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SEC proposes amendments to Rule 15c2-12 to add events for which notice must be provided

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On March 1, 2017, the Securities and Exchange Commission (the SEC) proposed amending Exchange Act Rule 15c2-12 to include additional event notices under continuing disclosure undertakings. The proposed amendments would require information be provided about (1) the incurrence and terms of bank loans, direct purchases of securities by banks and other non-publicly offered debt; leases; guarantees; derivative instruments; and monetary obligations resulting from judicial, administrative and arbitration proceedings; and (2) the occurrence of defaults, acceleration and termination events, modifications of terms or other similar events with respect to such debt.

Background

In recent years, municipal issuers and conduit borrowers have increasingly turned to bank loans, direct purchases of securities by banks and other non-publicly offered debt. There presently are no federal securities laws or regulations that require issuers or borrowers to immediately disclose information about this debt. Because the existence and terms of non-publicly offered debt can be important to holders of the issuer's or borrower's publicly offered debt, some municipal market participants have urged the SEC to add events with respect to non-publicly offered debt to the list of events for which notice must be provided under Rule 15c2-12.

Similarly, issuers and borrowers are not presently required under federal securities laws or regulations to immediately disclose information about leases, guarantees, derivative instruments, or monetary obligations resulting from judicial, administrative or arbitration proceedings. Information about these obligations, too, can be important to the holders of the issuer's or borrower's publicly offered debt.

While some information about non-publicly offered debt and other obligations may be provided in offering documents and in annual continuing disclosure filings, there can be a significant time lag between the time an obligation is incurred and the time it is disclosed, particularly for infrequent issuers. Furthermore, annual continuing disclosure filings and even offering documents may not always include all of the information that is material to holders of outstanding debt of an issuer or borrower.

Rule 15c2-12 provides that an underwriter cannot buy or sell a primary offering of municipal securities with an aggregate principal amount of $1,000,000, or more, unless it has "reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement has undertaken … in a written agreement or contract for the benefit of holders of such securities, to provide" specified information annually and notice within ten days of the occurrence of specifically identified events. (The term "obligated person" generally refers to any person or entity, including a state or local governmental issuer, that is obligated to support payment of all or part of the obligations on such municipal securities.) Currently there are fourteen listed events in Rule 15c2-12 that require disclosure under these rules.

The proposed amendments

The proposed amendments would add the following to the list of events for which notice must be given within ten days:

- "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;" and
- "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."

"Financial obligation" is defined as "(i) a debt obligation, (ii) lease, (iii) guarantee, (iv) derivative instrument, or (v) monetary obligation resulting from a judicial, administrative, or arbitration proceeding." Municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with Rule 15c 2-12 are excluded from the definition of "financial obligation."

The SEC indicated in its release proposing the amendments that notices of the incurrence of a financial obligation should include a description of the material terms of the financial obligation and suggested that these might include the date of incurrence, the principal amount, the maturity and amortization, the interest rate or method of computation of the interest rate, including any default rates, and other terms.

Market participants should evaluate the proposed amendments

Issuers, conduit borrowers, underwriters and other market participants should focus on how the proposed rule may impact them and consider potential unintended consequences. For example, the proposed rule may result in an issuer being required to provide a disproportionate amount of disclosure concerning its bank loans and other identified obligations relative to its disclosure concerning other financial or operational developments. Depending on the circumstances, a small bank loan may represent a development that is technically "material" but is much less significant than many other developments relating to the issuer. This, in turn, may prove to be confusing or misleading to investors. Under the proposed rule, issuers would need to be careful to consider the disclosure of their bank loans in light of their overall financial and operating condition.

In addition, under the language proposed by the SEC, issuers and conduit borrowers will encounter numerous interpretative questions concerning the two new events. First, there will be the questions of which financial obligations are material as well as which terms are material to

investors. Issuers and conduit borrowers may avoid the interpretative questions and post redacted versions of the relevant documents. While this may be good news for institutional investors, it may not provide meaningful information to retail investors, who could end up disadvantaged compared to investors who understand complex bank loan documents. The proposed rule includes a wide variety of financial obligations that trigger a filing requirement—some that many issuers will consider to be operational and not a long-term financial obligation. Issuers are likely to need to think through which of their obligations trigger reporting under the new events. In addition, the second of the two new events uses terms that are largely undefined. For example, the term "default" is a broad term and the simple qualification that it needs to "reflect financial difficulties" in order to trigger the requirement may not be helpful. The SEC's release provides little additional guidance on how the term "reflect financial difficulties" is to be interpreted in this context. Furthermore, the proposed amendments would require disclosure of a modification to a financial obligation that is not itself material, if such modification reflects financial difficulties.

Issuers and borrowers in particular should consider their own circumstances and determine how they may be required to comply with these new requirements. Issuers who have concerns should provide comments to the SEC before the deadline.

Commenting on the proposed amendments

The SEC is seeking public comment on the proposed amendments for 60 days following publication in the *Federal Register*.

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