

Disclosure Changes: Be Prepared for New SEC Requirements

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July 16, 2019

Overview of New SEC Rule 15c2-12 Requirements

Background and Context

- Federal Securities Regulation
- The Securities Act of 1933
 - Regulates primary market transactions
- The Securities Exchange Act of 1934
 - Primarily regulates secondary market transactions
- The U.S. Securities and Exchange Commission, created under the 34 Act to enforce federal securities laws.
- The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.
- The Tower Amendment (1976) restricts direct federal regulation of issuers by prohibiting pre-sale and post-sale reporting requirements.
- Rule 15c2-12 applies to underwriters but indirectly regulates issuers.

Background and Context

- Municipal securities are generally exempt from the registration requirements of the 33 Act.
- Governmental entities are generally exempt from the reporting requirements of the 34 Act.
- Neither are exempt from the anti-fraud provisions of the 33 Act and the 34 Act when raising capital through the public debt market.
- The SEC derives its powers over the municipal marketplace by virtue of its ability to regulate municipal broker-dealers and its power to enforce the anti-fraud provisions.
- Over the past 20 years the municipal market has grown significantly and with that growth has come a heightened interest in the market by the SEC.
- In the mid-1990's, the SEC published an "Interpretive Release" as well as amendments to Rule 15c2-12 which implemented annual disclosure requirements for municipal securities.
- Amendments to Rule 15c2-12 went into effect in 2010, which increased the level of continuing disclosure required for municipal securities, and the SEC continues to express concerns that disclosure in the municipal market is not adequate.
- SEC enforcement activity in the municipal market is becoming more frequent and is not limited to investigations after default.

Overview of Disclosure Responsibilities

- For municipal bond transactions, disclosure is generally divided into two areas:
 - Primary disclosure made when bonds are issued or remarketed. This disclosure is typically made in an “official statement” commonly referred to as an “OS”. The OS, in preliminary form (a “POS”) is used to market bonds prior to signing a bond purchase contract with an underwriter. The POS is then finalized with initial pricing data.
 - Continuing disclosure made on an annual or other periodic basis under a Continuing Disclosure Undertaking/Agreement pursuant to Rule 15c2-12 or otherwise.

Current Requirements

- Under current Rule 15c2-12, underwriters must determine the issuer has provided a continuing disclosure agreement/undertaking that requires the issuer to:
 - update annually the financial information and operating data included in the official statement for the bonds,
 - file annual audited financial statements (when and if available), and
 - provide notices of 16 events within 10 Business Days of the occurrence of the event.
- Additionally, issuers must provide notice of the failure to file any required annual information.
- All of these filings must be made to the Municipal Securities Rulemaking Board's Electronic Municipal Market Access system (EMMA)

Material Events

- The current list of events for which notice must be provided within 10 Business Days of the occurrence:
 - 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;
 - Substitution of credit or liquidity providers, or their failure to perform;
 - Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security;
 - Modifications to rights of security holders, if material;
 - Bond calls, if material, and tender offers;
 - Defeasances;
 - Release, substitution, or sale of property securing repayment of the securities, if material;
 - Rating changes;
 - Bankruptcy, insolvency, receivership or similar event of the obligated person;
 - The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
 - Appointment of a successor or additional trustee or the change of name of a trustee, if material.
 - **(NEW) 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;**
 - **(NEW) 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;**

Perceived Compliance Issues

- The SEC has been concerned over the past several years about compliance with continuing disclosure undertakings.
- 2010 release regarding 15c2-12 amendments addressed underwriters responsibilities.
- 2012 Compliance Alert reinforced the issue.
- 2012 SEC Municipal Market Report cited inconsistent and incomplete compliance.
- 2014 MCDC Initiative addressed the disclosure issue.
 - Self-reporting of securities fraud (material misstatements in offering documents)
 - Reporting underwriters (77 in total) represented 96% of the market.
 - No detailed information on the number of reporting issuers but 77 issuers were included in settlement actions.

Question #1

1. According to SEC Rule 15c2-12, a Continuing Disclosure Agreement must provide for the reporting of a material event within
 - a. 10 business days of occurrence of the event
 - b. 10 calendar days of occurrence of the event
 - c. 1 year of the occurrence of the event

SEC Concerns About Bank Loans

- Due to an increase in use of bank loans and direct placements, holders of public municipal debt have grown concerned about the lack of information available outside of the audited financial statements.
- In March 2017, the SEC published for comment amendments to Rule 15c2-12 that would require new continuing disclosure agreements to include new event notices targeting incurrence of non-public debt obligations and events relating to debt obligations that reflect financial difficulties.

