SEC RULE 15c2-12
and
2018 AMENDMENTS

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INTRODUCTION

KEY POINTS ABOUT 2018 AMENDMENTS

- **Significant Recent Amendments by SEC**
- **Introduce New Complexity and Continuing Disclosure Obligations**
- **SEC Did Not Adopt All Proposed Amendments (E.g., Relating to Disclosure of Liabilities Associated with Litigation and Operating Leases, Which Still Should Be Disclosed in Offerings, If Material)**
- **Nevertheless, the Amendments Adopted Are Significant**

KEY POINTS ABOUT DIRECT LOANS

- **Direct Loans to Municipalities Were $66.5 Billion at End of 2010**
- **Increased to $190.5 Billion by 1st Quarter of 2018**
- **Often Were Not Reported Publicly Until Audits Were Published**
- **Reporting Delays Could Extend Well Beyond a Year**
- **Meanwhile, Issuers' Bonds Continued To Be Traded**

KEY POINTS ABOUT 2018 AMENDMENTS

- **Intended to Mandate Prompt Reporting of Direct Loan/Debt Incurrence**
- **Includes Terms of Loans That Could Impact Investors**
- **In addition, Certain Events Indicating Issuer Financial Difficulties**
- **SEC Did Not Define "Material," Leaving That to the Courts**

RULE 15c2-12 BACKGROUND

KEY POINTS ABOUT RULE 15c2-12

- **SEC Lacks Authority to Regulate Municipal Issuers Directly**
- **Can Only Enforce Antifraud Provisions**
  (Rule 10b-5, Section 17(a), including negligence)
- **SEC Does Have Authority to Regulate Dealers**
- **Rule 15c2-12 Does NOT Apply Directly to Issuers**
- **Instead, the Rule Places Requirements on Dealers**

KEY POINTS ABOUT RULE 15c2-12

- **Dealers Serving as Underwriters Must Take Certain Steps in Most Offerings**
- **A Few Limited Exceptions (E.g., Short-Term Offerings, Limited Offerings to 35 or Fewer Sophisticated Investors, Offerings Under $1 Million)**
- **While the Rule Does Not Apply to Issuers, Dealers Cannot Underwrite Bonds Unless Issuers Meet Certain Requirements**

KEY POINTS ABOUT RULE 15c2-12

- **In Effect, Issuers Cannot Sell Their Bonds Unless They Provide Underwriters with Required Documentation**
- **Some of That Documentation Places Continuing Disclosure Obligations on Issuers**

KEY POINTS ABOUT CONTINUING DISCLOSURE

- **Issuers Must Be Aware of Their Continuing Disclosure Obligations and Must Satisfy Those Obligations**
- **Failures May Impact Issuers' Future Access to the Market**
- **Material Accuracy and Completeness Necessary To Comply with Antifraud Provisions (SEC Rule 10b-5, Section 17(a), State Securities and Common Law)**

KEY POINTS ABOUT RULE 15c2-12

- **Underwriters in Offerings Are Required to Investigate Issuer Compliance with Past Continuing Disclosure Undertakings**

- **Underwriters May Decline to Work with Issuers That Have Poor Compliance Records**

- **Disclosure Is Required of Continuing Disclosure Noncompliance, Which May Impact Bond Prices**

KEY POINTS ABOUT CONTINUING DISCLOSURE

- **Issuers May Need Frequent Continuing Access to Legal Disclosure Advice Outside of Offering Context**
- **This May Be Provided by Bond Counsel or Issuer Disclosure Counsel (Who May Also Assist with Policies and Procedures)**
- **NOT Underwriter Counsel**
- **Have Contractual Relationships That Clearly Specify Expected Services and Responsibilities**

RULE 15c2-12—PRIMARY OFFERINGS

PRIMARY OFFERINGS

➢Underwriters Must—

❖ Obtain and Review in a Professional Manner an Official Statement Deemed Final by an Issuer (Except for Information Dependent upon Pricing)

"**Final Official Statement**"—"sets forth information concerning the **terms of the proposed issue** of securities; information, including **financial information or operating data**, concerning … issuers …; and a **description of the [continuing disclosure] undertakings** …, and of any **instances in the previous five years** in which each person … **failed to comply, in all material respects, with any previous undertakings** ….

PRIMARY OFFERINGS

- **Underwriters Must—**
  - **In Negotiated Offerings, Provide Any Preliminary Official Statement to Investors upon Request**
  - **Contract with an Issuer to Receive Final Official Statements to Provide to Investors (This Is Done by Posting Official Statements on the MSRB's EMMA Website at *www.EMMA.MSRB.org*)**
  - **Continue Delivery of Final Official Statements for at Least 25 Days (Availability on EMMA)**

PRIMARY OFFERINGS

- **Underwriters Must—**
  - **Obtain a Continuing Disclosure Undertaking from an Issuer or, in Certain Offerings, another Obligated Person**

"Obligated Persons" include issuers, borrowers in conduit offerings, and developers in special tax and assessment bond issues

