
GFOA Alert: Bank Loan Disclosure

Over the past five years, the municipal securities market has witnessed a dramatic increase in the use of bank loans by municipal issuers as a tool to finance capital improvements as well as refund outstanding debt. Bank loans, which may be structured with fixed or variable interest rates and with defined maturities or flexible payment provisions, may offer a number of potential advantages over a public offering of municipal securities. The increasing use of bank loans has recently begun to attract the attention of regulators, such as the Municipal Securities Rulemaking Board (MSRB) and Securities and Exchange Commission (SEC), as well as the credit rating agencies, which are growing increasingly concerned about bank loan disclosure practices among municipal issuers.

Typically, the process for executing a bank loan is more streamlined than a traditional bond issue that is publicly marketed, with fewer costs of issuance and ongoing compliance requirements. In particular, banks loans often do not require an offering document or credit ratings. Additionally, bank loans are often structured in a more flexible manner than a traditional municipal bond issue, to conform to a specific project schedule or particular cash flow considerations. However, because bank loans are not typically executed in an environment that is as transparent as the municipal securities market, an issuer may have limited ability to assess information about whether the proposed interest rate, fees, and terms of a particular loan are consistent with bank loan market practices.

For these reasons, GFOA urges state and local governments that are considering bank loans to:

- Provide voluntary public disclosure of the bank loan;
- Develop specific policies and procedures that address the applicable legal and financial requirements of using bank loans for their jurisdiction; and
- Seek guidance from outside professionals including municipal advisors and bond counsel in reviewing the legal and financial terms of the bank loan.

Bank Loan Disclosure Considerations

In order to enhance market transparency and public communication to its citizens and other stakeholders who are interested in understanding a government's total debt profile, GFOA recommends that governments should voluntarily disclose information about bank loans. Disclosure of a bank loan would be relevant to bondholders if the bank loan is secured by any or all of the same revenues as the outstanding bonds, and is large enough to be material to the creditworthiness of the government. Additionally, if a government executes numerous bank loans, entities investing in the government's bonds may need to know about the combination of those loans in the aggregate. Lastly, certain terms and conditions of the bank loan (e.g., liquidity covenants, events of default, and acceleration provisions) may be important information for credit analysts and bond holders. While disclosure of bank loans is not currently required under MSRB or SEC rules, issuers are advised that increased regulatory scrutiny may result in mandatory disclosure of bank loans in the future, subject to similar standards of materiality and timeliness as apply to municipal securities.

Voluntary disclosure of bank loans may be accomplished in a variety of ways, either by posting the loan agreement itself or a summary of material terms on the MSRB's Electronic Municipal Market Access (EMMA), incorporating bank loan information in the government's comprehensive annual financial report, or releasing a summary of the material terms of the bank loan on the government's website. When using EMMA to disclose bank loan information, governments should be aware that the bank loan will not have a CUSIP reference number, and the information will need to be uploaded as "other Information" connected with a bond issue already established in EMMA. The government, in consultation with its municipal advisor, disclosure counsel, and bond counsel, should determine both the extent of information it provides and the manner in which it is disseminated.

GFOA also encourages governments to keep abreast of the current regulatory environment surrounding bank loan disclosure. For example, the MSRB recently requested public comment on a regulatory approach that would require municipal advisors to disclose information about the bank loans and direct purchases of their government clients on EMMA. GFOA will submit comments to the MSRB on this proposal and invites GFOA members to do the same. GFOA has significant concerns with this proposal, including the fact that municipal advisors are the only party in a municipal debt transaction that have a fiduciary responsibility to issuers, as outlined in the SEC's 2013 MA Rule. The MSRB's proposed approach to pass along responsibility of issuer disclosure of bank loans and private placements breaches that fiduciary duty, making municipal advisors also beholden to the investor community. Such a requirement would change the nature of issuers' relationships with municipal advisors in a way that is beneficial to neither issuers nor municipal advisors.

Comment letters are due May 27, 2016, and can be transmitted to the MSRB through this link. GFOA members can access full text of the short regulatory proposal here.

Resources

- GFOA Best Practice – Understanding Bank Loans (2013)
- MSRB Bank Loan Disclosure Market Advisory (2015)
- Moody's Investor Service – Growth in Bank Loans and Private Financing Creating Information Gaps in US Municipal Market (2012)
- Standard & Poor's Rating Services – Not All Loans are Equal: Some Terms and Conditions That Make Disclosure Critical in Evaluating Credit Risk (2014)
- National Federal of Municipal Analysts – Considerations Regarding Voluntary Secondary Market Disclosures About Bank Loans (2013)

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