New Requirements

- On August 20, 2018 the SEC announced final approval of the amendments to Rule that add new events (15) and (16) to the list events that must be included in continuing disclosure undertakings
- Stated reasons for the amendments:
 - Increasing use of private placements, direct purchases of municipal securities and direct loans as alternatives to public offerings of municipal securities.
 - SEC's aim was to increase the transparency of debt outside of the "bond" market because of the amount of such debt since the financial crisis.
- Compliance date for the amendments: February 27, 2019.

New Requirements

New event (15):

(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;

New event (16):

(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;

Definitions: Financial Obligation

The rule, as amended, defines the term “financial obligation” to mean:

(A) debt obligation;

(B) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or

(C) a guarantee of (A) or (B).

Definitions: Financial Obligation

- The term “financial obligation” does not include municipal securities themselves (but does include any associated financial obligations such as a derivative instrument entered into in connection with the municipal securities) as to which a final official statement has been provided to the MSRB consistent with 15c2-12.

Definitions: Financial Obligation

As discussed in the Release:

- The definition of the term “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.
- Amendments are focused on the types of obligations “that could impact an issuer’s liquidity, overall creditworthiness, or an existing security holder’s rights.”

Definitions: Debt Obligation

- As described in the Release, the term “debt obligation” includes short-term and long-term debt obligations of an issuer under the terms of an indenture, loan agreement, lease, or similar contract, regardless of the length of the debt obligation’s repayment period.
- In one of the modifications from the original proposed amendment, the amendment, as adopted, narrows the coverage of “leases” to only those leases that “operate as a vehicle to borrow money” and would thus meet the definition of “financial obligation.”
 - Lease-revenue obligations and certificates of participation transactions are likely “vehicles to borrow money”
 - Simple office copier leases are likely not “vehicles to borrow money”
 - Computer system leases may be more difficult to analyze and could very well depend on the scope and terms of the lease itself.

Definitions: Derivative

- 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 or obligated person is a counterparty provided that such instruments are related to an existing or planned debt obligation.
- The requirement that the derivative be related to existing or planned debt was a narrowing from the amendment as proposed.
- The term “derivative” could include, under certain circumstances, instruments that are related to an existing or planned debt obligation of a third party but derivatives that mitigate investment risk are not covered (i.e. they are not “debt-related”).

Definitions: Guarantee

- As described in the Release, guarantees would be included as a financial obligation if the guarantee is of a financial obligation or a derivative entered into in connection with, pledged as security or a source of payment for an existing or planned debt obligation.
- Only covers guarantees that cover debt, debt-like, or debt-related obligations.
- Both the guarantor and the beneficiary of the guarantee might need to make the disclosures.

Definitions: Material

- Although not defined in the rule, the SEC suggests the following factors to consider when assessing whether a financial obligation is material:
 - source of security pledged for repayment of the financial obligation,
 - rights associated with such a pledge (e.g., senior versus subordinate),
 - principal amount or notional amount (in the case of a derivative instrument or guarantee of a derivative instrument),
 - covenants,
 - events of default,
 - remedies,
 - other similar terms that affect security holders to which the issuer or obligated person agreed at the time of incurrence,
 - size of the overall balance sheet,
 - size of existing obligations, and
 - size of the overall bond portfolio.

Definitions: Default

- A default could be a monetary default, where an issuer or obligated person fails to pay principal, interest, or other funds due, or a non-payment related default, where an issuer or obligated person fails to comply with specified covenants.
- There are defaults that may reflect financial difficulties even if they do not qualify as “Events of Defaults” under transaction documents.

Definitions: Modification of Terms

- Not limited to modification of material terms but is limited to those modifications that “reflect financial difficulties.”
- As described in the Release, this broad term would include a written or verbal waiver of existing deal terms if such waiver reflects financial difficulties.

Definitions: Other Similar Events

- Catch-all phrase not specifically defined but Release states the events would share “similar characteristics” of defaults, events of default and modification of terms.

Definitions: Reflect Financial Difficulties

- Release refers to the required event notice for draws on debt service reserves that reflect financial difficulties and that issuers should be familiar with the concept.
- No additional guidance on this point is provided in the Release.
- Important to remember that once committed to provide this event disclosure, it would apply to all financial obligations, not just newly incurred and disclosed under event (15).

Question #2

2. Does your jurisdiction have updated debt management policies and procedures that take into account the new amendments?

