Bond Case Briefs

Municipal Finance Law Since 1971

What Do the SEC's New Continuing Disclosure Requirements Mean for Governmental Borrowers? - Miller Canfield

As reported in our October 10, 2018 alert, the Securities and Exchange Commission has amended Rule 15c2-12 (the "Rule"), which governs continuing disclosure by state and local governmental borrowers to add two new material events requiring disclosure within 10 business days after they occur. Unlike the other 14 material event notice requirements, application of these two new requirements may be less obvious and requires more careful analysis.

The two new events are:

(15) Incurrence of a financial obligation of the issuer or obligated person[1], if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or obligated person, any of which affect security holders, if material; and

(16) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the issuer or obligated person, any of which reflect financial difficulties.

With the February 27, 2019 compliance date approaching, and with many underwriters and municipal advisors focusing more closely on the new requirements, this alert offers more detailed analysis of steps governmental borrowers can take to facilitate compliance when they are required to do so.

When Will Issuers Need to Comply?

The amendments apply to continuing disclosure undertakings (CDU's) for publicly offered bonds or notes which are delivered on or after February 27, 2019. Until an issuer sells debt obligations with a CDU containing the new material events, the amendments have no effect on that issuer's continuing disclosure obligations.

What Are The New Material Events?

While the existing 14 events (including payment defaults, draws on reserves, unscheduled draws on credit enhancement, or changes in credit enhancement, adverse tax actions or opinions, material changes to bondholder rights, refundings, bond calls, rating changes, changes in trustee, mergers or bankruptcy) which continue to apply are fairly straightforward, the new requirements require disclosure within 10 business days of:

- "material" new financial obligations (or agreements concerning covenants, events of default, remedies, property rights or similar terms) incurred by the borrower for which there is no CDU and which could materially affect bondholders' interests [event (15)]

- events occurring in connection with a financial obligation which reflect financial difficulties for the borrower [event (16)]

What Is A "Financial Obligation?"

A financial obligation does not include any debt obligation for which the borrower posted an official statement and provided a CDU, or ordinary operating liabilities.

A financial obligation does include:

- a debt obligation
- a derivative instrument, such as a swap, entered into in connection with a debt obligation
- a guarantee of either a debt obligation or a derivative.

"Debt Obligations" include:

- privately placed bank or state authority purchases of bonds or notes or lines of credit
- installment contracts or lease purchase agreements
- energy conservation improvement financing contracts
- emergency loans from the State
- judgments
- any other obligation that is "debt-like"

What Information Must Be Filed?

The answer to this question is a bit open-ended, involves the exercise of judgment and depends on the facts and circumstances in the broader context.

Under event (15), only "material" financial obligations must be disclosed. The SEC release does not define "material." In addition, borrowers must provide certain information about the financial obligation, where material. While guidance on this question is likely to evolve, a rule of thumb may be that if a holder of a security for which the borrower has provided a CDU would find financial obligation terms relevant to a decision to buy or sell the security, and the price at which to do so, the name of the financial obligation and relevant terms should be included in the event filing.

Examples of terms to be disclosed include:

- amount financed and term and interest rate
- security and source of payment, including priority of payment
- defaults and events of defaults
- remedies, including acceleration, penalties and default rates
- modifications of terms and triggers for modifications
- key covenants, such as maintenance of ratings, most favored nations provisions, coverage and additional debt tests

Under event (16), the occurrence of an event under a financial obligation creates an obligation to disclose if that event reflects financial difficulties. In this circumstance, default (even if not yet an event of default triggering remedies), acceleration, termination events which obligate the borrower to pay a penalty, modification of terms and the imposition of remedies may each trigger a disclosure obligation. In this case, the relevant financial obligation may be one the borrower incurred before or after it executed a CDU which included new events (15) and (16), if the triggering event occurs after delivery of the new CDU.

Whether a disclosure obligation arises will depend on the context – the size of the borrower, the magnitude of the financial obligation relative to the size of the borrower and the impact or potential impact of the covenant or covenant breach on the borrower generally and on the bondholders to be benefitted by the CDU. An event which by itself may be immaterial may become material or reflect financial difficulty if it occurs in the context of multiple other events.

Managing Compliance with the New CDU Requirements

While borrowers have no obligation with respect to the new material events until they issue publicly offered securities on or after February 27, 2019 pursuant to an official statement, it wouldn't hurt to take an inventory of any outstanding financial obligations to identify those which may be material and to catalog material terms of those obligations. Underwriters have a responsibility under the amended rule not only to obtain a CDU satisfying the Rule from the borrower, but also to determine the ability and willingness of the issuers whose bonds they buy to comply with the Rule and as part of their due diligence may request the details of those obligations.

Borrowers will need to develop a system (which may or may not rise to the level of a formal policy or procedure) for identifying, cataloging and tracking these obligations so they can have confidence they will be able to post, within 10 business days, both (i) notice that a material financial obligation has been incurred together with material terms of such obligations or agreements and (ii) the occurrence of events arising in connection with any financial obligation or agreement which reflect financial difficulties.

Many borrowers will have very few obligations to track while others may have several, with many material terms.

How Do You Post?

The Municipal Securities Rulemaking Board has updated EMMA to include the new material events. Once a borrower has identified a material financial obligation, the borrower or its agent may post the details of the financial obligation or identify the financial obligation with and attach the entire document. If a borrower chooses to post the full document, certain types of sensitive information, such as account numbers and signatures, should be carefully redacted, while material terms should remain viewable.

For events which reflect financial difficulties, a description of the event and/or notice from the holder of the related obligation, should be disclosed.

[1] An "obligated person" is an entity, other than the nominal issuer or credit enhancer, which is legally committed to support all or a material portion of the payment of the obligation. Materiality here also depends on the context, but generally is regarded as translating to a commitment to support payment of at least 20% of the financial obligation

January 29, 2019

Miller Canfield

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com