements without the risk of insider trading. Insider trading is a fair concern for Obligors and Analysts alike, but chilling all Obligor-to-Analyst communications is an overbroad way to address the concern.

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4. *Securities laws prevent Obligors from communicating with Analysts.*

This vague statement is another example of an Obligor's fear overtaking the reality of municipal bond regulation. Usually, this statement is a reference to the anti-fraud provisions of Rule 10b-5, as applied in connection with the disclosure requirements of Rule 15c2-12.

Rule 10b-5 applies to Obligors and prohibits a material misstatement or omission regarding securities. Rule 15c2-12 indirectly applies to Obligors and requires disclosure of material information in municipal bond offering documents as well as in secondary market disclosures regarding municipal bonds.

There seems to be a myth that the materiality standards of Rule 10b-5 and Rule 15c2-12 create both a "floor" and a "ceiling" for disclosure—that is, a myth that the securities rules require a certain level of disclosure and prevent any disclosure beyond that level. However, beyond the prohibition against material misstatements of fact, the securities rules do not prohibit additional disclosure by Obligors. For example, although Rule 15c2-12 lists a number of material items that should be disclosed in the secondary market, that list is not an exclusive list of all material items and does not prevent the disclosure of other items that may or may not be material.

In fact, once an Obligor has "spoken to the market" by disclosing information, securities laws (Rule 10b-5) may require the Obligor to make further disclosures to keep the prior information correct, complete, and updated. Thus, while securities laws do not prevent disclosure, they may in these circumstances require disclosure.

B. If an Obligor fails to return telephone calls from an Analyst, is there anything the Analyst can do to force a response?

An Obligor should understand that the market will react negatively to a refusal to respond to Analysts, and the Obligor should therefore return an Analyst's telephone calls. Also, an Obligor is more likely to respond to an Underwriter than an Analyst, and therefore an Analyst might try to contact an incommunicative Obligor indirectly rather than directly. However, an Analyst has no legal basis for forcing an Obligor to respond to its calls or written requests for information unless the applicable bond documents provide otherwise.

C. If an Obligor or Trustee demands proof that an Analyst is a current bondholder, is the Analyst required to provide proof? Are only current bondholders entitled to receive information and participate in quarterly calls and other group calls? Are

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Broker-Dealers entitled to information, even though they are not themselves bondholders?

The disclosure regulations applicable to Obligors do not differentiate between bondholders and non-bondholders. Thus, an Obligor should not demand proof that an Analyst is a current bondholder, and an Analyst should not be required to provide proof of ownership. That said, an Obligor has some latitude under the law as to whether it speaks with Analysts, and as a practical matter an Obligor is more likely to speak with an Analyst that is a current bondholder. If an Obligor refuses to provide information unless the Analysts demonstrates proof of ownership, and if an Analyst is not willing or able to do so, then the Analyst might be able to argue that the requested information is required to be disclosed by the Obligor to bondholders and non-bondholders alike. However, since the mandatory disclosure requirements for Obligors are not expansive, this argument will only succeed under limited circumstances.

If the Trustee requires proof of ownership, a different set of issues is presented. While the relationship of a bondholder or non-bondholder to the Obligor is primarily a matter of securities law, the relationship of a bondholder or non-bondholder to the Trustee is primarily a matter of contract. The applicable contract might be the Trust Indenture governing the bond issuance (in which the Trustee is the indenture trustee for *bondholders*) or might be a Rule 15c2-12 Undertaking (in which the Trustee is the dissemination agent for the Obligor with respect to *bondholders and non-bondholders*). Each of these contracts must be considered separately.

The Trust Indenture contains the rules that create and govern the relationship of the Trustee to the bondholders. The Trust Indenture has no similar import for non-bondholders. For example, the Trustee is a fiduciary for bondholders, but not for non-bondholders[11]; and the Trustee usually has contractual disclosure obligations to the bondholders, but not to non-bondholders.[12] Because the Trust Indenture does differentiate between bondholders and non-bondholders, the Trustee may request, and an Analyst should be prepared to provide, proof of ownership to the Trustee.[13] The proof required varies by Trustee according to their individual policies.

