

MSRB Cautions Underwriters Against Providing Bondholder Consents

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On February 7, 2012, the Municipal Securities Rulemaking Board (“MSRB”) issued for public comment draft interpretive Notice No. 2012-04 (the “Notice”). The Notice provides an interpretation of MSRB Rule G-17¹ relative to the provision by underwriters of certain consents on behalf of holders of municipal securities.

In the Background to the Notice, the MSRB expresses concern that, “in some cases, underwriters have consented to trust indenture or resolution amendments that affect existing parity bondholders, even though those authorizing documents and the official statements for the existing bonds did not provide expressly that underwriters could provide such consents.” The underwriter consents in question are those that are or could be given by underwriters during the brief period that an underwriter is the owner of a municipal bond or other security pending redistribution to securities investors.

The MSRB expresses its belief and understanding in the Notice that an underwriter who provides bondholder consents that affect all parity bondholders could, depending on the facts and circumstances, be in violation of the Rule G-17 duty of dealers to deal fairly with all persons in the conduct of their municipal securities activities. The Notice articulates a broad interpretation to the effect that Rule G-17 establishes a general duty of a dealer to deal fairly with all persons in the conduct of its municipal securities, even in the absence of fraud. The duty is not limited to investors with whom a dealer engages in specific municipal

securities transactions. The MSRB further notes that no “material adverse effect” standard need be applied when analyzing amendments which affect existing bondholders under Rule G-17.

The facts and circumstances potentially giving rise to a Rule G-17 violation under the Notice would include underwriter consents resulting in a “reduction in security” for parity bonds unless (i) the bond authorizing documents expressly provide that an underwriter could provide bondholder consent and (ii) the offering documents for the existing securities expressly disclose that bondholder consents could be provided by underwriters of other securities issued under the authorizing document. The MSRB sets forth the following specific examples of what constitutes a “reduction in security” for a municipal bond issue: (i) elimination of a reserve fund, a reduction in its amount or the substitution of a surety policy for a cash-funded reserve; (ii) a reduction in the priority of debt service on existing securities in relation to other expenditures; (iii) a reduction in a minimum debt service coverage ratio that is a condition of the issuance of additional securities under the authorizing document; and (iv) the elimination or reduction in the amount of collateral for existing securities.

Presumably, this list is illustrative, but not necessarily exhaustive, of the types of consents that could result in “reduction in security” for purposes of the Notice, so underwriters will need to carefully consider the impact that any issuer-requested consent would have, and the facts and circumstances under which it is given, for



purposes of application of the Notice upon its final adoption. In the interim, the Notice would appear to be a very clear indication of the higher level of scrutiny which the MSRB intends to apply to Rule G-17 compliance matters going forward.

Finally, the Notice expressly excludes from its coverage consents given under circumstances where an underwriter has purchased securities for its own account without a view to distribution. Also excluded are consents given by an underwriter regarding amendments that have no effect on existing bondholders, such as amendments to variable rate demand obligations after those existing VRDOs have been subject to a mandatory tender (amendments at that time do not affect previous owners of the VRDOs), and consents given after all bond have been defeased.

Comments on the Notice must be submitted to the MSRB no later than March 6, 2012. ■

Please contact Dan Malpezzi or Donna Kresier in the McNees Financial Services and Public Finance group if we can answer any questions or provide further assistance.

¹ *MSRB Rule G-17 provides as follows: Rule G-17 Conduct of Municipal Securities and Municipal Advisory Activities. In the conduct of its municipal securities or municipal advisory activities, each broker, dealer, municipal securities dealer, and municipal advisor shall deal fairly with all person and shall not engage in any deceptive, dishonest, or unfair practice.*

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