SQUIRE PATTON BOGGS

SEC Proposes Rule 15c2-12 Amendments to Require Bank Loan/ Private Placement Disclosure

On March 1, 2017, the Securities and Exchange Commission (SEC) published proposed amendments to SEC Rule 15c2-12 [Release No. 34-80130] that would require event notices to be posted upon the incurrence of "financial obligations" or the occurrence of certain events with respect to financial obligations. The amendments would go into effect three months after adoption by the SEC of final amendments. Comments are due to the SEC within 60 days from the date of publication in the Federal Register.

Under the proposed amendments, continuing disclosure agreements for new issuances of municipal securities subject to Rule 15c2-12 would be required to include two new events for which timely notice must be provided by posting information on the Municipal Securities Rulemaking Board's EMMA website. The two events would be added to Paragraph (b)(5)(i)(C) of the rule as new paragraphs (15) and (16) as follows:

> (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; and
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> (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.

A new definition would also be added to Paragraph (f) as follows:

> (11) The term financial obligation means a (i) debt obligation, (ii) lease, (iii) guarantee, (iv) derivative instrument, or (v) monetary obligation resulting from a judicial, administrative, or arbitration proceeding. 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.

In the Proposing Release, the SEC requests comment on all aspects of the proposed additional required event notices, as well as the potential costs and benefits of the rule amendments.

It is anticipated that several market participants will submit comments, including the National Association of Bond Lawyers and the Government Finance Officers Association. Additionally, the National Federation of Municipal Analysts and other "buy-side" market participants are also expected to comment.

Some of the concerns raised by the rule amendment are highlighted below.

Disclosure Regarding Bank Loans and Private Placements

The amendments, as proposed, would require continuing disclosure agreements entered into after the effective date of the amendment to require issuers and obligated persons to commit to provide notice within 10 business days of the incurrence of any material financial obligation or the occurrence of certain events with respect to a financial obligation that reflect financial difficulties. An issuer or obligated person who has outstanding bonds subject to the new event notice requirements who incurs a material financial obligation, including a bank loan or a private placement of bonds for which no official statement is prepared and posted to the MSRB's EMMA website, will be required to disclose the material terms of the transaction.

Inclusion of Operating Leases in Definition of Financial Obligations

The proposed definition of "financial obligation" is quite broad and includes obligations, such as operating leases, which would not normally be considered debt obligations and may not be brought to the attention of an issuer's finance officer (typically the person charged with compliance with the continuing disclosure undertaking). Under those circumstances, it would be difficult to provide notice within 10 business days of the signing of an operating lease.

Derivative Instruments

The proposed definition of "financial obligation" also includes "derivative instruments," but this term is not defined. The commentary in the proposing release states this term is intended to "capture any swap, security-based swap, futures contract, forward contract, option, or any combination of the forgoing, or any similar instrument to which an issuer or obligated person is a counterparty." The use of the generic term "derivative instrument" is concerning because there are many types of derivative financial products that are not debt-related. Certain types of investment products could be categorized as derivative (repurchase agreements, for example).

Materiality Standard

The proposed events are both qualified by materiality, so that the events need only be disclosed "if material." This is concerning because there is currently no useful guidance about the determination of materiality in the context of Rule 15c2-12. The experience of both issuers and underwriters with the SEC's recent Municipality Continuing Disclosure Cooperation initiative (MCDC) is a reminder of the broad interpretation the SEC's Enforcement Division has of the concept of materiality for purposes of the rule. That could make it difficult for issuers and obligated persons to determine with a high level of confidence that a financial obligation is not material, and could also make it very challenging for underwriters to check compliance as part of the underwriter's diligence procedures.

SEC's Estimate of Time and Expense of Compliance

As is required, the proposing release includes discussion regarding the total burden the amendments will have on market participants, including broker-dealers and issuers. As with prior estimates by the SEC of the time involved to fully comply with the rule, the SEC makes some rather arbitrary estimates of the time required to comply with the rule and the proposed amendments. Various market participants have challenged the SEC's time and cost estimates over the years, but no adjustment has been made. In the case of the proposed amendments, the SEC estimates that it will require broker-dealers an additional 10 hours per year to conduct the additional investigation to determine compliance with the additional event notices. If a broker-dealer handles 20 deals a year, that would be about 30 minutes per deal.

Regarding issuers, the SEC estimates that 20,000 issuers will file 2,300 additional event notices as a result of the rule amendments. The SEC does not think these event notices will require any additional time than other event notices, which it estimates as requiring approximately two hours per filing. Given that the event notice will need to include the material terms of the financial obligation, it will likely take a bit more time to prepare and complete a notice filing for one of these proposed events. Additionally, the SEC does not expect issuers to incur any external costs (e.g., outside legal review) in the preparation of notices for these new events.

Throughout the commentary in the proposing release, the SEC explains the need for the amendment by stating that the new disclosure requirements will provide timely access to "information about the current financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders could be affected." Additionally, the SEC also states that the amendment will provide investors with timely access to "information about the creation of contingent liquidity risk and refinancing risk, including these risks' potential impact to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected."

We will continue to monitor developments regarding the proposed amendments. If you have questions about how the proposed amendments might affect your disclosure compliance procedures, please contact the Squire Patton Boggs lawyer with whom you regularly work.