The case of a Trustee requiring proof of ownership sometimes arises where a group of bondholders has formed a committee or otherwise assembled for periodic discussions among themselves, or together with the Trustee. Such a group may not possess or discuss material non-public information from the Obligor, but it may possess the collective private thoughts of the group members. If the Trustee or the group (or any member of the

[11] It has been traditionally thought that, in the absence of a default, the Trustee acts as an agent or stakeholder for the Obligor on behalf of the bondholders. Under this view, the Trustee becomes a fiduciary for the bondholders only upon the occurrence of a default. However, in recent years courts have extended the Trustee's fiduciary duty to bondholders to non-default situations.

[12] Although this is traditionally the case, it has become more common in recent years for Trust Indentures, and sometimes related loan agreements which are binding on the Trustee as assignee of the issuer, to provide that certain information may be made available to non-bondholders either directly by the Obligor or by the Trustee.

[13] This applies also in circumstances where the Trustee is dissemination agent under a Rule 15c2-12 Undertaking but the information requested is beyond that which was provided by the Obligor.

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group) has received legal advice, that advice may become part of the discussions. In order to keep these discussions confidential (and to maintain the attorney-client privilege as best as possible in respect of any legal advice), the Trustee and the bondholder group have an interest in permitting only bondholders to participate in discussions and gain access to group information.[14]

Unlike a Trust Indenture, a Rule 15c2-12 Undertaking in which the Trustee is the dissemination agent for the Obligor does not distinguish between bondholders and non-bondholders. As noted above, the Obligor should not distinguish between bondholders and non-bondholders for disclosure purposes, and therefore a Trustee acting as dissemination agent for an Obligor should not do so.[15]

Although Trust Indentures and Rule 15c2-12 Undertakings in which the Trustee is the dissemination agent contractually require certain disclosures by the Trustee, only in limited circumstances do these contracts limit disclosures by the Trustee. If a Trustee relies on a contract for declining to disclose information to an Analyst, the Analyst should make further inquiries to determine whether any such contractual limitation does in fact exist.[16]

D. If an Obligor refers an Analyst's questions to another party (e.g., a financial advisor, underwriter, or dissemination party) as the information source, responsible party, or decision-maker, should this excuse the Obligor's failure to provide information? What happens if the referral party does not provide the requested information?

An Obligor is permitted to assign responsibility to a party serving as a dissemination agent, but that agent works at the direction of the Obligor, and the Obligor remains responsible for the adequacy of the disclosure. Thus, although the assignment of disclosure responsibility creates an extra layer between an Obligor and an Analyst, it does not change the underlying set of rules regarding disclosure by Obligors. If an Analyst has

[14] Another related question is whether a Trustee or bondholder group can deny a bondholder access to group discussions or information even after the bondholder has submitted acceptable proof of ownership. For example, a group composed of par holders who have directed the Trustee to retain counsel and have regular discussions with the Trustee and its counsel may want to exclude discount purchasers from the discussions. Or a group of bondholders in which the smallest bondholder position is $1 million may want to exclude bondholders with smaller positions from such discussions. In these instances, the Trustee must maintain its dual responsibilities to the majority bondholders, who have directed the Trustee to take action, and to each individual bondholder, who may have an interest not represented by the majority. While there may be valid reasons for the Trustee to act as gatekeeper, shielding access to group information, the Trustee must also exercise caution so as not to breach its fiduciary duty to the bondholders who are not part of the group. Again, this issue is one regarding information that is not provided by the Obligor, such as independent legal or financial analysis, not an issue regarding Obligor-generated information.

[15] Some Trustees may decline to release information directly to an investor where the information has already been disseminated to the NRMSIRs and SIDs, instead directing the investor to these public repositories. If the information is already publicly available as a result of such dissemination, there is no harm in the Trustee providing it directly to the interested investor.

[16] Some Trust Indentures expressly provide that certain disclosures by the Obligor to the Trustee may not be further disclosed by the Trustee to any third party, including any bondholder. These provisions are rare and usually limited to specific types of information marked by the Obligor as proprietary or confidential.

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exhausted the possibility of obtaining information from a dissemination agent, the Analyst may contact the Obligor directly. However, because the disclosure requirements for Obligors (and their agents) are limited, it may be the case that neither the Obligor nor the agent is willing—or required—to disclose the information being requested.

Problems of Not Enough Information

E. If an Obligor cites one or more of the following reasons for not providing a specific type of information to an Analyst (perhaps on advice of counsel), how should the Analyst respond?

