

## INSIGHTS

## Extensive New Disclosure Requirements for Underwriters of Municipal Securities Take Effect August 2, 2012

May 9, 2012

Underwriters of municipal securities will be required to make extensive new disclosures in writing to issuers of municipal securities beginning August 2, 2012 under an interpretation of Municipal Securities Rulemaking Board Rule G-17 (the Notice)<sup>1</sup> approved by the Securities and Exchange Commission.<sup>2</sup> Rule G-17 is known as the "fair dealing rule" and requires underwriters and other parties regulated by the Municipal Securities Rulemaking Board (MSRB) to deal fairly with all persons as well as prohibits deceptive, dishonest, or unfair practices. The Notice interprets Rule G-17 to require underwriters to provide issuers specific detailed written disclosure on matters ranging from the underwriters role in the transaction to specific conflicts of interest. Among many notable features, it requires the underwriter to "reasonably believe that the official to whom disclosures are addressed is capable of independently evaluating the disclosures" and if not, "the underwriter must make additional efforts reasonably designed to inform the official or its employees or agent." The Notice addresses the duties of underwriters to the municipal entity issuer of municipal securities. It does not address the duties of underwriters to obligated persons. It further applies only to negotiated underwritings, except where competitive underwritings are specifically mentioned, and does not apply to selling group members. We provide a summary of the Notice and its requirements and reminders below. You will find a link to the Notice at the end of this Client Alert. We encourage you to review it and the accompanying MSRB commentary in their entirety.

*The Notice is important for **Underwriters** because it establishes requirements they must meet under federal securities law; for **Issuers** because they are to receive the disclosures required and, in some instances, expected to provide written acknowledgement; and for **Counsel** in municipal securities transactions because it may affect their clients and disclosure and documentation relating to a transaction.*

### **Disclosure Concerning Underwriter's Role**

Underwriters must disclose to the issuer (i) their duty to deal fairly, (ii) the nature of their primary role to purchase and distribute securities in an arm's length transaction with the existence of differing interests, (iii) their lack of a fiduciary duty to the issuer and implications thereof, (iv) their duty to purchase and sell securities at a fair and reasonable price, and (v) their requirement to review the offering document in the context of the transaction.

### **Disclosure of Compensation and Conflicts**

Underwriters must disclose whether their underwriting compensation is contingent on the closing or size of the transaction and, if so in either case, the conflict of interest created. Additionally, underwriters must disclose if (i) they would receive any payment or incentives

from third parties based on the products, structures, and pricing levels that the issuer selects, (ii) they have or are going to enter into profit sharing arrangements with investors, (iii) they issue or purchase credit default swaps for which the reference is the issuer for which the deal is serving as underwriter or an obligation of that issuer and (iv) if they stand to receive any incentive for recommending a complex financing.

#### **Disclosure of Recommended Structures**

Underwriters are required to adjust the level of disclosure they provide issuers on a particular financing depending on the reasonable belief of the underwriter regarding the (i) issuer's knowledge or experience, (ii) capacity of evaluating the risks of a proposed financing, (iii) financial ability to bear the risks of the recommended financing and (iv) general complexity of the recommended financing.

#### **Timing and Manner of Disclosure**

The disclosure required by the Notice must be made in writing to an official of the issuer that the underwriter reasonably believes has the authority to bind the issuer and to the underwriter's knowledge is not a party to a disclosed conflict. Timing of the disclosure depends on the type of disclosure with the underwriter's role disclosure being required at the earliest stages and compensation disclosure at engagement. Written acknowledgement, or documentation of why written is unattainable, is required.

#### **Truthful and Accurate Representations**

In addition to requiring that all representations made by underwriters to issuers be truthful and accurate and not misrepresent or omit material facts, underwriters must have a reasonable basis for the representations and information they provide. Representations regarding specialized knowledge and experience must correlate to the personnel actually working on the transaction. Such responsibilities include representations and other material information provided by underwriters for disclosure documents, as well as issue price certificates and responses to RFPs.

#### **Compensation and Gifts**

Depending on transaction specific factors, the Notice states that an underwriter's total compensation for a new issue can be so disproportionate to the nature of the underwriting as to constitute an unfair practice with regard to the issuer and violate Rule G-17. Additionally, Rule G-17's duty of fair dealing includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable and the representations made by the underwriter regarding the market are accurate. Underwriters are also required to abide by retail order periods and designations of orders that they agree to with issuers. In particular, the Notice states that knowingly placing or accepting orders framed as meeting an Issuer's requirements when they do not violates an underwriters duty of fair dealing.

#### **Gifts and Payments**

Underwriters are reminded to consider whether payments they make for expenses of issuer personnel in the course of a transaction are legitimate or in violation of Rule G-20's limitation on gifts, gratuities, and non-cash compensation. The Notice highlights excessive or lavish travel, meal, lodging and entertainment expenses that inure to the personal benefit of issuer personnel and exceed the Rule G-20 limits.

The complete text of the MSRB'S notice may be found [here](#).

*Bracewell & Giuliani LLP has assisted many of its clients in securities related matters for both underwriters and issuers alike. If you have any questions or would like further detail, please contact [Paul S. Maco](#) or [Shawn W. Cloonan](#).*

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<sup>1</sup> The Notice is captioned “INTERPRETIVE NOTICE CONCERNING THE APPLICATION OF MSRB RULE G-17 TO UNDERWRITERS OF MUNICIPAL SECURITIES” and was published by the MSRB in MSRB Notice 2012-25 (May 7, 2012), together with a summary of the Notice and commentary prepared by the MSRB available at: [http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-25.aspx#\\_ftnref6](http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-25.aspx#_ftnref6).

<sup>2</sup> Securities Exchange Act Release No. 66927 (May 4, 2012), available at: <http://www.sec.gov/rules/sro/msrb/2012/34-66927.pdf>.