

# Continuing Disclosure for Municipal Securities: An Overview

*The nuts and bolts of the SEC's requirements on continuing disclosure related to municipal securities.*

By Tammie Beckwith Schallmo, Robert E. Lewis III, and Michael Malinowski



PATPITCHAYA/STOCK.ADOBE.COM

**M**ost issuers of municipal bonds must provide specific financial information (annual information filing or AFI) to the market. After the closing of a bond issue, they must update that information on an ongoing basis in an annual filing known as “continuing disclosure.” This information mainly reflects the financial health of the issuer and is made available to the public and more, specifically to bondholders and other stakeholders.

Rule 15c2-12 of the Securities and Exchange Commission (SEC) requires dealers that underwrite municipal securities to enter into an agreement with the issuer, who covenants to provide updates to certain required

information as outlined in the continuing disclosure agreement. The issuer can hire a third party, known as a dissemination agent, to handle these ongoing submissions.

## Continuing Disclosure History

As a result of the Great Depression, Congress enacted the Securities Act of 1933 and the Securities and Exchange Act of 1934 (the Securities Acts). Municipal issuers were mostly exempted from the registration and reporting requirements set forth in the Securities Acts on the basis of federal-state comity. However, municipal issuers were

subject to and continue to be subject to the anti-fraud provisions of the Securities Acts. Specifically, SEC Rule 10b-5 requires accurate disclosure and forbids the omission of material facts so that information disclosures are not misleading. The Tower Amendment of 1975 codified that the SEC is prohibited from requiring municipal issuers to satisfy its registration and reporting requirements.

In spite of the Tower Amendment prohibitions, the SEC created a regime requiring municipal security disclosure with the implementation of Rule 15c2-12 in 1990 through its ability to regulate broker-dealers (underwriters). With some exemptions, Rule 15c2-12 prohibits underwriters from purchasing from municipal issuers bonds that are sold in the primary market without an official statement (offering document). Thus, if a municipal issuer wanted to sell bonds in the public market, it had to create an official statement to allow an underwriter to buy its bonds. Rule 15c2-12 was expanded in 1995 to require underwriters to enter into a continuing disclosure agreement with the municipal issuer to provide updated financial information and other material information to the secondary market.

This information was previously filed with a Nationally Recognized Municipal Securities Information Repository (NRMSIR) and state information depositories. The first six NRMSIRs were eventually reduced to four. Although the system provided information to the secondary marketplace, the system was inefficient, and it was inconsistent with the data reported regarding the timeliness of filings. Additionally, municipal issuers did not always send their data to all the NRMSIRs, which meant some bondholders did not have access to the same information as others, depending on which NRMSIR it subscribed to for information updates.

With the advent of the internet, the marketplace demanded a modernized, streamlined, one-stop approach for continuing disclosure filings.

## Continuing Disclosure in the Modern Municipal Bond Marketplace

Since July 1, 2009, continuing disclosure documents must be filed in a word-searchable pdf on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) website. AFI filings must be posted within a specified number of days from the end of the fiscal year.

For example, if an issuer's fiscal year ends on June 30 and the filing deadline is within 210 days, the annual financial information must be posted by January 26 of the following year. If the issuer is unable to provide the information by the due date, the issuer may be required to post a Failure to File Notice on the EMMA website on or before the filing deadline.

Some undertakings may state that the audited financial statements must be submitted to EMMA within 30 days after availability to the issuer. The requirements vary by state and often times, by the firm that the issuer chooses to underwrite the issuance of its securities. As a result, it is important for issuers to obtain, read, and understand their continuing disclosure requirements.

---

## In recent years, the SEC has placed additional scrutiny on disclosure compliance.

---

In recent years, the SEC has placed additional scrutiny on disclosure compliance. This scrutiny was highlighted by the Municipalities Continuing Disclosure Cooperative (MCDC) Initiative, first announced in March 2014, as well as subsequent enforcement actions brought against government entities and officials.

In 2016, the SEC announced settlements with 71 municipal issuers and obligated persons under its MCDC Initiative. This initiative and other recent SEC actions highlight the importance of issuers' fulfilling their disclosure obligations promptly and describing their prior compliance accurately in their official statements.