1. The requested information is not material.

Materiality is indeed the touchstone for disclosure in both the primary and secondary markets. However, it is sometimes difficult for an Obligor and Analysts to come to a common understanding of what information is and is not "material." Much information in which an Analyst may be interested—questions about an Obligor's disclosed financial statements, for example—may nevertheless not be "material" as a legal matter. But a determination that information is not material can have a double implication. On the one hand, information that is not material is not required to be disclosed to the public generally, even where material information must be so disclosed. On the other hand, the same information that is not material does not give rise to any "selective disclosure" issues and therefore is permitted to be shared with one Analyst without being disclosed to the public generally.

If an Obligor argues that disclosure is not required because the requested information is not material, the Analyst may argue (a) that the information is in fact material and should be disclosed, (b) that the information is at least arguably material, and questions of materiality should be resolved in favor of disclosure, or (c) that the information is not material, but that the information nevertheless may and should be disclosed to the Analyst.

With respect to municipal bond disclosure, the question of whether information is material has an additional complexity because of the list of eleven specific events in Rule 15c2-12. Under Rule 15c2-12, an Underwriter may not purchase or sell municipal securities in an offering unless the Obligor has undertaken, in a written agreement or contract for the benefit of the securities holders (a "Rule 15c2-12 Undertaking"), to disclose the occurrence of any of the listed eleven events if the occurrence of such events is material. As a matter of drafting, the rule does not state that the listed eleven events are material or are not material—it only requires disclosure if they are material. Moreover, the rule does not purport to be an exhaustive list of material events. Thus, the listed events may at times be material or immaterial, and other non-listed events may be material. The bottom line under Rule 15c2-12 is that (a) only the listed events must be disclosed as part of the undertaking, and (b) the listed events must be disclosed only if they are material.

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Still, an Obligor may be required (under Rule 10b-5, for example), to disclose events that are not listed at all under Rule 15c2-12.

In any case, Rule 15c2-12 does not provide an answer to the question of whether a certain type of information is material.

2. *No one else has requested this information, and it would be burdensome to disclose.*

Whether anyone else has requested the information is of no direct relevance to whether the Obligor is required disclose the information. Usually, when an Obligor says that no one else has requested the information, the Obligor means that the information is not perceived by the market to be material—that the unpopularity of a request is indirect evidence of the immateriality of the requested information. However, the judgment of whether information is material or not is an objective one, not a subjective one in the discretion of the Obligor or other Analysts. The fact that no other Analyst has requested the information does mean that the disclosure is not required or that the request is inappropriate.

Whether information is burdensome to disclose is of no relevance to whether the Obligor is required to disclose the information. If information is required to be disclosed under Rule 10b-5, Rule 15c2-12, or otherwise, it must be disclosed even if the disclosure is expensive and time-consuming. Often, when an Obligor says that disclosure would be burdensome in response to an Analyst's disclosure request, the Obligor is taking the position (a) that the information is not material and is not required to be disclosed, (b) that it might voluntarily disclose the information, despite the lack of a requirement, if the information were readily available, but (c) the information is not readily available, and it would be burdensome to disclose the information, so no voluntary disclosure will be made. If all of this is true, then the Analyst has no legal tool to force the disclosure. On the other hand, it may be untrue that disclosure is not required—and, if so, then a financial or personnel burden is no excuse for non-disclosure.

3. *This type of information has not been provided in the past.*

Whether information has been disclosed in prior issuances or at an earlier date in the same issuance is of no direct relevance to whether disclosure is required in a subsequent issuance or circumstance. For matters of disclosure, there is no waiver or estoppel—whether a potential disclosure is required in one instance is measured without reference to other instances, and an Analyst is no less entitled to disclosure now because the Analyst took no action in response to a past instance of non-disclosure.

That said, a request for information that is not typically disclosed by Obligors will, in the abstract, be less likely to be a required disclosure than information of a type that is routinely disclosed by Obligors. This is a matter of correlation, not

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causation. Most Obligors disclose only what is required, so precedents for what has been disclosed tend to line up with what is required to be disclosed. But information is not required to be disclosed because that type of information has been disclosed traditionally, and information is not free from disclosure because it has not been subject to disclosure traditionally.

