

RULE 15C2-12 AMENDMENTS – TWO NEW EVENT NOTICES REQUIRED FOR CONTINUING DISCLOSURE BEGINNING ON FEBRUARY 27, 2019

Bond Counsel Alert
February 22, 2019

On August 20, 2018, the Securities and Exchange Commission (“SEC”) approved amendments (the “Amendments”) to Rule 15c2-12, the Municipal Securities Disclosure Rule under the Securities Exchange Act of 1934. The Amendments have an effective date of February 27, 2019. This client alert provides a brief overview of the Amendments and an immediate action step that should be taken by all municipalities and school districts.

New Event Notice Requirements

The Amendments add two (2) new events to the existing list of 14 events which require the filing of a notice with the Municipal Securities Rulemaking Board (the “MSRB”) through the EMMA system. The new events were added under paragraphs (b)(5)(i)(C)(15) and (16) of Rule 15c2-12:

(15) Incurrence of a financial obligation of the [municipality or school district], if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the [municipality or school district], 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 [municipality or school district], any of which reflect financial difficulties (emphasis added).

Financial Obligation Defined

Additionally, the Amendments added the definition for the term “financial obligation.” The term is referenced in each of the new events and is the key to understanding the notice requirements. The definition is added under paragraph (f) (11) of Rule 15c2-12:

(11) (i) The term financial obligation means a: (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) guarantee of paragraph

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(f)(11)(i)(A) or (B). (ii) The term financial obligation shall not include municipal securities as to which a final official statement has been provided to the MSRB consistent with this rule.

Guidance

The guidance provided in the release adopting the Amendments (the “Adopting Release”) is critical to understanding what the SEC considers “material,” “financial obligation,” “debt obligation,” “derivative instrument,” “guarantee,” “default,” “modification of terms,” and “other similar events” to mean, in order to understand what municipalities or school districts are expected to undertake to disclose and then to disclose.

The definition of financial obligation does not include ordinary financial and operating liabilities incurred in the normal course of a municipality’s or school district’s business, only a municipality’s or school district’s debt, debt-like, or debt-related obligations. It is significant to note that “financial obligation” as defined under the Amendments includes direct placements and bank loans, but the definition is expansive enough to capture other types of financial transactions, such as capital leases, interest rate swaps, guarantees, and other funding vehicles as described below.

The term “debt obligation,” which is included in the definition of “financial obligation,” includes leases “that operate as vehicles to borrow money” (e.g., energy performance contracts or installment purchase contracts). In addition, the term “debt obligation” includes short-term and long-term debt obligations of a municipality or school district under the terms of an indenture, loan agreement, lease, or similar contract.

A “derivative instrument” includes any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument to which a municipality or school district is a counterparty in the definition of “financial obligation” provided that such instruments are related to an existing or planned debt obligation.

Finally, the term “guarantee” is intended to capture any guarantee provided by a municipality or school district (as a guarantor) for the benefit of itself or a third party, which guarantees payment of a financial obligation.

Incurrence of a Financial Obligation

A financial obligation generally should be considered to be incurred when it is enforceable against a municipality or school district. For many transactions, where a contractual commitment or sale agreement has been entered into prior to closing or funding (e.g., certain bank loans), it may be prudent to treat the incurrence of a financial obligation as occurring upon the sale or commitment date rather than the closing date.

The reporting of an event is only required “if material.” Pursuant to the Adopting Release, a municipality or school district will need to consider whether a financial obligation or the terms of a financial obligation, if they affect security holders, would be important to a reasonable investor when making an investment decision. The SEC continues its lack of guidance on the issue of materiality.

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Event Reflecting Financial Difficulties

A default could be a monetary default, where a municipality or school district fails to pay principal, interest, or other funds due, or a non-payment related default, where a municipality or school district fails to comply with specified covenants. Typically, if a monetary default occurs, or a non-payment related default is not cured within a specified period, such default becomes an “event of default” and the trustee or counterparty to the financial obligation may exercise legally available rights and remedies for enforcement, including an event of acceleration. Pursuant to the Adopting Release, there are events that may reflect financial difficulties even if they are not defined as “Defaults” or “Events of Defaults” under the transaction documents.

Compliance Date

A municipality or school district will be subject to the Amendments following the issuance of an obligation (i.e., note or bond) that is issued on or after February 27, 2019 pursuant to an official statement.

Immediate Action Required

The filing of a notice with EMMA of the incurrence of a financial obligation will only apply to financial obligations incurred after February 27, 2019 and the date of the first official statement of the municipality or school district subject to the Amendments. However, the filing of a notice for an event reflecting financial difficulties under the terms of a financial obligation will apply to all outstanding financial obligations of a municipality or school district regardless of the date on which the financial obligation was incurred.

Therefore, as the first step to prepare for the new event notice requirements under Rule 15c2-12, all municipalities and school districts should identify and list their outstanding obligations that meet the definition of a “financial obligation.” The Disclosure Compliance Officer under the municipality’s or school district’s Continuing Disclosure Compliance Procedures must maintain such list and notify the dissemination agent of any events reflecting financial difficulties under the terms of an outstanding financial obligation.

We are reviewing in more detail the Amendments and we expect to be reaching out to our municipal and school district clients shortly with advice and options regarding these developments.

In the meantime, if you have any comments or questions, please contact any of the attorneys listed below:

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