DODD-FRANK WALL STREET REFORM ACT: CHANGES AND CHALLENGES FOR THE MUNICIPAL MARKET

By Veronica Johnson

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In the aftermath of the financial collapse of 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act is potentially the largest overhaul of financial regulation since the Great Depression, though many provisions must be enacted and enforced through regulatory bodies. The process of issuing those regulations, staffing new offices, accepting public comment, and issuing final versions of the new regulations is still on-going.

Municipal securities have historically been subject to less supervision than other publicly traded securities. The SEC requires publicly traded companies to make large annual disclosures that have never been required for municipal securities. The Act is an effort to reform the municipal securities market, along with the rest of the financial system.

The Act attempts to further control the municipal securities market through the creation of an Office of Municipal Securities (the "Office") at the Securities and Exchange Commission. The Office will administer the new rules related to municipal securities brokers and dealers, municipal securities advisors, municipal securities investors, and municipal securities issuers. The Office will also conduct studies to determine the most effective ways to further regulate the municipal markets.

Changes at the MSRB

Another regulatory body, the Municipal Securities Rulemaking Board (the "MSRB"), was given greater rulemaking authority in the Act. The Act requires municipal advisors to register both with the SEC and the MSRB. The definition of municipal advisor, currently a topic of heated debate, is quite broad under the SEC's proposed rules. If the proposed rules become permanent, many persons who are not currently regulated by the SEC or MSRB will be pulled under the umbrella of both agencies. All municipal advisors have a fiduciary duty to any municipal entity for whom such person acts as a municipal advisor, meaning that the municipal advisor cannot "engage in any act… which is not consistent with a municipal advisor's fiduciary duty."

The MSRB registration requirements include assessments, fair dealing rules, and "pay-to-play" rules, among other conditions. Further, the MSRB is now authorized to enforce its rules and regulate advice that may be given to municipal entities or guarantors. Under the supervision of the SEC, the MSRB is required to collect data regarding the business operations of entities engaging in municipal securities transactions, and must also conduct compliance examinations. The regulatory changes around municipal advisors are some of the most significant changes imposed thus far under the Act, although further changes are likely to come as the agencies develop the new regulatory framework under the Act. For instance, the MSRB recently amended Rule G-20 to prevent municipal advisors anything of value in excess of $100 per year to any person, other than an employee, in relation to municipal advising services.

Examination of the municipal markets

From the SEC website:

"The Securities and Exchange Commission is conducting a review of the municipal securities market, examining a wide range of issues including disclosure and transparency, financial reporting and accounting, and investor protection and education. SEC Chairman Mary L. Schapiro first announced in May that Commissioner Elisse B. Walter, along with fellow Commissioners and staff from across the agency, would lead this effort. Ultimately, the Commission staff will prepare a report concerning the state of the municipal securities market, including their recommendations for further action that the Commission should pursue, which may include legislation, rulemaking and changes in industry practice.

The Commission conducted field hearings in San Francisco and Washington, D.C. to examine the state of the municipal securities market. Plans for additional field hearings have been suspended due to the budgetary constraints under which the Commission is operating. However, protecting investors in the municipal securities market is a core function of the Commission and the staff is continuing its efforts to gather information about the market and develop recommendations for improving the state of the municipal securities market."

Continuing Disclosure Requirements

Although the SEC is not authorized, under the existing securities laws, to require disclosures from municipal issuers, the SEC does have the authority to regulate the underwriters who enable municipal issuers to issue debt. As of December 1, 2010, the underwriters are prohibited from trading securities unless they reasonably believe that the state or local government issuing the securities has agreed to disclose such things as annual financial statements and notices of certain events, such as payment defaults, rating changes and prepayments. Through this mechanism, the SEC is requiring disclosures from municipal issuers.

Rule 15c2-12 Amendment

Effective December 1, 2010, the SEC has revised its continuing disclosure requirements, known as Rule 15c2-12 requirements.

Rule 15c2-12 (the "Rule"), originally adopted in 1989, provides the basic framework for secondary market disclosures by issuers and borrowers in the municipal bond market. The Rule obligates underwriters to review offering documents for municipal bonds, and file them with the MSRB. The Rule also requires issuers and borrowers to prepare and file annual reports, financial information, and notices of certain events with the MSRB.

As of December 1, 2010, the list of events that must be reported has been expanded and the time-frame for reporting has been restricted. The old rule required notice of certain events if the event was "material." The amendment removes the materiality determination for the following events:

- Failure to pay principal and interest
- Unscheduled payments from a debt service reserve fund
- Unscheduled payments from parties providing support for the bonds
- Change of the parties providing credit or liquidity support for the bonds

- Failure of such parties to perform
- Defeasances
- Rating changes
- Tender offers
- Bankruptcy, insolvency, receivership, or a similar proceeding (for the issuer or borrower)

The following list of events is still only required "if material":

- Non-payment related events of default
- Modification of the rights of bondholders
- Redemptions
- Release, substitution or sale of property that secures repayment of the bonds
- Consummation of a merger, consolidation, acquisition involving a borrower, the sale of all or substantially all assets of the borrower, or a contract to engage in any of the previously listed events, or termination of such a contract
- Appointment of a successor trustee or additional trustee, or trustee name change

All such events must now be reported within 10 days, whereas the old rule specified reporting "in a timely manner."

Further, the amendments now include variable rate demand obligations within the Rule's continuing disclosure requirements. Prior to December 1, 2010, such bonds were exempted if certain criteria were met.

Looking Forward

New regulations will continue to be written, released for comment, and finalized as studies mandated by the Act come to completion. The Act mandates studies relating to the efficiency and adequacy of disclosures in the municipal securities market. One such study evaluates the likely effect of repealing the Tower Amendment, the Amendment that prevents the SEC from directly regulating municipal issuers. As the law changes, maintaining compliance is vitally important for issuers, 501(c)(3) borrowers, and advisors.

Please contact one of McNees' municipal finance lawyers to discuss any questions about your responsibilities during this evolving regulatory environment.