- a. Yes
- b. No
- c. Don't know
- d. Working on it now (that's what I'm doing here!)

Changes to CDA/CDU

- New Continuing Disclosure Agreements/Undertakings executed on and after February 27, 2019 will include the two new events.
- Likely to include the events exactly as written in the Release.
- Ongoing discussion regarding whether to incorporate all the commentary in the Release regarding the meaning of the words in the actual amendment.

Making Material Event Disclosures

- Timing of filing material event notices.
 - Within 10 Business Days of the incurrence of the financial obligation or the occurrence of the default (or similar event).

Making Event Disclosures

- No form of notice is prescribed.
- A notice for event (15), according to the Release, should include a description of the material terms of a financial obligation such as :
 - Date of incurrence
 - Principal amount
 - Maturity and amortization
 - Interest rate (if fixed) or method of computation (if variable)
- A redacted copy of the loan or credit agreement should suffice but limit redactions to sensitive terms (account information, signatures, etc.)

Thoughts on Compliance “Readiness”

- Compliance readiness will depend on a number of things including:
 - The size of the government organization
 - The process undertaken when debt, debt-like and debt related obligations are incurred
 - The process in place to monitor compliance with debt agreements
 - The process in place to comply with other required event notices

Thoughts on Compliance “Readiness”

- Compliance readiness will be achieved when there is an appropriate and reliable intersection between debt management and continuing disclosure processes.
- The amendments grew out of a stated desire for more timely communication to the market of debt incurrence and financial difficulties but compliance will depend on timely internal communication of those events.

Thoughts on Compliance “Readiness”

- Ask these important questions:
 - Who is charged with making filings under the issuer’s CDA)?
 - Are there changes that need to be made to the existing policies to assure that person is made aware of the incurrence of a new financial obligation so they can (i) assess materiality, and (ii) prepare and timely submit notice pursuant to the continuing disclosure agreement of such financial obligation?
 - Will that person be aware of covenants contained in existing financial obligation agreements and compliance issues that may reflect financial difficulties?
 - Who within the organization will determine whether the government is experiencing financial difficulties?

Thoughts on Compliance “Readiness”

- Creating or expanding an existing list of debt obligations may be one way to facilitate future compliance.
- Although not required under the Rule, a catalogue or journal that includes a summary of terms and filing information may be helpful to an underwriter doing diligence in future years.
- The task of adding financial obligations to a list may also be a helpful reminder to file the event notice.
- Each organization will need to assess its own internal communications process to put it in the best workable position to comply with future continuing disclosure agreements.

Question #3

3. Once a jurisdiction has signed a new Continuing Disclosure Agreement on or after February 27, 2019 “compliance” means:
- a. Disclosing all new material financial obligations entered into thereafter
 - b. Disclosing any default-like event reflecting financial difficulties of any outstanding financial obligation of the jurisdiction (even those incurred prior to February 27, 2019)
 - c. Both the above

When to Call Legal Counsel

- Legal counsel can be helpful in facilitating compliance “readiness” by assisting in the review of existing financial obligations and existing processes.
- Typically, legal counsel will be involved in the incurrence of a financial obligation and can advise on the appropriate redaction and filing.
- On those transactions when legal counsel is not involved or is a counsel unfamiliar with continuing disclosure agreements, consult your regular bond or disclosure counsel.
- Filings under event (16) should be relatively rare and legal counsel should be involved to review what will be said about the circumstances of any potential financial difficulty.

Question #4

S35

4. Does your entity have financial obligations that will be covered by Continuing Disclosure Agreements entered into on or after February 27, 2019?

- a. Yes
- b. No
- c. Not sure

Question #5

S36

5. When does your entity typically make annual continuing disclosure filings to EMMA?

- a. 180 days after end of FY
- b. 150 days after end of FY
- c. 120 days after end of FY
- d. Over 180 days after end of FY

What Should I Do?

