

“What keeps you up at night?”

Saul Ewing
Public Finance
Practice:

George T. Magnatta
Chair

The application of MSRB Rule G-17 to underwriters providing bondholder consent for municipal securities

By George T. Magnatta and Joshua S. Pasker

SUMMARY

The Municipal Securities Rulemaking Board is requesting comment on a draft interpretive notice regarding the application of MSRB Rule G-17 to the situation when an underwriter acts as a bondholder and provides consent in a municipal securities transaction.

The Municipal Securities Rulemaking Board (“MSRB”) is seeking comment on a draft interpretive notice concerning the application of MSRB Rule G-17 (“Rule G-17”) to the situation when an underwriter of municipal securities provides its consent as a bondholder. Rule G-17 provides that each broker, dealer, municipal securities dealer (a “Dealer”), and municipal advisor shall deal fairly with all persons and shall not engage in any deceptive, dishonest or unfair practice in connection with its municipal securities or municipal advisory activities. In its draft interpretive notice released on February 7, 2012 (the “Draft Notice”), the MSRB states that Rule G-17 is most often cited in connection with duties owed by Dealers to investors; however, per the Draft Notice, Rule G-17 is broader in scope “because it establishes a general duty of a Dealer to deal fairly with all persons in the conduct of its municipal securities activities. . . .”

The Draft Notice discusses the situation in which an issuer of municipal securities (or an obligated person) may request the Dealer that is the underwriter of the securities to provide its consent to certain changes to a trust indenture or resolution (the “Authorizing Document”) under which the securities are issued at the point in time that the securities are briefly owned by the underwriter prior to redistribution of the securities to investors. The Draft Notice states that the MSRB is concerned that such consents provided by an underwriter to changes that would *reduce the security for existing bondholders or the value of their bonds* may be a violation of Rule G-17. The Draft Notice states that an underwriter consent that would “reduce the security” for existing bondholders would be a violation of Rule G-17 unless: (i) the Authorizing Document expressly provided that an underwriter could provide bondholder consent and (ii) the offering documents for the existing securities expressly disclosed that bondholder consents could be provided by underwriters of other securities issued under the Authorizing Document.

“What keeps you up at night?”

The Draft Notice provides the following examples of what is meant by a “reduction in security:” (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. It is important to note that the Draft Notice does not propose a “material adverse effect” standard for analyzing amendments that affect existing bondholders under Rule G-17. In the Request for Comment (“RFC”), the MSRB states that such a standard might be subject to varying interpretations by different underwriters.

The Draft Notice would not apply to an underwriter who purchases bonds for its own account without a view to distribution. The RFC states that the Draft Notice does not “address” amendments agreed to by underwriters that have no effect on existing bondholders. In the RFC, the MSRB states that: (i) if an underwriter agreed to amendments to variable rate demand obligations (“VRDOs”) after the existing VRDOs had been subject to a mandatory tender, the consents would have no effect on previous owners of the VRDOs, or (ii) if all of the existing bonds had been defeased prior to the underwriter’s consent, the Draft Notice would not apply, because the consents would not affect the defeased bondholders.

All comments to the Draft Notice are due by March 6, 2012 and all comments will be available for public inspection on the MSRB’s website. If the Draft Notice is filed with the Securities and Exchange Commission, the MSRB will request that the Draft Notice be applied prospectively.

For more information on the Draft Notice please contact George T. Magnatta (215.972.7126, gmagnatta@saul.com), Chair of the Public Finance Practice of Saul Ewing LLP, or any other member of the Saul Ewing LLP Public Finance Practice.

This Alert was written by George T. Magnatta, Chair of the firm’s Public Finance Practice, and Joshua S. Pasker, a member of the firm’s Public Finance Practice. George can be reached at 215.972.7126 or gmagnatta@saul.com. Joshua can be reached at 215.972.7783 or jpasker@saul.com. This publication has been prepared by the Public Finance Practice for information purposes only.

The provision and receipt of the information in this publication (a) should not be considered legal advice, (b) does not create a lawyer-client relationship, and (c) should not be acted on without seeking professional counsel who have been informed of the specific facts. Under the rules of certain jurisdictions, this communication may constitute “Attorney Advertising.”

© 2012 Saul Ewing LLP, a Delaware Limited Liability Partnership.
ALL RIGHTS RESERVED.