

Rule 15c2-12 Amendments

**The HFA Institute
NCSHA**

January 17, 2019

Rule 15c2-12

- SEC Rule that applies to broker-dealers acting as municipal securities underwriters; does not apply directly to issuers
 - ❖ 1989 – Primary Disclosure
 - ❖ 1995 – Continuing Disclosure

Existing Rule 15c2-12 Requirements

Two principal Rule requirements are:

- Receipt and review by the underwriter of a “deemed final” official statement (generally a *preliminary official statement*) before commencing the offering of the municipal securities [Rule 15c2-12(b)(1)]
- That the underwriter reasonably determine that there is a contractual undertaking of the issuer (*or an obligated person*) to provide (i) annual financial information and (ii) in a timely manner, notice of specified material events [Rule 15c2-12(b)(5)]

Existing Rule 15c2-12 Requirements

“Annual Financial Information”:

- “financial information or operating data, provided at least annually, of the type included in the final official statement with respect to an obligated person”
- “Annual financial information for each obligated person for whom financial information or operating data is presented in the final official statement”
- “If not submitted as part of the annual financial information, then when and if available, audited financial statements for each obligated person”

Existing Rule 15c2-12 Requirements

- “issuer” is defined by the Rule as the governmental issuer of the municipal securities
- “obligated person” is defined by the Rule as any person, including the issuer, committed to support payment of the municipal securities
- The issuer must “deem” the official statement to be final before the underwriter offers the municipal securities
- Any one or more of the issuer or an obligated person can execute a continuing disclosure agreement

Amendments Address Specific Concerns

- Bank loans, private placements, direct purchases, and other significant financial obligations of an issuer should currently, if material, be disclosed in an issuer's or obligated person's new issue disclosure and audited financial statements
- The issue being addressed by the Amendments is whether any such disclosure should be done at the time the financial obligation was entered into (rather than waiting for the next applicable new issue or audit)
- Voluntary efforts had not achieved the disclosures that the SEC sought (both NABL and GFOA had supported voluntary disclosure efforts)

Loan v. Security

- Not always clear whether a borrowing is a “loan” or a “security”
- Important for federal securities law purposes, because if a “loan” the federal securities laws do not apply
- BUT, regardless of whether a loan or a security, the investor wants information with respect to such borrowing if the source or repayment is the same as that which secures the Bonds of the issuer

Rule 15c2-12 Amendments

- The amendments added two new events to the current list of 14 material events requiring prompt disclosure

New Material Event (15)

- “(15) Incurrence of a financial obligation of the obligated person, ***if material***, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, ***if material***”
 - Note the reference to materiality
 - This is a fundamental concept under federal securities law, and the SEC saw no need to provide further guidance

New material event (16)

- “(16) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which ***reflect financial difficulties***”
 - Note that the standard here, in contrast to paragraph (15), is not materiality but whether event reflects financial difficulties

Expansion of “Event” Concept

- The lead-in language to the Rule 15c2-12 material event provision has not changed: “In a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events ***with respect to the securities being offered*** in the Offering.”
- However, the material events may now relate not only to the particular bonds that are the subject of the continuing disclosure agreement, but any other financial obligation of the obligated person, if material to the municipal securities being publicly offered

Expansion of “Event” Concept

- New event (15) will pick up the incurrence of a financial obligation after the continuing disclosure agreement is entered into, if material
- New event (16) will pick up defaults or similar events relating to any financial obligation, including those financial obligations that were outstanding at the time the continuing disclosure agreement was executed
 - “default” may not have matured into an “Event of Default” as defined in the applicable indenture or agreement

Definition of “Financial Obligation”

- “The term financial obligation means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii). The term financial obligation shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with this rule.”

Definition of “Financial Obligation”

- Note that even if the final Official Statement is properly provided to EMMA (thereby meeting for the municipal securities which are the subject of such OS the exclusion from the “financial obligation” definition), any associated financial obligation, such as a derivative or guarantee, will require its own filing with EMMA under new material event (15)

Definition of “Debt Obligation”

- SEC noted that whether a particular obligation was “debt” for state law purposes was not determinative as to whether it was a “debt obligation” within the meaning of the “financial obligation” definition
- SEC advised that it is applying the “debt obligation” event to “circumstances under which an issuer or obligated person has borrowed money”
- SEC advised that “debt obligation” includes lease obligations that “operate as vehicles to borrow money”

Information to be Filed

- SEC advised that a notice for a financial obligation, if material, “generally should include a description of the material terms of the financial obligation. Examples of some material terms may be the date of incurrence, principal amount, maturity and amortization, interest rate, if fixed, or method of computation, if variable (and any default rates); other terms may be appropriate as well, depending on the circumstances.”
- Cleanest path is to file the agreement that is the financial obligation, with appropriate redactions

Compliance Date

- February 27, 2019
- Amendments will need to be included in those Continuing Disclosure Agreements “entered into in connection with ***Offerings*** that occur on or after the compliance date”
- The SEC clarified that “For the purposes of these [new] amendments, the Commission believes that an Offering generally should be considered to occur on the date the continuing disclosure agreement is executed.” That will generally be the settlement / delivery / closing date.

Compliance Date

- This is subject to an exception that “if a preliminary official statement is distributed before the compliance date, with an expectation that the Offering will occur on or after the compliance date, the preliminary official statement should generally attach a form of continuing disclosure agreement that reflects the adopted amendments.”
- Other financial obligations or amendments should be treated as incurred when enforceable against the issuer or obligated person

Preparation for Compliance

- Paragraph (16) includes defaults or other events relating to currently existing financial obligations
- An issuer (or obligated person) should identify contracts that may trigger a material event notice under paragraph (16)
- Audited financial statements would be a good starting point

Preparation for Compliance

- However, audited financial statements are only a starting point
- The scope and content of disclosures required by GASB, or GAAP, and by Rule 15c2-12 may differ
- Issuers or obligated persons also need to carefully consider any confidentiality or non-disclosure provisions that may impact compliance with paragraph (15) or (16)

< The End >

- 3190870