Continuing Disclosure: Preparing for the Recent Amendments to Rule 15c2-12

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How have the amendments changed Rule 15c2-12?

The amendments to Rule 15c2-12 add two new events to the list of 14 events for which issuers are required to provide notice to the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system (EMMA) within 10 business days of occurrence:

- Event #15 - the incurrence by the issuer of:
  - A **material** financial obligation, or
  - An agreement to any of the following, **any of which affect security holders, if material:**
    - Covenants,
    - Events of default (regardless of whether they have arisen to the level of events of default under the applicable financing documents),
    - Remedies,
    - Priority rights, or
    - Other similar terms of a financial obligation.

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- Event #16 - the occurrence of any of the following related to a financial obligation **which reflects financial difficulties**, regardless of when the financial obligation was incurred:
  - Default,
  - Event of acceleration,
  - Termination event,
  - Modification of terms, or
  - Other similar events.

How have the amendments changed Rule 15c2-12?

- With respect to Event #16, (i) there is no materiality qualifier; (ii) disclosure is required regardless of whether such obligation was incurred before or after February 27, 2019 and (iii) for such event to trigger a notice requirement, it must reflect financial difficulties of the issuer.

When do the amendments become effective?

- The changes will apply to continuing disclosure agreements executed on or after February 27, 2019.
- In order to ensure compliance with Rule 15c2-12, continuing disclosure agreements executed on and after February 27, 2019 must include the two new events.

Do the existing exemptions from Rule 15c2-12 still apply?

— Yes, the existing exemptions still apply. Under the Rule, continuing disclosure is not required in connection with a primary offering of municipal securities if:

- The entire issue of municipal securities is for less than $1 million;
- The municipal securities are sold in $100,000 minimum denominations to no more than 35 sophisticated investors;
- The municipal securities are sold in $100,000 minimum denominations and mature in nine months or less from the date of initial issuance; or
- The municipal securities were issued prior to July 1995 (or prior to December 1, 2010 for certain “puttable” securities).

Do the existing exemptions from Rule 15c2-12 still apply?

- The Rule also includes the following two limited exemptions:
  - **Small Issuer Exemption** – the Rule provides that, for certain "small issuer offerings" in which the issuer has no more than $10,000,000 of municipal securities outstanding that are subject to the Rule, the continuing disclosure agreement may provide for more limited financial disclosures than for most other offerings.
  - **Short-Term Securities Exemption** – the Rule includes another limited disclosure exemption for municipal securities that mature in 18 months or less from the date of initial issuance. Although an issuer is not required to the file annual financial information under this exemption, the issuer is required to file the event notices. Therefore, on and after February 27, 2019, the two new events would need to be added as part of this filing requirement.

Financial obligations are required to be reported when they are “incurred.” What does that mean?

- A financial obligation generally should be considered to be incurred when it is enforceable against an issuer.

What is a “financial obligation”?

- The amendments define “financial obligation” to mean:
  - A debt obligation;
  - A derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or
  - A guarantee of a debt obligation or derivative instrument.
- In short, a “financial obligation” means an issuer’s debt, debt-like, and debt-related obligations.
- The definition of “derivative” used in the amendments is intended to include any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument to which an issuer is a counterparty; provided that such instruments are related to an existing or planned debt obligation.

What is a “debt obligation”?

- Debt Obligations are vehicles for borrowing money, regardless of what they are called.
- Debt obligations are intended to include short-term and long-term loans or debt securities (including direct placement transactions) of an issuer that will be repaid over time, regardless of the length of their repayment period.
- A lease that serves as a vehicle to borrow money would be considered a debt obligation.

What is excluded from the definition of “financial obligation”?

- Examples of obligations **EXCLUDED** from the term “financial obligation” include:
  - Ordinary financial and operating liabilities incurred in the normal course of business by an issuer
  - Monetary obligations resulting from a judicial, administrative, or arbitration proceeding
  - Municipal securities as to which a final official statement has been provided to EMMA consistent with Rule 15c2-12 (securities for which continuing disclosure is already being provided)

What are some examples of leases that are typically considered debt obligations?

- Lease-revenue transactions
- Certificates of participation transactions

What are some examples of leases that are typically not considered debt obligations?

- Commercial office building leases
- Airline and concessionaire leases at airport facilities
- Computer and copy machine leases

Is the financial obligation material?

