

Bond Case Briefs

Municipal Finance Law Since 1971

SEC Said to Study Muni Bank Loan Disclosure That Vanguard Wants.

The U.S. Securities and Exchange Commission is considering whether to require state and local governments to disclose bank loans and private placements, according to people familiar with the matter, reflecting bondholders' concerns about the fast-growing segment of municipal finance.

The rule, known as 15c2-12, requires securities dealers to ensure that states and local governments report updated financial information and material events to bondholders. Mutual funds, investment banks and credit analysts have been pushing regulators to respond to extend such requirements to bank loans, which become more prevalent since the 2008 crisis, particularly among smaller borrowers.

"We need a full picture on the balance sheet of our issuers," said Hugh McGuirk, who oversees \$23 billion of municipal bonds at T. Rowe Price Inc. in Baltimore. "If we're not seeing the breadth and depth of that market with the terms that go along with it that increases the probability of some sort of surprise."

Direct lending by banks has proliferated in the \$3.7 trillion market as states, local governments and non-profits find they can borrow at rates comparable to those on bonds, without the fees or disclosure requirements associated with public-debt offerings. In 2015, S&P Global Ratings evaluated 126 bank loans totaling \$5.2 billion. Estimates of the size of the market run as high as \$80 billion a year, said Nat Singer, chair of the Municipal Securities Rulemaking Board, the municipal market's self-regulator.

Because loans aren't classified as securities, states and cities aren't immediately required to disclose them, despite the risk they can pose to bondholders. The loan terms can favor banks over other investors and add to a borrower's financial risk.

For example, banks can demand accelerated principal and interest if a payment is skipped or a government's cash falls below a specific target, which could push the borrower into a liquidity crisis if it can't cover the bills. Such provisions last year led S&P to cut one Wisconsin town's credit rating from the third-highest grade to junk until the terms were renegotiated.

"It has the potential to mask the level of indebtedness," said Chris Alwine, head of municipals at Vanguard Group Inc. which holds about \$160 billion of the securities. "You might be in a subordinated position that you don't know about."

John Nester, an SEC spokesman, declined comment.

Since the SEC can't regulate state and local government bond issuers, other than through the anti-fraud laws, it imposes its disclosure rules indirectly through its authority over banks.

In 1989, the SEC adopted Rule 15c2-12, requiring bond underwriters to review official statements before a municipal issuer publicly sold securities. It was amended in 1995 and added requirements

for continuing disclosure, which the SEC last revisited in 2010.

The rule requires municipal issuers to disclose 14 types of material events within 10 business days, such as failure to pay principal and interest, draws on reserve funds or changes to the security of bondholders. The disclosures are posted on the MSRB's website.

In January 2015, the MSRB asked the SEC to reconsider whether to require bank-loan disclosure. The regulator has encouraged issuers to voluntarily disclose key details about the loans on its online repository, but few municipalities have done so.

The MSRB's call to revisit the rule has been joined by the Securities Industry and Financial Markets Association and the Bond Dealers of America, both of which represent underwriting firms.

Emily Brock, federal liaison for the Government Finance Officers Association, said the MSRB's EMMA website isn't user friendly, hampering voluntary disclosure of bank loans. GFOA encourages debt managers to voluntarily disclose.

"We're working with a system that can't accommodate the disclosure in an easy way," said Brock, whose organization hasn't taken a position on revisiting the SEC rules. "We too want quality data."

The SEC could use Form 8-K in the corporate securities market as a template for events that might be appropriate to include for continuing disclosure by municipal bond issuers. One such event is the "creation of a direct financial obligation or an obligation under an off-balance sheet arrangement."

"Requiring similar reporting by municipal issuers would address our concerns about these obligations that are not subject to Rule 15c2-12 and therefore are not now reported," wrote then-MSRB Chair Kym Arnone to the SEC in 2015.

Bloomberg Business

by Martin Z Braun

June 16, 2016 — 7:35 AM PDT