4. *The Government Finance Officers Association (GFOA) guidelines do not require the disclosures.*

The GFOA guidelines can be helpful to Analysts (in creating a standard for voluntary disclosure by Obligors that is higher than the standard required by law) but they can also be counterproductive to Analysts (in creating the perception of a disclosure "ceiling" that need not be exceeded, even on a voluntary basis, for any reason). Some Obligors will argue that their voluntary compliance with the GFOA guidelines is a "gift" to Analysts and will act as if Analysts requesting information above and beyond that set forth in the guidelines are "greedy." This is a misperception. The GFOA guidelines are intended to set a general standard for the types of information that should be disclosed by most Obligors in most circumstances. However, just as the GFOA guidelines do not require disclosure by Obligors, they do not prevent Obligors from disclosing more information than the guidelines require. A given Obligor, or certain circumstances, may make a particular disclosure meaningful and appropriate even if it is not part of the GFOA guidelines.

Problems Specific to Secondary Market Disclosure

F. If an Obligor insists that it has complied with a Rule 15c2-12 Undertaking, but an Analyst believes that the Obligor is out of compliance, what recourse does the Analyst have?

The Rule 15c2-12 Undertaking is entered into by an Obligor for the specific benefit of the holders of the bonds issued by the Obligor. Thus, while Rule 15c2-12 does not directly obligate an Obligor to disclose information or enter into an undertaking (but instead directly regulates Underwriter action), the rule and undertakings pursuant to the rule are intended to benefit, and to be policed by, bondholder Analysts. If an Analyst believes that an Obligor has not complied with its Rule 15c2-12 Undertaking, its first recourse should be to the Obligor itself. If an Obligor is unwilling to admit non-compliance with the undertaking, or if the Obligor simply refuses to comply with the undertaking, then a bondholder usually has two options under the typical undertaking. First, the bondholder can take whatever action it deems necessary (usually court action) to enforce certain terms of the undertaking—often only the filing of the annual disclosures—on its own. Second, the bondholder can join with other bondholders who together form a majority of the bondholders (by aggregate principal amount) and take joint action to enforce the undertaking, which would include not only the filing of the annual disclosures but also to challenge the adequacy of whatever disclosure has been made. This scheme is designed to prevent one cantankerous bondholder from initiating

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spurious legal challenges, but nevertheless to permit bondholders to force the benefits due to them under Rule 15c2-12 Undertakings.[17]

G. If an Obligor fails or refuses to explain the details for being out of compliance with a Rule 15c2-12 Undertaking, may an Analyst demand an explanation? Is an explanation that the Obligor was unaware of the disclosure requirements a sufficient response? What about an explanation that the third-party dissemination agent was responsible for the compliance failure?

Typically, a Rule 15c2-12 Undertaking does not permit an Analyst, acting on its own, to force an explanation of any alleged non-compliance by the Obligor. Bondholders are beneficiaries under Rule 15c2-12 Undertakings, and it is likely in the best interest of the Obligor to provide bondholder Analysts with an explanation of any non-compliance by the Obligor. However, if the Obligor refuses to do so, it is usually a majority of the bondholders, not just a single non-majority bondholder, who can force an explanation under the terms of the undertaking (see question and answer F and footnote 4 above).

Ignorance is no defense under a Rule 15c2-12 Undertaking, and an explanation by the Obligor that it was unaware of a disclosure requirement is not likely to succeed as a legal matter. A defense of ignorance is also unlikely to be genuine, because of the Obligor's execution of the Rule 15c2-12 Undertaking and the general familiarity of Obligors with continuing disclosure requirements.

Likewise, while an Obligor is permitted to assign responsibility to a party serving as a dissemination agent, that agent works at the direction of the Obligor, and the Obligor remains responsible for the adequacy of the disclosure. Thus, an explanation that a third-party dissemination agent, and not the Obligor, is to blame for disclosure non-compliance is not an explanation that exculpates the Obligor or mandates forgiveness of the non-compliance.

That said, the remedy for violation of a Rule 15c2-12 Undertaking is usually only specific performance—that is, forced disclosure of what should have been disclosed in the first place—so the validity of the explanation is often not relevant to the purpose of the undertaking and its enforcement.

H. Is an Obligor required to disclose a prior failure to comply with a Rule 15c2-12 Undertaking?

The definition of "final official statement" in Rule 15c2-12(f)(3) includes a requirement that such a statement include any instances in the past five years in which an Obligor (or agent) failed to comply, in all material respects, with any previous undertakings in a Rule 15c2-12 Undertaking. While this requirement does not (like the other parts of the rule) apply to Obligors directly, its application to underwriters will effectively result in the

[17] Although Rule 15c2-12 Undertakings are generally standardized in this regard, bondholders should obtain a copy of the Rule 15c2-12 Undertaking applicable to their issuance and review its particular terms before reaching any conclusion regarding enforcement mechanics for the undertaking.

