FASD FOCUS

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PUBLIC FINANCE UPDATE – NOVEMBER, 2014

A number of important public finance developments have occurred this year that affect municipal bond issuers, including special districts with outstanding bonds or bank loans and those considering new bond issues or bank loans. This update focuses on three of the most significant recent developments.

MUNICIPAL CONTINUING DISCLOSURE COOPERATION INITIATIVE

Pursuant to Rule 15c2-12 of the Securities Exchange Act (the "Rule"), in order to publicly offer municipal bonds, an underwriter is required to obtain an official statement that sets forth information regarding the terms of the proposed bond issue, information regarding the issuer and any other "obligated person" within the meaning of the Rule and other information material to an evaluation of an investment decision with respect to the bonds. The underwriter is also required to obtain a written undertaking from the bond issuer and any other obligated person to provide periodic updates of the financial and operating data contained in the official statement relating to the bond issue, as well as notice of certain material events specified in the Rule. The information provided is posted on a central repository maintained by the Municipal Securities Rulemaking Board. The Rule specifically requires the official statement to disclose the failure of an issuer or other obligated person to comply in any material respect with its continuing disclosure undertakings during the five years prior to the date of that official statement.

On March 10, 2014, the Division of Enforcement (the "Division") of the U.S. Securities and Exchange Commission (the "SEC") released its "Municipalities Continuing Disclosure Cooperation Initiative" (the "Initiative"). The Initiative arose out of the SEC's "concern that many issuers have not been complying with their obligation to file continuing disclosure documents and that federal securities law violations involving false statements concerning such compliance may be widespread." The Initiative encourages issuers and underwriters to review official statements relating to bonds issued or underwritten, as applicable, by them to determine what was stated about the issuer's compliance with its continuing disclosure undertakings during the five years prior to the date of the official statement, and to cause issuers and underwriters to evaluate whether a particular official statement contained a material misstatement or omitted material information regarding an issuer's compliance with its continuing disclosure undertakings during that five year period.

The Initiative also encourages a similar review by obligated persons other than bond issuers. This update only focuses on the impact of the Initiative on issuers and underwriters. However, as a result of the Initiative, special districts that issue publicly sold bonds in which third parties are deemed "obligated persons" for purposes of the Rule should give renewed attention as to the disclosure, if any, regarding such obligated person's compliance with its prior continuing disclosure undertakings in pertinent official statements.

The Initiative offers "favorable" settlement terms to issuers that report to the Division an official statement relating to bonds issued by them that contained "material inaccurate statements" regarding the issuer's compliance with its continuing disclosure undertakings during the five years prior to the date of such official statement. The Initiative also offer favorable (but different) settlement terms to underwriters that report to the Division such material inaccurate statements in an official statement relating to bonds underwritten by them. Self-reporting is accomplished by completing the form attached to the Initiative and submitting it to the Division. The reporting deadline for both issuers and underwriters was initially September 10, 2014. However, on July 1, 2014, the Division modified the Initiative and extended the reporting deadline for issuers (but not underwriters) from September 10, 2014 to December 1, 2014.

In view of the Initiative, issuers should consider conducting a compliance review with respect to their existing continuing disclosure undertakings to make sure their filings are accurate and current, both with respect to required periodic updates of information and material events notices. In addition, in anticipation of the December 1, 2014 self-reporting deadline, issuers should determine whether underwriters of their publicly-sold bonds have self-reported the related official statement pursuant to the Initiative. Finally, issuers should consider a review of the official statements relating to bonds issued by them with respect to statements, if any, characterizing their compliance with prior continuing disclosure undertakings during the five years prior to the date of the official statement.

In reviewing an official statement, issuers should consider (i) whether they were in compliance in all material respects with their prior continuing disclosure undertakings during the five years prior to the date of the official statement; (ii) what was said about such compliance; (iii) whether there was a misstatement or omission regarding such compliance; and (iv) whether such misstatement or omission could be considered material under the anti-fraud provisions of the securities laws. Unfortunately, the SEC has given no guidance as to what it may consider "material" in this regard.

In evaluating whether to self-report, issuers may also want to take into consideration that once five years from the date of an official statement has elapsed, the SEC may no longer seek financial penalties against an issuer resulting from a material misstatement or material omission in an official statement. It should also be noted that an underwriter's decision to self-report with respect to a particular official statement by the September 10th deadline does not obviate an issuer's need to evaluate whether to self-report, nor does it automatically mean that an issuer has to self-report with respect to the same official statement. However, an underwriter's self-reporting of a particular issuer may result in the Division scrutinizing that issuer's determination not to self-report with respect to the same official statement. In any event, the decision whether to self-report should be carefully evaluated with legal counsel, as self-reporting potentially has serious legal and market place consequences. Regardless of an issuer's determination, it should document its efforts in evaluating whether to self-report by the December 1st deadline.

