Foster Garvey

Expanded Continuing Disclosure Obligations

Legal Alert
March 17, 2017

Contact

Allison C. Schwartzman

William G. Tonkin

Related Services

Public Finance & Municipal Government

Proposed Amendments to SEC Rule 15c2-12 Would Expand List of Events Requiring EMMA Notices to Include Private Placements and Incurrence of Other Financial Obligations

On March 1, 2017, the Securities and Exchange Commission (the "SEC") issued proposed amendments to its Rule 15c2-12 ("Rule 15c2-12"). If adopted in their current proposed form, the amendments would add to the list of events requiring an issuer or obligated person to file an Electronic Municipal Market Access ("EMMA") notice under any continuing disclosure undertaking entered into after the effective date of the final amendments. Under the proposed amendments, future continuing disclosure undertakings would require notice of the incurrence of material financial obligations, as well as any agreements pertaining to covenants, events of default, remedies, priority rights or similar terms of a financial obligation which affect bondholders, if material. The proposed amendments also would require the issuer or obligated person to provide notice of any default, acceleration, termination, modification, or other similar event under the terms of a financial obligation that reflects financial difficulties. The SEC is currently taking comments on the proposed amendments, the full text of which is available here.

Background

Municipal securities are generally exempt from federal securities registration and disclosure requirements. However, the SEC indirectly imposes disclosure requirements on certain issuers (and conduit borrowers) of municipal bonds by requiring underwriters purchasing municipal securities to comply with Rule 15c2-12. In general, Rule 15c2-12 prohibits an underwriter from purchasing or selling municipal securities unless the underwriter determines that a continuing disclosure undertaking is in place for the benefit of the holders of the securities. A continuing

disclosure undertaking must require the issuer or "obligated person" (any person committed to support the payment of the municipal securities, other than providers of bond insurance, letters of credit or other liquidity facilities) to provide annual financial information and notice of the occurrence of certain listed events.

Proposed Amendments

The proposed amendments to Rule 15c2-12 are contained in the SEC's Release No. 34-80130 (the "Release"). They would add to the list of events required to be disclosed under continuing disclosure undertakings. The proposed amendments focus on "financial obligations," defined broadly to include any material debt obligation (both short-term and long-term), lease (both capital and operating), guarantee, derivative instrument, and monetary obligation resulting from judicial, administrative, or arbitration proceedings. Municipal securities for which a final official statement has been provided to the Municipal Securities Rulemaking Board would be excluded from the definition of "financial obligation."

Under the SEC's proposed amendments, an obligated person entering into a new continuing disclosure undertaking after the effective date of final amendments would be required to provide notice (within ten business days) of incurrence of a financial obligation, if material, or any agreement pertaining to a financial obligation including covenants, events of default, remedies, priority rights, or other terms which affects bondholders, if material. The SEC's proposed amendments also would require the obligated person to provide notice of any default, acceleration, termination, modification, or other similar event under the terms of a financial obligation that reflects financial difficulties.

Practical Implications

If adopted in their current form, the SEC's proposed amendments to Rule 15c2-12 would likely have significant practical implications for certain issuers and conduit borrowers managing ongoing compliance with continuing disclosure undertakings. The proposed amendments would also add complexity to the process of reviewing past compliance with continuing disclosure undertakings, which would affect certain issuers and conduit borrowers, and the underwriters of their municipal offerings, working to confirm that (as required by Rule 15c2-12) an Official Statement discloses instances in the previous five years in which the obligated person failed to comply with its continuing disclosure undertakings. Although much of the SEC's Release is focused on the increased use in recent years of direct placements of debt obligations (also known as private placements), and the associated desire for transparency regarding those financings, the proposed changes go beyond requiring information regarding the incurrence and terms of privately placed debt. In its current form, the proposed changes to Rule 15c2-12 would require filing an EMMA notice to disclose:

- Execution of any operating or capital lease, if material, and its material terms (such as a financing contract for equipment or a financing lease for real property used under Washington State's LOCAL program);
- Incurrence of a debt obligation, if material, and its material terms (including short-term and long-term debt);

- Providing a guarantee of a third-party's obligations, for example, entry into a contingent loan agreement with respect to a third-party's obligations, if material, or a guarantee with respect to an obligated person's own obligations (such as a self-liquidity facility) and the material terms of related agreements;
- Execution of any swap, security-based swap, futures contract, forward contract, option or similar instrument and the terms thereof (whether pertaining to debt, energy or fuel prices, or otherwise), if material;
- Monetary obligations resulting from judicial, administrative, or arbitration proceedings, if material, including those arising from consent decrees or, presumably, from settlements; and
- Any default, acceleration, termination, modification or similar event with respect to any such financial obligation, if it reflects financial difficulties.

The proposed amendments require disclosure of new "financial obligations" only if those obligations "affect security holders" and are "material." However, given the general lack of guidance from the SEC regarding the meaning of "materiality," it could be difficult for issuers and borrowers to evaluate which financial obligations, and which provisions within the relevant agreements, could be considered "material" by the SEC or investors.

While an efficiently functioning secondary market for municipal bonds is important to issuers and conduit borrowers of publicly offered municipal securities, it is possible that the SEC's proposed amendments, if adopted in their current form, could impair access to the public debt market for smaller borrowers who may not have sufficient staff or funding to provide continuous monitoring and notices regarding the entity's operations, as well as for larger entities who may enter into an overwhelming volume of "financial obligations" as part of their normal operations.

Current Status

The SEC's proposed changes to Rule 15c2-12 have not been finalized or adopted. Even if the amendments to Rule 15c2-12 are adopted in their current form, an issuer or conduit borrower will not be required to provide notices with respect to "financial obligations" under the amended Rule 15c2-12 until and unless it enters into a new continuing disclosure undertaking under the revised Rule 15c2-12. To provide comments to the SEC regarding the proposed changes to Rule 15c2-12, follow directions for commenting described in the Release.

If you have questions about the SEC's proposed amendments to Rule 15c2-12, please contact a Foster Pepper Municipal or Public Finance attorney.