SEC Adopts Rule 15c2-12 Amendments

Legal Alert
August 22, 2018

Related Services

Public Finance & Municipal Government

On August 20, 2018, the U.S. Securities and Exchange Commission (SEC) adopted amendments to the SEC's continuing disclosure rule (Rule 15c2-12). The amendments added two new "event notices" to the existing list of 14 events for which notices must be filed under continuing disclosure undertakings, and added a new definition related to the new event notices. The amendments appear in SEC Release No. 34-83885 (the "Release").

Rule 15c2-12 prohibits an underwriter from purchasing or selling municipal securities in an aggregate principal amount of $1 million or more in a primary offering unless the underwriter has reasonably determined that the issuer or an obligated person of such municipal securities has undertaken in a continuing disclosure agreement to provide specified information to the Municipal Securities Rulemaking Board ("MSRB"). This specified information includes a list of events for which notices must be filed with the MSRB (*i.e.* "event filings" or "EMMA filings").

The two new events added by the SEC's 2018 amendments to Rule 15c2-12 are:

(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

(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.

The amendment defines "financial obligation" as follows:

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.

Underwriters must comply with the amendments 180 days after the amendments are published in the Federal Register (the "compliance date").

What does it mean?

For municipal securities that are sold or remarketed in a primary offering on or after the compliance date, the continuing disclosure undertaking must require event filings for the new events.

Observations

- The amendments will affect only continuing disclosure agreements entered into on or after the compliance date.
- The amendments do not affect existing undertakings or undertakings made prior to the compliance date. There is no obligation on the part of issuers and obligated persons to amend their existing continuing disclosure undertakings to include the new events and definition.
- The existing exceptions to and exemptions from Rule 15c2-12 continue to apply. For example, Rule 15c2-12 does not apply to offerings of municipal securities of less than $1 million. Nor does it usually apply to direct loans made to issuers.
- For continuing disclosure undertakings made on and after the compliance date, issuers and obligated persons will be required to make event filings to disclose "material" financial obligations incurred on or after the compliance date. There is no obligation for the issuer or obligated person to provide an event notice listing the material financial obligations existing as of the date of the continuing disclosure undertaking.
- Under continuing disclosure undertakings made on and after the compliance date, issuers and obligated persons will need to make event filings with respect to defaults, events of acceleration, termination events, contract modifications and other "similar events" under the terms of a financial obligation, if such events reflect financial difficulties, regardless of when the financial obligation was incurred. For example, if an issuer extends the maturity of a 2012 bank loan because it lacks sufficient funds to repay the loan at maturity, that event likely would need to be disclosed under a post-compliance date undertaking.
- Regarding "defaults . . . under the terms of a financial obligation . . . which reflect financial difficulties," the Release provides that the SEC deliberately chose not to refer to "events of default" because the latter are often subject to a grace or cure period. The SEC believes that even if a "default" is cured before it ripens into an "event of default," the fact the "default" occurred may be material to investors under certain circumstances.

- The Release does not provide guidance regarding the use of the phrase "other similar events" in new event number (16). An example might be a requirement to retain a financial consultant if debt service coverage drops below a specified level. The determination of whether an event notice must be filed would depend on whether the decline in debt service coverage reflects "financial difficulties" or some other factor. It may be difficult to determine whether an issuer or obligated person has made all required filings relating to such events.
- Of the two new events, only one is qualified as to the "materiality" of the event—new event number (15). As it has in past releases pertaining to Rule 15c2-12, the SEC refused to describe what might be "material" in the context of a newly incurred financial obligation. The Release provides that "it may be appropriate for issuers and obligated persons to consider not only the source of security pledged for repayment of the financial obligation, but also the rights associated with such a pledge (e.g., senior versus subordinate), par amount or notional amount (in the case of a derivative instrument or guarantee of a derivative instrument), covenants, events of default, remedies, or other similar terms that affect security holders to which the issuer or obligated person agreed at the time of incurrence, when determining its materiality."
- The Release provides that a notice for new event number (15) "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." The Release also provides that an issuer or obligated person could comply by filing the relevant transaction documents, so long as they include the material terms of the financial obligation.
- The new definition of "financial obligation" does not include ordinary financial and operating liabilities incurred in the normal course of an issuer's or obligated person's business. It includes only an issuer's or obligated person's debt, debt-like, and debt-related obligations. But, for example, the term would include a lease that operates as a vehicle to borrow money.

. . . and a Friendly Reminder

Many issuers and obligated persons have continuing disclosure undertakings that require annual filings by the end of the nine month after the close of their fiscal years. For those with a fiscal year ending December 31, the due dates for these annual filings is coming up on September 30.

Conclusion

The new amendments to Rule 15c2-12 will affect continuing disclosure undertakings entered into in February 2019 (assuming the Release is published soon in the Federal Register) and thereafter. There will be added burdens to many issuers and obligated persons under those new undertakings, especially those entities that borrow money by means other than public offerings of debt, guarantee obligations of others, or use derivative instruments.

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