## Consequences for Failure to Make Required Disclosures

The failure to comply with continuing disclosure obligations has several consequences, including but not limited to the following:

- Bondholders may sue an issuer for specific performance.
- An issuer's access to the municipal bond market may be affected or may result in increased interest rates on new issues.
- The secondary market liquidity of an issuer's bonds may be affected.
- Issuers must reveal continuing disclosure noncompliance in future official statements (five-year look-back).

## Types of Continuing Disclosure

There are two main categories of continuing disclosure: AFI and reportable event notices. Each bond issue has its own required information that must be disclosed to the market. Issuers are also encouraged to disclose certain information, such as bank loans or alternative financings. AFI includes audited financial statements, operating

statistical data, and other financial information provided by the issuer.

Reportable event notices include any of the following 16 occurrences and are required to be filed on EMMA within 10 business days after the occurrence. Events 15 and 16 were added for continuing disclosure agreements entered into on or after February 27, 2019.

1. Principal and interest payment delinquencies.
2. Nonpayment-related defaults.
3. Unscheduled draws on debt service reserved reflecting financial difficulties.
4. Unscheduled draws on credit enhancements reflecting financial difficulties.
5. Substitution of credit or liquidity providers, or their failure to perform.
6. Adverse tax opinions or events affecting the tax-exempt status of the security.
7. Modifications to the rights of security holders.
8. Bond calls and tender offers.
9. Defeasances.
10. Release, substitution, or sale of property securing repayment of the securities.
11. Rating changes.
12. Bankruptcy, insolvency, or receivership.
13. Merger, acquisition, or sale of all issuer assets.
14. Appointment of a successor or additional trustee or the change of a trustee's name, if material.
15. Incurrence of a financial obligation of the issuer or obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or obligated person, any of which affect security holders, if material.
16. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties.

Event 15 was originally intended to ensure that current investors are made aware of private placements not covered by Rule 15c2-12 that could be material to an investor. An unintended consequence is one for which the market has deemed certain capital leases to be material, requiring disclosure to EMMA. Therefore, an issuer must either (1) post to EMMA details regarding material leases or contact its public finance professional for assistance in determining materiality or (2) make a posting as the issuer's dissemination agent.

## Limited Continuing Disclosure

When bonds are issued in an aggregate amount of less than \$10 million, the issuer is subject to a limited continuing disclosure, as long as a prior bond issue does

not subject the issuer to a full continuing disclosure. In a limited continuing disclosure, AFI must still be filed on EMMA, but it is typically limited to audited financial statements. Conversely, a full AFI report contains updates to various tables of certain information originally provided in the issuer's official statement.

## Exemptions from Rule 15c2-12

Issuers are exempt from continuing disclosure under certain circumstances if one of the following applies:

- The bond issue is for less than \$1 million in aggregate principal.
- The bonds are sold to investors in authorized denominations of \$100,000 or more to no more than 35 sophisticated investors.
- The bonds are sold in authorized denominations of \$100,000 or more and mature in nine months or less from initial issuance.
- Offerings are sold directly to an investor without using an underwriter (direct loan).

## Importance of Continuing Disclosure Compliance

Complying with continuing disclosure is a very important component of maintaining the liquidity of an issuer's bonds and ensuring that investors will be interested in purchasing a future issuance of securities. Additionally, there is a debate within the industry about whether more disclosure and quicker disclosure lead to lower interest rates when the bonds are sold.

New efforts have been made to provide additional information to the secondary market beyond what is available on EMMA or required by continuing disclosure agreements. This article does not offer an in-depth discussion of this debate but does provide a word of caution to municipal entities to ensure that any data provided to investors—whether or not required by a continuing disclosure agreement—are reviewed for accuracy and materiality before posting.

Lastly, issuers that provide timely and accurate disclosure may avoid regulatory scrutiny from the SEC as it continues to expand its focus on the municipal marketplace. Many recent SEC cases brought against municipal issuers concern the accuracy of the data they have provided to the marketplace.

---

**Tammie Beckwith Schallmo** is senior vice president/managing director for PMA Securities LLC. Email: [tammie@pmanetwork.com](mailto:tammie@pmanetwork.com)

**Robert E. Lewis III** is senior vice president/managing director for PMA Securities LLC. Email: [rlewis@pmanetwork.com](mailto:rlewis@pmanetwork.com)

**Michael Malinowski** is quantitative analyst for PMA Securities LLC. Email: [mmalinowski@pmanetwork.com](mailto:mmalinowski@pmanetwork.com)