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disclosure of any past disclosure non-compliance. It should be noted, however, that this disclosure of non-compliance is not a continuing disclosure requirement, but rather a disclosure requirement for future final official statements. Thus, if an Obligor is non-compliant in the period between issuances, no disclosure of that non-compliance is required.

I. If the disclosure commitment language is incorrect in a preliminary official statement and the Obligor or Bond Counsel resists correcting the language in time for a competitive bid, how should the Analyst respond? Is it sufficient if the Obligor or Bond Counsel orally assures the Analyst that the language will be corrected in the final official statement? Should the Analyst insist on receiving in writing the proposed corrected language?

The better course is to obtain the new language in writing. However, Bond Counsel is likely to resist providing the language in writing for a variety of reasons. First, providing the language to one Analyst can cause a selective disclosure problem. Second, providing the language before the final official statement is drafted can reduce Bond Counsel's flexibility in choice of language when the final official statement is drafted. Of course, the best course is for Bond Counsel to correct the preliminary offering statement in time for the competitive bid. But if that fails, an oral assurance from Bond Counsel may be the best that an Analyst can achieve as a practical matter.

J. How can an Analyst obtain current contact names and telephone numbers for an Obligor, to assist with secondary market inquiries for current information regarding an Obligor's credit quality?

There is no one best path for an Analyst to follow in obtaining current contact information for an Obligor. In many cases, an Analyst must make use of whatever information is available and place telephone calls with many different people before finding the best contact for an Obligor.

K. May an Obligor provide uneven disclosure, for example, more information (quarterly) to large bondholders who request information in writing and less information (annually) to Nationally Recognized Municipal Securities Information Repositories (NRMSIRs)?

The problem of uneven or "selective" disclosure is addressed above. The bottom line is that uneven disclosure is highly problematic, especially in a manner that would provide an entire set of quarterly numbers to certain preferred Analysts. Of course, nothing prevents an Obligor from making quarterly information available to the market at large, through NRMSIRs or otherwise, on a voluntary basis. Healthcare issuers have frequently agreed to do so, for example, in order to increase the liquidity of their bonds. Moreover, the SEC's 1994 interpretive release regarding antifraud protections indicates that in some circumstances annual information will not suffice and more frequent information disclosure is required. Still, whether on a voluntary or mandatory basis, quarterly

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financial information made available to one Analyst should in most circumstances be made available to all Analysts.

L. By sending information to the NRMSIR, has an Obligor satisfied all obligations and requirements to provide information in the secondary market?

No. By complying with a Rule 15c2-12 Undertaking, the Obligor has satisfied that undertaking, but no other requirement. For example, the Obligor may have continuing disclosure requirements under Rule 10b-5, and, even if an Obligor has no continuing obligation to disclose information under Rule 10b-5, any information that an Obligor does disclose (including any information disclosed under a Rule 15c2-12 Undertaking) is subject to antifraud regulation that might require a broader disclosure than that which was made. Moreover, the Obligor may have contractual disclosure obligations, for example in the bond documents.

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Exemption from the Securities Act: Municipal securities are exempt from the Securities Act of 1933 under Section 3(a)(2) if issued or guaranteed by a state or political subdivision or public instrumentality thereof. Accordingly, such municipal securities are exempt from the express private fraud remedies of Section 12(2) of the Securities Act.
Critical Time: Issuance and resale

State Purchasing Guidelines; Gifts to Government Officials: Contributions to political candidates are limited in value by both federal and state law. Federal law limits, with few exceptions, the contributed amount to $2,000 (11 CFR 110). Many states also limit amounts contributed to political parties and candidates within the state, such as Fla. Stat. Ch 9 § 106.08, which limits the contributed amount to $500.00. Violation of these federal and state laws constitutes a misdemeanor and usually requires the payment of substantial monetary fines.
Critical Time: Pre-issuance

