SEC Adopts Amendments to Municipal Securities Disclosure Rule 15c2-12

Description

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Paragraph (b)(5) of Rule 15c2-12 (17 C.F.R. 240.15c2-12) prohibits a participating underwriter from purchasing or selling municipal securities in an offering unless it has reasonably determined that an issuer or obligated person of the municipal securities has undertaken in a continuing disclosure agreement to provide certain information to the Municipal Securities Rulemaking Board (MSRB).

The information that must be provided consists of: (i) certain annual financial and operating information; (ii) audited financial statements; (iii) notices of certain material events within ten business days of the occurrence of such events; and (iv) timely notice of the failure of an issuer or obligated person to provide required annual financial information by the date specified in a continuing disclosure agreement.

Currently, Rule 15c2-12 lists fourteen material events that must be reported under continuing disclosure agreements, including principal and interest payment delinquencies, material non-payment related defaults, defeasances, and rating changes, among others.

However, in recent years, issuers and obligated persons have increasingly used direct purchases of municipal securities and direct loans from banks as alternatives to public offerings of municipal securities. Prior to the amendment, these direct placements were only disclosed on a voluntary basis. Consequently, as the SEC has stated, “market participants raised concerns that issuers and obligated persons may not properly disclose the existence or the terms of bank loans, particularly when the terms of the bank loans may affect the payment priority from revenues in a way that adversely affects bondholders.”

In response to these concerns, the SEC has amended Rule 15c2-12 to include two new material events, timely notice of which must be required under continuing disclosure agreements. These two new events are:

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 securities 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.

The term “financial obligation” is defined in the amendment to include 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 either (i) or (ii). The term financial obligation does not include municipal securities as to which a final official statement has been provided to the MSRB consistent with Rule 15c2-12.

The SEC has explained that this definition, which is narrower than the original definition that it had proposed in March 2017, is intended to cover “debt, debt-like, and debt-related obligations of issuers and obligated persons.” Accordingly, the amendment will require notice of the issuance of bonds through direct placements that are not publicly offered.

Notably, the final amendment does not include leases in the definition of “financial obligation,” as was the case with the March 2017 proposed amendment. The SEC has stated that this deletion was intended to remove what would have been an overly burdensome requirement in the case of small, non-debt lease arrangements.

However, guidance from the SEC is clear that the definition still covers leases that operate as vehicles to borrow money or are functionally equivalent to debt obligations.

Additionally, the SEC maintains “that the definition captures any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument to which an issuer or obligated person is a counterparty. . . provided that such instruments are related to an existing or planned debt obligation.”

The final amendment also limits the rule’s application to guarantees—as compared to the March 2017 proposed amendment—by narrowing the rule’s scope to guarantees of either a debt obligation or a derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation. However, the SEC has clarified that “the term ‘guarantee’ is intended to capture any guarantee provided by an issuer or obligated person (as a guarantor) for the benefit of itself or a third party, which guarantees payment of a financial obligation.”

The amendment will take effect 180 days after its publication in the Federal Register. After its effective date, continuing disclosure agreements will need to require issuers and obligated persons to provide notice of the two new material events set forth in the amendment. Moreover, once a continuing disclosure agreement containing the new material events is entered into by an issuer or obligated person, those entities will need to ensure that proper disclosures of direct placements and other financial obligations are made to the MSRB in a timely manner.

Please contact Partridge Snow & Hahn LLP if you have questions about this amendment.

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