If an issuer determines to self-report and properly and completely fills out the form attached to the Initiative, the Division will recommend standardized settlement terms, as follows:

>> The issuer will consent to cease and desist from future failures to comply with its continuing disclosure obligations.

>> The issuer will neither admit not deny the findings of the SEC.

>> The issuer must undertake to:

- Establish appropriate policies and procedures and training regarding continuing disclosure obligations;
- Comply with existing continuing disclosure obligations;
- Cooperate with any subsequent investigation by the Division;
- Disclose the settlement terms in any final official statement for the next five years; and
- Provide the SEC staff with a compliance certification.
- The issuer will not be required to pay a civil penalty.

There is no assurance that the above settlement terms will be available to an issuer that is eligible for the Initiative but fails to report by the December 1st deadline. In fact, the Division has stated that if an issuer fails to self-report a material misstatement or material omission in an official statement regarding compliance with its prior undertakings, the Division will likely recommend and seek financial sanctions against the issuer.

MUNICIPAL ADVISOR RULES

In January of this year, the SEC adopted regulations requiring the registration of municipal advisors (SEC Rules 15Ba1-1 through 15Ba1-8) (the "MA Rules"). The MA Rules clarify who is and isn't a "municipal advisor" and offer guidance on when a person is providing "advice" for purposes of the municipal advisor definition. The MA Rules require municipal advisors (i.e., firms that give advice, absent an exemption or exclusion, to municipal entities or obligated persons) to be registered and impose a fiduciary duty on municipal advisors for advice given to municipal entities. The MA Rules also define what activities require registration as a municipal advisor, and the MA Rules interrelate with other rules that prohibit a firm from acting as both an underwriter and a municipal advisor in the same transaction.

For issuers with financial advisors on retainer or which engage financial advisors for a particular bond issue, the MA Rules should have little impact. As a threshold matter, issuers should determine that their financial advisors are independent registered municipal advisors ("IRMAs") within the meaning of the MA Rule. Assuming an issuer has retained a financial advisor that is an IRMA, it should be able to obtain advice or suggestions with respect to a particular bond issue from an underwriter regardless of whether it has formally engaged that particular underwriter. An underwriter providing structuring advice or suggestions to an issuer with respect to a bond issue will likely require the issuer to evidence in writing that it has retained a financial advisor as an IRMA to advise it with respect to the bond issue. Issuers with a financial advisor/IRMA on retainer may consider posting this information on their website to avoid the need to provide evidence of such retainer each time that it deals with an underwriter.

For issuers that do not regularly use a financial advisor, the MA Rules may result in the need to formally "engage" an underwriter within the meaning of the MA Rule in order to obtain structuring advice from such party with respect to a particular bond issue.

There are three basic forms of exemptions that allow an underwriter to provide a municipal entity with advice:

a. The municipal entity represents that it will rely on an independent registered municipal advisor with respect to issues on which the underwriter is providing advice,
b. The municipal entity provides a "letter of intent" or other form of engagement for a firm to act as its underwriter with respect to a particular financing, or
c. An underwriter provides advice in response to an RFP/RFQ.

The primary exemptions and exclusions from the MA Rule are described below.

Public Officials and Employees. Public officials do not have to register to the extent that they are acting within the scope of their official capacity. This exemption covers people elected or appointed to serve on a governing body, advisory board or committee. Similarly, this exemption covers employees of a municipal entity to the extent that they act within the scope of their employment. A "municipal entity" includes any state, political subdivision of a state, or municipal corporate instrumentality of a state or of a political subdivision of a state, and therefore includes special districts.

Registered Investment Advisers. Registered investment advisers and associated persons do not have to register if they provide investment advice regarding the investment of the proceeds of municipal securities or municipal escrow investments. This exemption helps ensure that the MA Rule does not create duplicative regulation of investment advisers. This exemption does not apply to advice on the structure, timing, and terms of issues of municipal securities or municipal derivatives. That is because advice in these areas is outside the focus of investment adviser regulation.

Registered Commodity Trading Advisor. Registered commodity trading advisors under CFTC rules and their associated persons do not have to register if the advice they provide relates to swaps. This exemption helps ensure that the MA Rule does not create duplicative regulation with existing CFTC regulation of swap advisers.

Attorneys. Attorneys do not have to register if they are providing legal advice or traditional legal services with respect to the issuance of municipal securities or municipal financial products. This exemption does not apply to advice that is primarily financial in nature or to an attorney representing himself or herself as a "financial advisor" or "financial expert" on municipal advisory activities.