Rule 10b-5: Section 10(b) of the Exchange Act and Rule 10b-5 proscribe fraud in connection with the *purchase and sale* of securities. To maintain a securities fraud cause of action under Rule 10b-5, the following five elements must be satisfied: (1) the existence of a substantive fraud, including material misrepresentations or omissions, a scheme or artifice to defraud; or a fraudulent act, practice, or course of business; (2) the defendant perpetrated the fraud in connection with the purchase or sale of a security or in the offer or sale of a security; (3) the use of interstate commerce or the mails; (4) reliance by the investor, or other effect of the scheme on investors; and (5) willfulness to commit the prohibited act.
Critical Time: Entire life of deal

Regulation FD: Regulation FD is a regulation adopted by the SEC in 2000 in an effort to prevent selective disclosure by public companies. Regulation FD applies only to issuers who have a class of securities registered under Section 12 of the Securities Act. Regulation FD does not apply to municipal securities
Critical Time: Anytime, if applicable

15c2-12: New Issue Disclosure Requirements and Continuing Disclosure Requirements:
Penalties: revocation of registration, entry of cease and desist order, imposition of an administrative fine, initiation of a judicial proceeding to impose a civil penalty and/or enjoin further violations.
Critical Time: From issuance on

RFP

PRE-AWARD

POST-AWARD/ PRESALE

SALE (SELL-SIDE)

SELL SIDE

- **Responses to Request for Proposals (RFP).**
- The investment banking analyst may be asked to write answers to credit-related questions.
- **The formal pitch.**
- The analyst attends the formal pitch to the issuer or conduit borrower and participates in the presentation about the qualifications of the firm to do the deal. The analyst sells himself/herself on the ability to give credit advice to the issuer. Analyst/Banker will help with rating agency presentations. Addresses banking firm's ability to communicate and monitor the transaction in the secondary market.

SELL SIDE

- **Meetings with issuers**
- The analyst and investment banker travel together to call on potential clients.
- **Preaward Due Diligence:** The client may provide a presentation to the analyst and banker to find out whether the deal sounds bankable. After the presentation (usually made to a variety of firms), the analyst and banker will undertake further analysis of the deal and get back to the client with thoughts, such as feasibility, structuring and rate ideas. Used for complex structures, new technology, high yield projects, etc.
- **Preaward Relationship Building:** The investment banker and analyst may informally call on multiple potential buy-side clients. This is sometimes referred to as "pre-marketing." There are some securities law concerns regarding "an offer to sell."

SELL-SIDE

Due Diligence

- The analyst and investment banker meet with and/or have conference calls with the issuer and other parties to the transaction (feasibility consultant, rating agencies, bond counsel, auditor) as needed to perform due diligence on the transaction.
- Review/comment on documents such as the Preliminary Official Statement and trust indenture.
- Provide structuring suggestions, pricing ideas and other feedback to the banker as another set of eyes. The underwriter provides the Official Statement, and the investment banker is the person ultimately responsible for structuring.
- If a letter of credit or insurance is being sought, the analyst may work with the credit person at the banks.
- Participate in the committee process to approve the transaction (often as a voting member).
- Prepare an internal-use-only research report to be used with the committee, the bank, and subsequently posted on the firm's intranet site for use by salesmen, underwriters and retail brokers. These reports are sometimes shared with co-managers.

RATING AGENCIES

Due Diligence

- The sell-side analyst and investment banker meet with and/or have conference calls with the issuer, rating agencies, and other parties to the transaction (feasibility consultant, rating agencies, bond counsel, auditor) as needed to perform due diligence on the transaction.
- Review/comment on documents such as the Preliminary Official Statement and trust indenture.
- Begin preparation of a report to be used with committee. These reports are sometimes shared with co-managers.

INSURERS

Due Diligence

- Meet with the analyst and investment banker and meet with and/or have conference calls with the issuer and other parties to the transaction (feasibility consultant, rating agencies, bond counsel, auditor) as needed to perform due diligence on the transaction.
- Review/comment on documents such as the Preliminary Official Statement and trust indenture.
- Provide structuring suggestions and other feedback to the banker as another set of eyes.

SELL SIDE

- Attend the institutional investor road show.
- Participate in a retail road show.
- Explain the deal to the sales and trading force in an internal meeting.
- Talk to institutional investors about the deal.
- Participate in pricing calls and decisions on how to allocate bonds.
- Act as a mediator between purchaser and obligor.

RATING AGENCIES

Prepare memoranda for acceptance committee; fine tune covenants.

INSURERS

Prepare memoranda for acceptance committee; fine tune covenants.

15c2-12

Rule 10b-5