

NFMA Summary of the SEC Rule 15c2-12 Amendments issued on August 20, 2018

The Securities and Exchange Commission (Commission) has issued its Final Rule on Amendments to Rule 15c2-12 governing Municipal Securities Disclosure on August 20, 2018 (Final Rule). The Commission issued its Proposed Amendments to Rule 15c2-12 in March 2017 (Proposed Amendments) and cited 65 comment letters from market participants. The National Federation of Municipal Analysts (NFMA) submitted a letter dated May 10, 2017, which is posted on www.nfma.org under Resources/Position Statements. The Final Rule will take effect on February 27, 2019.

The Final Rule is the culmination of six years of work by industry groups and regulators to improve certain aspects of municipal securities disclosure, first identified by the Commission in its Report on the Municipal Securities Market, dated July 31, 2012. The Municipal Securities Rulemaking Board (MSRB) first issued an advisory in 2012 calling for voluntary disclosure of additional debt instruments, including bank loans, bank purchases, private placements and other parity debt obligations. Despite several efforts to encourage greater voluntary disclosure of additional debt and loan documentation, the MSRB reported that its EMMA system received a low number of loan documents or summaries.

The Final Rule addresses some important shortcomings in current disclosure practices that were identified by the NFMA in a letter to then-Chair White of the Commission on August 10, 2016, posted on www.nfma.org, under Resources/Position Statements. The NFMA plans to continue to pursue solutions to other issues discussed in that letter that will improve municipal market disclosure.

New Material Events

The Final Rule adds two categories to the Material Events disclosure requirements. Continuing Disclosure Agreements (CDAs) for new publicly issued bonds will need to require issuers or obligated persons to disclose information related to these two events within ten business days of occurring.

1. **Material Event No. 15** – “Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of defaults, remedies, priority rights, or other similar terms of a financial obligation of an obligated person, any of which affect securities holders, if material.” Disclosure of material events under this category will be included in CDAs for bonds issued after the effective date. There is no requirement to amend existing CDAs to include this event.

As proposed, Material Event No. 15 generated many industry comments to the Commission. Key among the issues raised was the lack of clarity in defining materiality and the scope of the definition of “financial obligation”.

The Commission left in the materiality determination, but offered some limited insight on what they view to be material. We understand that the Commission’s position on this topic is that materiality is determined by an assessment of facts and circumstances related to a specific situation. The Commission reiterated its view by saying, “The Commission continues to believe that materiality determinations should be based on whether the information would be important to the total mix of information made available to the reasonable investor.”

The definition of “financial obligation” included in the Proposed Amendments was considered to be too broad, according to many of the industry commenters. The original definition debt obligations, leases, guarantees, derivative instruments or monetary obligations resulting from judicial, administrative or arbitration proceedings.” Specifically, the prospect of reporting the incurrence of all leases and monetary obligations from judicial decisions was considered to overly burdensome and would capture a wealth of agreements incurred in the ordinary course of business.

To address these issues in the Final Rule, the Commission narrowed the scope of leases to “a lease that operates as a vehicle to borrow money generally should be treated like an obligation incurred under the terms of the indenture, loan agreement or similar contract.” Similarly, reporting on derivative instruments was limited to “a derivative instrument entered into in connection with, or pledged as, security or a source of payment for, and existing or planned debt obligation” and notification of guarantees was curtailed to those guarantees “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 reporting of the incurrence of monetary obligations resulting from judicial, administrative or arbitration proceedings was eliminated in the Final Rule. Important to the decision to remove the reporting of these obligations was that insurance coverage or reserves are often available to cover payments and that these obligations were unlikely to infringe upon the rights or interest of security holders.

2. **Material Event No. 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 Commission included Material Event No. 16 as proposed in the Final Rule. Disclosure of material events under this category will be included in CDAs for bonds issued on or after February 27, 2019. There is no requirement to amend existing CDAs to include this event. However, the incurrence of Material Event No. 16 applies to all of an issuer’s or obligated person’s outstanding financial obligations.

Summary

The Final Rule proposed by the Commission in 2017 and finalized in 2018 is an important step in improving overall disclosure of all additional debt incurred by an issuer or obligated person with publicly issued debt outstanding. The Final Rule clarifies many issues raised under the original proposal and succeeds in tying most of these requirements to debt issuance. It also streamlines the reporting requirements, which should ease the regulatory burden on issuers and obligated persons.