

MSRB Proposes Limits on Underwriter Consents to Indenture Amendments

[Len Weiser-Varon](#) on February 08, 2012

The MSRB has put out for comment a proposed interpretive notice <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-04.aspx> designed to eliminate or reduce instances in which underwriters of new bonds issued under a parity indenture or bond resolution consent to amendments to such instrument on the issuance date of the new bonds during the brief period in which the underwriter owns the bonds prior to their resale to the underwriter's customers. According to the MSRB's request for comment: "While underwriters may technically be bondholders during the period between the time they purchase an issuer's bonds and the time they distribute the bonds to investors, they are still underwriters while they hold bonds with a view to distribution. As such, they will not be negatively affected by the amendments to which they consent. In fact, they may have a monetary incentive to consent to the amendments and, accordingly, a conflict of interest."

The proposed interpretive release would characterize such underwriter consents to amendments as a potential violation of MSRB Rule G-17, which requires broker-dealers to "deal fairly with all persons in the conduct of their municipal securities activities." The notice does not impose a blanket prohibition on such consents, and declines to establish any standard (such as amendments that are materially adverse to existing bondholders) for what might constitute an unfair consent by an underwriter. The notice does provide, as an example of an underwriter consent that could be deemed a violation of MSRB Rule G-17, a consent to amendments that would reduce the security for existing bondholders (e.g., eliminating or reducing a debt service reserve requirement, releasing collateral or loosening additional indebtedness tests.)

The notice provides that such underwriter consents would not constitute a duty of fair dealing violation if (i) the indenture or resolution expressly provide that an underwriter can provide bondholder consent and (ii) the offering documents for the outstanding previously issued bonds disclosed that bondholder consents could be provided by underwriters of other securities issued under the indenture or resolution. The voting of bonds acquired by a broker-dealer without an intent to distribute also would be exempted, as would underwriter consents to amendments to the terms of variable rate demand obligations at the time of their mandatory tender.

The notice is interesting in that it interprets a broker-dealer's fair dealing duty as applying literally to "all persons", including prior bondholders with which it has no relationship. The notice does not address other techniques used by issuers to facilitate indenture amendments, such as disclosure in offering documents that purchasers of newly offered bonds will be "deemed" to have consented to specified amendments. Such other techniques may not raise the same concerns, as they typically involve new bondholders that will actually have long-term exposure to the amended security provisions. In any event, to the extent such other techniques do not involve action by the underwriter, the MSRB has no jurisdiction to regulate such techniques.

The MSRB's release indicates that the interpretive notice, when finalized, will have prospective application only. Comments are due to the MSRB by March 6, 2012.