Engineers. Engineers do not have to register if they provide engineering advice such as feasibility studies and cash flow analysis and similar activities related to engineering aspects of a project. This exemption does not apply to activities in which an engineer provides advice regarding municipal financial products or the issuance of municipal securities.

Banks. Banks do not have to register to the extent they provide advice on certain identified banking products and services, such as deposit accounts, extensions of credit (loans and letters of credit, for example), the purchase of bonds for their own account or bond indenture trustee, paying agent or escrow agent services. This exemption does not apply to banks if they are (a) engaging in other municipal advisory activities such as providing advice on municipal derivatives or the issuance of municipal securities; or (b) providing advice on municipal derivatives, in part because municipal derivatives were a source of significant losses by municipalities in the financial crisis.

Accountants. Accountants do not have to register if they are providing accounting services that include audit or other attest services, preparation of financial statements, or issuance of letters for underwriters.

Independent Registered Municipal Advisor. People who provide advice in circumstances in which a municipal entity has an independent registered municipal advisor with respect to the same aspects of a municipal financial product or issuance of municipal securities do not have to register, provided that certain requirements are met and certain disclosures are made.

Swap Dealers. Registered swap dealers under CFTC rules do not have to register as municipal advisors if they provide advice with respect to swaps in circumstances in which a municipal entity is represented by an independent advisor. This exemption helps ensure that the MA Rule does not create duplicative regulation with existing CFTC regulation of swap dealers and recognizes a similar exemption under CFTC rules. This exemption does not apply to swap dealers that engage in other municipal advisory activities such as providing advice on the issuance of municipal securities or the investment of the proceeds of municipal securities or municipal escrow investments.

Underwriters. Underwriters will now have to be very careful that they do not provide advice or recommendations to municipal entities prior to their formal engagement as underwriter for a particular transaction, lest they be considered a municipal advisor, which would disqualify them from serving as an underwriter on any transaction where they were deemed to have given such advice.

LIBERALIZATION OF RULES ON "QUALIFIED MANAGEMENT CONTRACTS"

Issuers must monitor the use of tax-exempt bond financed facilities to ensure that there is no private use of these facilities (including through management or maintenance arrangements) in excess of that permitted by the Internal Revenue Code of 1986, as amended, while the applicable tax exempt bonds are outstanding. On Friday, Oct. 24, 2014, the Internal Revenue Service released interim guidance relating to certain private business use issues pursuant to Notice 2014-67 (the "Notice"). While the main focus of the Notice is on governmental entities and 501(c)(3) organizations participating in the Medicare Shared Savings Program established under the national Affordable Care Act, the Notice also liberalizes Rev. Proc. 97-13, 1997-1 C.B. 632, as amended by Rev. Proc. 2001-39, 2001-2 C.B. 38, by providing a new safe harbor for management contracts. Under the new safe harbor, all the compensation for management services must be based on a stated amount, a periodic fixed fee, a capitation fee, a per-unit fee, or a combination of the preceding. The compensation for management services also may include a percentage of gross revenues, adjusted gross revenues, or expenses of the facility (but not both revenues and expenses). The term of the contract, including all renewal options, must not exceed five years. Such contract need not be terminable by the governmental or not for profit owner of the facility prior to the end of the term. For purposes of this safe harbor, a tiered productivity award as described above will be treated as a stated amount or a periodic fixed fee, as appropriate. Prior to the Notice,

management contracts where the manager was compensated through such arrangements were either required to have a term of less than five years, or required to be terminable by the governmental or not for profit owner, without penalty or cause, prior to the end of their stated term.

Note that these changes do not affect the private use treatment of management arrangements that are structured as leases pursuant to which the manager pays a fee to the governmental entity.

Special districts that engage third parties to manage or maintain bond financed facilities may want to review existing contracts to determine whether it is appropriate to amend these contracts to reflect the new requirements. Similarly, special districts that have adopted policies and procedures relating to private use may desire to modify the same to reflect the more liberal standards.

The changes made to Rev. Proc. 97-13 apply to contracts entered into or materially modified on or after Jan. 22, 2015, but also may be applied to contracts entered into before Jan. 22, 2015.

If you have questions regarding any of these topics, please contact Morris G. (Skip) Miller, Esq. at 561-838-4556 or skip.miller@gmlaw.com, or Denise Ganz, Esq. at 954-527-2410 or denise.ganz@gmlaw.com. Mr. Miller, resident in the West Palm Beach office and Ms. Ganz, resident in the Boca Raton office, are each AV Preeminent rated attorneys by Martindale-Hubbell, shareholders in Greenspoon Marder Law and members of The Florida Bar.

by
Morris G. (Skip) Miller, Esq. and Denise Ganz, Esq., *Greespoon Marder Law*