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Seven Things to Know About the SEC's Amendments to Rule 15c2-12: McGuireWoods

In about six months, municipal bond issuers and obligated persons will see additions to their continuing disclosure undertakings related to SEC Rule 15c2-12, and broker-dealers will need to have systems in place to ensure compliance with those new undertakings.

On Aug. 20, the Securities and Exchange Commission released adopted amendments to Rule 15c2-12, adding two events to the list of events needed to be included in continuing disclosure undertakings related to Rule 15c2-12. The amendments also add to Rule 15c2-12 a corresponding definition and make a technical amendment.

Pursuant to these amendments, future continuing disclosure undertakings must include the following notice events:

(a) Incurrence of a material financial obligation of the issuer or obligated person, 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

(b) 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.

The amendments define "financial obligation" as 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 definition does not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board (MSRB), consistent with Rule 15c2-12.

In addition to issuers and obligated persons updating the form of a continuing disclosure agreement (and their disclosure policies), and broker-dealers updating their 15c2-12 compliance procedures, below are seven notable takeaways from the adopting release (Exchange Act Release No. 34-83885):

1. **Existing continuing disclosure undertakings are unaffected.** The amendments apply only to "primary offerings" that close on or after the compliance date, which is 180 days after publication of the amendments in the Federal Register. A "primary offering" is an offering of municipal securities directly or indirectly by or on behalf of an issuer of such securities, including any remarketing of municipal securities (i) that is accompanied by a change in the authorized denomination of such securities from $100,000 or more to less than $100,000; or (ii) that is accompanied by a change in the period during which such securities may be tendered to an issuer of such securities or its designated agent for redemption or purchase from a period of nine months or less to a period of more than nine months.In other words, after the amendments become effective, existing continuing disclosure undertakings will be unaffected by the amendments. However, existing undertakings related to securities that are remarketed as part of a primary offering under 15c2-12 (where the remarketing closes after the compliance date), will

need to be revised to comply with the amendments.

2. **The definition of "financial obligation" includes only debt, debt-like and debt-related obligations, but it does not include ordinary liabilities.** In the adopting release, the SEC notes that ordinary financial and operating liabilities are not included in the definition of financial obligation. When earlier proposed, the amendments included a broader definition of financial obligation. However, based on public comments received, the SEC elected to narrow the definition of financial obligation to transactions that are debt, debt-like or debt-related because those transactions are more likely to affect liquidity, overall creditworthiness or an existing security holder's rights. (See Section III(A)(2)(i) of the adopting release.)
3. **Event notices must be filed upon the occurrence of any of the events that reflect financial difficulties, regardless of whether the related financial obligation was incurred before the effective date of the amendments.** Unlike the impact of the amendments on existing continuing disclosure undertakings described in (1) above, if a default or other event reflecting financial difficulties under any financial obligation occurs (regardless of when that financial obligation was incurred), an event notice would be required under an undertaking that includes the notice events added by the amendments. (See Section III(A)(3)(v) of the adopting release.)
4. **Broker-dealers will not need to perform diligence on an issuer's or obligated person's past compliance with the events added by the amendments unless the issuer or obligated person has a continuing disclosure undertaking that includes the added events.** The SEC recognized that for continuing disclosure agreements entered into before the compliance date, the recommending dealer would receive notice solely of those events covered by such continuing disclosure undertaking, which would likely not include any of the events added by the amendments. Consequently, the adopting release states that for municipal securities issued prior to the compliance date, broker-dealers will not need to have procedures in place that provide reasonable assurance that they will receive prompt notice of the events added by the amendments. However, a dealer cannot recommend the purchase or sale of a municipal security unless the dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to paragraphs (b)(5)(i)(C) and (D) and paragraph (d)(2)(ii)(B) of Rule 15c2-12 with respect to the security.
5. **Leases are not included in the definition of financial obligation, except when they are debt or debt-like.** The proposed definition of financial obligation included leases, but the SEC deleted lease from the definition in the adopted version because it considered the term too broad. However, any lease that operates as a vehicle to borrow money, such as an equipment financing lease, is included in the definition. (See Section III(A)(2)(i) of the adopting release.)
6. **A notice of the incurrence of a material financial obligation generally should include a description of the material terms of the financial obligation.** However, the SEC provided little guidance on its interpretation of materiality, leaving the determination to the reporting entity. The SEC provided the following examples of material terms: date of incurrence, principal amount, maturity and amortization, interest rate (if fixed) or method of computation (if variable) plus any default rates, and other terms, depending on the circumstances. The SEC acknowledges that this requirement may, depending on the facts, be achieved by submitting a summary of the terms, the term sheet or the applicable transaction documents, like a continuing covenant agreement.
7. **Derivative instruments of the type described in the definition of financial obligation must always be disclosed on EMMA, even if the underlying debt would be exempt from disclosure under the amendments because the underlying debt is the subject of a final official statement that was provided to the MSRB.** Such exemption from disclosure extends only to securities for which a final official statement is required to be provided to the MSRB under Rule 15c2-12. It does not extend to the derivative instrument related to those securities. In addition, the exemption does not extend to securities for which the final official statement was

provided to the MSRB voluntarily. Only securities in a primary offering that is subject to Rule 15c2-12 are exempt under the amendments.

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