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PUBLIC FINANCE ADVISORY
SEC AMENDMENTS TO RULE 15C2-12 EFFECTIVE FEBRUARY 27, 2019

Background

Most issuers of tax-exempt bonds are familiar with Rule 15c2-12 (the "Rule") promulgated by the U.S. Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended. As a condition to their purchase of publicly offered bonds in a primary offering, underwriters are required by the Rule to obtain a commitment or undertaking (an "Undertaking") on the part of each person or entity which is obligated to make material payments with respect to the bonds (each an "obligated person") to make available on the "EMMA" website of the Municipal Securities Rulemaking Board, (1) periodic updates of financial and operating data of the kind that was provided in connection with the initial offering for sale of the bonds, and (2) certain "event notices," which are to be posted within ten business days following the occurrence of the reportable events listed in the Rule. Until recently, the Rule listed fourteen "reportable events," including payment delinquencies and other defaults with respect to the bond issue in question, IRS challenges to the tax-exempt status of the bonds, rating changes, certain changes to the terms of the bonds, bond calls and defeasances, and bankruptcies and other insolvency conditions affecting the bond issue. The Undertakings with respect to such disclosures are generally set forth in continuing disclosure certificates or agreements delivered by the obligated persons at the time of issuance of the bonds.

Recent Amendments

Effective February 27, 2019, the Rule was amended to require that Undertakings made with respect to bonds issued on or after that date include two new reportable events. The Rule amendments reflect the SEC's concern about the relevance to outstanding publicly sold bond issues of other privately placed bonds, bank loans or other financial arrangements involving the obligated persons with respect to bonds, as well as other transactions that bondholders might regard as bearing on the creditworthiness of bonds.

The two new reportable events are:

- "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

- "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."

For these purposes, a "financial obligation" is any debt obligation, derivative instrument (*e.g.*, a swap, option, or futures contract), or guarantee of a debt obligation or derivative. "Debt obligations" include loans and *financing* leases but not *operating* leases or other obligations incurred in the normal course of business (*e.g.*, trade debt).[1]

[1] "Financial obligations" for this purpose do *not* include other municipal securities for which a final official statement has been made available on EMMA in accordance with the Rule.

Financial Obligations – Incurrence or Agreement

Undertakings under the amended Rule will now require an obligated person to make an event report if it separately enters into a new bank loan, private placement of bonds, financing lease of property, or other financial obligation – but only if the transaction is material with respect to the outstanding bond issue. Similarly, amendments or modifications to the terms of any *existing* financial obligations, including financial obligations entered into prior to the issuance of the covered bonds (including by waiver), may require disclosure if the amendments could materially affect the rights of bondholders – for example, by affecting the preferences and priorities of bondholders. Compliance with their financial obligation Undertakings will require, among other matters, a written summary of the material terms and conditions of the financial obligations or amendment(s), or the filing of the actual instrument(s) reflecting the terms and conditions (from which certain terms may be redacted).

The Rule amendments do not define materiality but instead rely on the rules generally applicable to securities law disclosure, by which a fact is "material" if it would be "important to the total mix of information available to the reasonable investor" in making an investment decision with regard to the securities. The standard to be applied here is the same as the standard applied in deciding whether information should be disclosed, for example, in preparing disclosure materials for an offering of bonds to the public.

Financial Obligations – Events Reflecting Financial Difficulties

The second new category of reportable events involves defaults and other developments with respect to any financial obligations of the obligated person, again including financial obligations entered into prior to the issuance of the covered bonds, that *"reflect financial difficulties"* of the obligated person. This reporting requirement might come into play, for example, if an obligated person renegotiates the terms of a separate bank loan under circumstances that reflect "financial difficulties" on the part of the obligated person. One subjective issue here will be whether a particular change to other credit arrangements, such as a modification of, or waiver of compliance with, financial covenants, reflects financial difficulties of the reporting party, as opposed to, say, the party's ability simply to negotiate more favorable credit terms.

Application of New Provisions

These new requirements apply to Undertakings that are entered into on or after February 27, 2019 and, with respect to such Undertakings, to reportable events occurring on or after such date. Undertakings made with respect to bonds issued prior to the effective date of the Rule amendments are unaffected.

Some "Take-Away" Points

Issuers of tax-exempt bonds and other obligated persons that are subject to Undertakings under the amended Rule should be mindful of the following:

i. The new requirements may come into play whenever a financial obligation is entered into, whenever any existing or preexisting financial obligation is modified, or whenever there is a default, acceleration, termination, or similar event relating to any existing or preexisting financial obligation. The best practice will be for obligated persons to identify which of their liabilities and other arrangements constitute financial obligations for purposes of the Rule and then implement policies to monitor on an ongoing basis the incurrence and modification of such obligations so that they can timely report any reportable events.

ii. "Traps for the unwary" in identifying and tracking financial obligations may include the following:

- Short-term debt obligations (which are nonetheless financial obligations);
- Changes to the terms of debt arrangements that are unrelated to the bond issue for which continuing disclosure is being made; and
- The entering into, or modifications, amendments or waivers with respect to, capacity, asset purchase or other agreements which, while not debt in name, have enough debt- or guaranty-like characteristics that they constitute financial obligations for purposes of the Rule.

iii. Compliance with Undertakings under the amended Rule will require subjective, fact-and-circumstance determinations to be made. In particular, these include determinations as to (1) whether something is in fact a financial obligation, (2) whether a particular financial obligation is material, (3) whether any agreements affecting the terms of existing financial obligations would affect the rights of bondholders to an extent that is material, and (4) whether defaults, modified terms, and other developments relating to financial obligations reflect financial difficulties.

iv. If disclosure is required, a determination must then be made as to what must be disclosed, and in how much detail.

The foregoing does not constitute legal advice and appropriate counsel should be consulted before acting or relying on any matters discussed herein. A determination as to what to disclose is a mixed question of law and fact as to which bond or securities counsel should be consulted. If you have further questions, please do not hesitate to reach out to a member of Pope Flynn's Public Finance practice.

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