RULE 15c2-12—CONTINUING DISCLOSURE

CONTINUING DISCLOSURE

➢**Continuing Disclosure Components Pursuant to Issuers' Undertakings—**

- ❖ **Annual Disclosure**
- ❖ **Event Disclosure**

CONTINUING DISCLOSURE

- **Annual Disclosure—**
  - **Issuer or Obligated Person "For Whom Financial or Operating Data Is Presented in the Official Statement" Must File Updated Financial and Operating Information with the MSRB's EMMA Website (*www.EMMA.MSRB.org*)**
  - **Also Must File "When and If Available, Audited Financial Statements" and, If Not Available, Unaudited Financial Statements**

CONTINUING DISCLOSURE

- Continuing Event Disclosure, "In a Timely Manner Not in Excess of Ten Business Days"

- This Is Within Ten Days of Event of Incurrence, NOT Discovery

- To Meet the Timing Required by the Undertaking, Issuers/ Obligated Persons Must Engage in Monitoring (E.g., Rating Changes)

CONTINUING DISCLOSURE

➢ **Required Event Disclosures—**

- ❖ Principal and interest payment delinquencies
- ❖ Non-payment related defaults, if material
- ❖ Unscheduled draws on debt service reserves reflecting financial difficulties
- ❖ Unscheduled draws on credit enhancements reflecting financial difficulties

CONTINUING DISCLOSURE

➢Required Event Disclosures—

- ❖ Substitution of credit or liquidity providers, or their failure to perform
- ❖ Adverse tax opinions and certain tax notices and determinations
- ❖ Modifications to rights of security holders, if material
- ❖ Bond calls, if material, and tender offers

CONTINUING DISCLOSURE

➢ **Required Event Disclosures—**

- ❖ Defeasances
- ❖ Release, substitution, or sale of property securing repayment of the securities, if material
- ❖ Rating changes **(even though rating agencies file this information)**
- ❖ Bankruptcy, insolvency, receivership or similar event of the obligated person

CONTINUING DISCLOSURE

➢Required Event Disclosures—

- ❖ Merger, consolidation, or acquisition involving an obligated person or sale of substantially all assets
- ❖ Appointment of a successor or additional trustee or change of name of a trustee, if material

CONTINUING DISCLOSURE

- **Required Event Disclosures—**

In a timely manner, **notice of a failure** of any person **to provide required annual financial information on or before the date specified** in the undertaking

MCDC REPRISE

- **SEC Acted Under Antifraud Provisions Against Issuers and Underwriters for Failure to Disclose Accurately/ Completely Issuer Continuing Disclosure Compliance Failures—**
  - **71 Issuers**
  - **72 Underwriters (Underwriting Approximately 96% of Municipal Securities)**

2018 Amendments Introduce Significant New Compliance Complexity for Both Issuers and Underwriters

RULE 15c2-12—2018 AMENDMENTS

2018 AMENDMENTS

➢**2018 Amendments Add the Following Events (as of February 27, 2019)—**

- **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**

Would Apply to Financial Obligations Incurred and Agreements Entered After Bond Offering

2018 AMENDMENTS

➢2018 Amendments Add the Following Definition—

- ❖ 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.

SEC States the Definition Does Not Include Ordinary Financial and Operating Liabilities Incurred in the Normal Course of Business

2018 AMENDMENTS

➢**2018 Amendments Add the Following Events (as of February 27, 2019)—**

- **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**

Would Apply to Financial Obligations Existing Prior to a Bond Offering (Even Today), Because the Condition Could Exist Immediately After the Bond Offering

RULE 15c2-12—COMPLIANCE POINTERS

COMPLIANCE POINTERS

➢**With Respect to the New Event Disclosure Requirements, the Following Steps Appear to Be Wise for Compliance and To Establish Good Faith—**

- ❖ **Adopt/Amend Policies and Procedures (Get Help)**
- ❖ **Assign Clear Responsibilities**
- ❖ **Engage in Regular Staff Training**

COMPLIANCE POINTERS

- **Identify Existing "Financial Obligations" When Engaging in New Bond Offerings**

- **Get Professional Help in Analyzing "Materiality" "Financial Distress" (Obtain Opinions)**

COMPLIANCE POINTERS

- **Begin Identifying and Analyzing Existing Obligations NOW**
- **May Involve a Variety of Internal Departments (E.g., Autonomous Fire/Police Departments May Purchase Multiple Expensive Fire/EMS Vehicles/Build Facilities, Schools, Park Departments, Public Works)**
- **Analyze New Obligations Before They Are Incurred**

COMPLIANCE POINTERS

- **Monitor Constantly for Incurrence of Obligations, Defaults, Accelerations, Terminations, Modifications of Terms, Similar Events**

- **Maintain Accurate Records to Assist in Monitoring and To Prove Good Faith**

- **Comply with Your Policies and Procedures!! (Noncompliance May Be Used Against You)**

COMPLIANCE POINTERS

- Understand Issuer's Role and Responsibilities
- Monitoring, Accuracy and Completeness Are Crucial (Remember MCDC)
- Understand Roles and Responsibilities (and Limits Thereon) of Underwriters, Counsel and Other Professionals

COMPLIANCE POINTERS

- **Have Written Contracts That Provide for Services Issuer Needs (See GFOA Best Practices at *www.GFOA.org*)**
- **Understand/Negotiate Contracts**
- **Ask For, Receive Opinions (Preferably Written) for Reliance**
- **Exercise Care—Litigation Is Enormously Expensive**

THE END