- To determine whether a financial obligation, or the terms of a financial obligation, are material, the SEC cited in its Adopting Release the test from *TSC Industries v. Northway*.
- The SEC described the test as "the same analysis regularly made by [an issuer or obligated person] when preparing disclosure documents," stating that "an issuer or obligated person will need to consider whether a financial obligation or the terms of a financial obligation, if they affect security holders, would be important to a reasonable investor when making an investment decision."

What can issuers do now to prepare for bond issues that are expected to close on or after February 27, 2019?

- Issuers should begin to develop and implement policies and procedures that address how they will do the following on an ongoing basis:
  - Identify and catalog all existing financial obligations.
  - Review each new financial obligation prior to or upon incurrence.
  - Review the agreements associated with existing and new financial obligations and summarize the terms, including the following:
    - Date of incurrence
    - Principal amount
    - Maturity
    - Amortization
    - Interest rate, if fixed
    - Method of calculation of interest rate, if variable
    - Any default rates
    - Security
    - Key covenants
    - Events of default; events of acceleration and termination events

What can issuers do now to prepare for bond issues that are expected to close on or after February 27, 2019?

- Determine whether a new financial obligation is material and requires the filing of a notice.
- Determine whether the agreements associated with a new financial obligation affect security holders and are material and require filing of a notice.

What can issuers do now to prepare for bond issues that are expected to close on or after February 27, 2019?

- Determine whether **BOTH**: (i) a default, event of acceleration, termination event, modification of terms, or other similar events have occurred under the terms of the issuer's existing financial obligations and (ii) the occurrence of such event reflects financial difficulties.
- Consider creating a spreadsheet or building a database (or other accessible and reviewable collection) of all of the issuer's financial obligations, together with their respective agreements, as well as maintaining records of the reviews.
- Determine who will be charged with monitoring the database.

What can issuers do now to prepare for bond issues that are expected to close on or after February 27, 2019?

- Continuously review and analyze the database to determine: (i) whether the issuer: (1) has incurred any new material financial obligation, or (2) agreed to any material terms with respect thereto, any of which affect security holders, and adding them to the database; and (ii) whether a default, event of acceleration, termination event, modification of terms, or other similar event has occurred under the terms of the issuer's existing financial obligations, which reflects financial difficulties.
- Develop a process for reporting the incurrence of new material financial obligations and any of the above events to EMMA within 10 business days after incurrence.

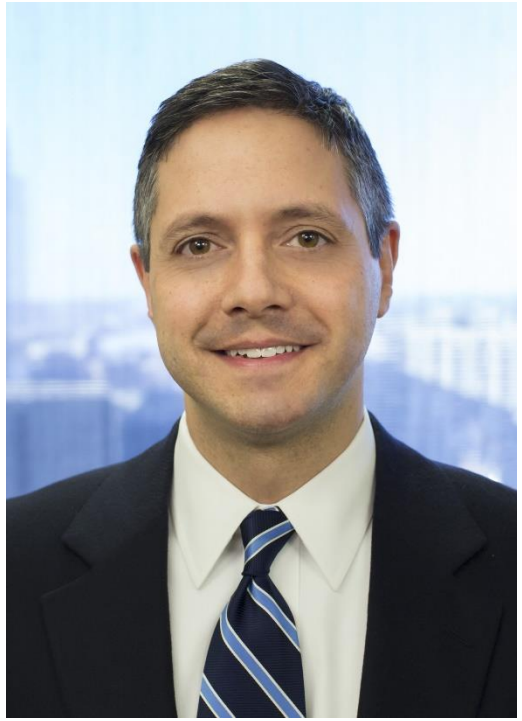
What can issuers do now to prepare for bond issues that are expected to close on or after February 27, 2019?

- Filing the material terms in summary form?
- Filing the entire agreement, subject to redaction of confidential information (signatures, contact information, account numbers and other personally-identifiable information)?
- A combination of the two?

Where can issuers find more information?

- The MSRB, SEC, NABL and GFOA are hosting a free webinar on the amendments to Rule 15c2-12 and related changes to EMMA on January 17, 2019, at 3:00 p.m. EST. The webinar will also be available on-demand at www.msrb.org. You can register for webinar at: http://www.msrb.org/News-and-Events/Press-Releases/2018/MSRB-Announces-Enhancements-to-EMMA-System.aspx.

QUESTIONS AND ANSWERS



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