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New regulation requires bond issuers to disclose all new "material" financial obligations

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A new federal regulation taking effect soon will increase the burden of compliance with federal securities law on issuers of tax-exempt securities.

Rule 15c2-12 has been amended to add new continuing disclosure requirements for issuers. Commencing February 27, 2019, continuing disclosure undertakings of issuers must contain two new events about which issuers must report via the Municipal Securities Rule Making Board's Electronic Municipal Market Access (EMMA) website. The two new categories of event notices (which are in addition to the 14 categories of event notices already required by the rule) are:

1. Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material (emphasis added).
2. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties (emphasis added).

It is important to note that these amendments are not retroactive; the amendments will only affect those continuing disclosure undertakings entered into on or after February 27, 2019 (unless an earlier continuing disclosure undertaking had voluntarily included the amendments). Issuers with older continuing disclosure undertakings will not have to comply with these new reporting requirements until they enter into a new continuing disclosure undertaking that incorporates the new regulations.

The amendments to the rule 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 term financial obligation shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with this rule.

While not defined in the rule, the term "'debt obligation' was intended to capture the short-term and long-term obligations of an issuer or obligated person under the terms of an indenture, loan agreement, or similar contract that will be repaid over time." Debt obligations include private/direct placements of a loan with a bank, and the term also includes lease arrangements used as a "vehicle to borrow money."

Although the rule states that issuers will only need to report "material" financial obligations or terms that affect security holders, the SEC has so far declined to provide any "bright-line" test as to what it considers material. Issuers subject to the new reporting requirements must carefully evaluate each new "financial obligation" for materiality. Additionally, issuers should implement internal procedures to identify all financial obligations subject to the disclosure under the rule. Note also that material financial obligations that contain covenants, events of default, remedies, priority rights or other similar terms that affect securities holders, if material, must also be disclosed. Defaults, events of acceleration, termination events, modifications of terms or other similar events under the terms of any financial obligation, not just material financial obligations, must also be disclosed if indicative of financial difficulties. Any required event filing must be drafted and posted on EMMA within 10 business days after such event has occurred.

As the compliance date approaches and the municipal securities market adapts to the new reporting requirements, consulting with bond counsel when dealing with the new materiality and disclosure requirements is recommended.