- **The first step: Talk with your bond and/or disclosure counsel**
- Review your existing debt management, post-issuance compliance and continuing disclosure policies
- *Under SEC Rule 15c2-12, underwriters must have a reasonable basis to believe in a government's future compliance before underwriting a transaction; **past material non-compliance may result in the underwriters declining to underwrite future transactions.***
- While no prescribed form of notice has been provided by the SEC, it is expected that
 - an event notice for material financial obligations would include a summary or copy of the underlying document(s) (e.g. the loan agreement or capital lease).
 - and/or an event notice regarding a default or other event that reflects financial difficulty would include a summary of the default and the financial difficulties being experienced

Internal Tracking

Name/Description	Date of Incurrence	Maturity	Key Provisions	Bank/Placement Agent	Date Posted to EMMA [if required]
Banks Loans/Direct or Private Placement					
Existing					
New					
Capital Leases (Financed Purchases)					
Existing					
New					

Name of Entity:
 Debt Manager/Person Completing This Document:
 Debt Manager/Person Responsible for Maintaining Document:
 Members of Internal Debt Disclosure Board:
 Bond Counsel: (if varies, add a column below)
 Disclosure Counsel: (if varies, add a column below)
 Municipal Advisor: (if varies, add a column below)
 Principal/Notional Amount: add a column below

Current/New Financial Obligations [Fiscal Year _____]:

Last Updated xx/yy/20zz
 Person Updating Document: _____

EMMA Filing

TEMPLATE – SAMPLE COVER SHEET FOR FINANCIAL DIFFICULTIES SUBMISSIONS TO EMMA

The Issuer is filing this information as an event disclosure pursuant to its existing continuing disclosure undertakings.

Issuer/Credit/Issue Name:

CUSIP Numbers:

Date of Event:

Type of Information: Event Reflecting Financial Difficulties
Type of Event (Select All That Apply) – [Default][Event of Acceleration][Termination Event][Modification of Terms]

Description: [Initial statement is the description text for the EMMA dataport screen. Additional statement includes short description of filing or of attached document]

This information is only accurate as of its date. The Issuer makes no commitment to provide any notice (advance or otherwise) of any amendment, modification, redemption, cancellation, or other event or circumstance with respect to the filing other than as may be otherwise required pursuant to its existing continuing disclosure undertakings.

The undersigned represents that they are responsible for providing annual reports and event filings pursuant to the [issuer's continuing disclosure agreement], and is authorized to distribute this information publicly.

[Date]

[Name]

[Issuer]

[Contact Information]

[Note to drafter: Bond and/or disclosure counsel may have other text for inclusion with the use any cover sheet similar to this template. Prior to submitting notice for this listed event, bond or disclosure counsel should be consulted as this listed event is new.]

Underwriter's Approach to New Requirements

Duties of Underwriters

- In the aftermath of MCDC, compliance by underwriters with requirements of rule 15c2-12 is paramount.
- Review an official statement describing the issuer's continuing disclosure undertaking and any material non-compliance in the past 5 years.
- Form a reasonable belief in the issuer's compliance with its new continuing disclosure undertaking.

What Will be Different Going Forward?

- When the CDA will be executed on or after February 27, 2019, the CDA and any description of the CDA in the POS and OS should refer to events 15 and 16, as well as the first 14.
- The CDA should either incorporate the defined terms in the Adopting Release (e.g., financial obligation, debt obligation) by cross-reference or include those defined terms in the CDA itself. Alternatively, the defined terms could be included in the issuer's policies and procedures.
- Don't forget muni forwards if the CDA will not be entered into until after February 26.
- If the issuer does not already have policies and procedures for compliance with 15c2-12, it should consider adopting them.

Effective Issuer Policies & Procedures

- Consider compiling a list of your existing “financial obligations”. This may entail reaching out to other departments within your government.
- Assess what “financial obligations” you consider to be material and memorialize that analysis.
- Determine who will be charged with monitoring whether:
 - You have incurred any new material financial obligations;
 - Whether you have agreed 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 financing documents),
 - remedies,
 - priority rights, or
 - other similar terms of a financial obligation

Effective Issuer Policies & Procedures

- Who will monitor whether any of the following events has occurred and whether that occurrence “reflects financial difficulties”:
 - default,
 - event of acceleration,
 - termination event,
 - modification of terms, or
 - other similar events under the terms of a financial obligation.

Effective Issuer Policies & Procedures

- What will be the process for reporting the incurrence of a new material financial obligation and any of the above events reflecting financial difficulties to EMMA within 10 business days after incurrence?

Underwriter Due Diligence

- Expect increased due diligence from your underwriter to help form a reasonable basis in your compliance with your new CDAs.
- Underwriters may double check your list of financial obligations by reviewing your audited financial statements and agendas of governing bodies.
- Consider assisting underwriters bidding on competitive issues by stating in your POS and OS that you have policies and procedures for compliance and, if applicable, that you have retained a third party to assist you.

Question #6

S47

6. Has your entity started to establish internal processes to categorize and track financial obligations and when financial difficulties may arise?

- a. Yes
- b. No
- c. No, but plan to soon
- d. No, not sure when we will begin this process

Discussion