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This Time is Different: What You Need to Know Now About the New Rule 15c2-12 Events

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*By: **Edward Fierro** **Britt Cass Steckman***

On August 20, the Securities and Exchange Commission added two events to the existing fourteen events under Rule 15c2-12,[1] which requires certain notice filings with the Municipal Securities Rulemaking Board's EMMA system within ten business days of occurrence. The new events require issuers and obligated persons in municipal securities offerings to contract to file notice of:

- Incurrence of a financial obligation of the issuer or obligated person, if material, 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 ("Event 15"); and

- Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties ("Event 16").

The Compliance Date for including Events 15 and 16 in a continuing disclosure agreement ("CDA") is 180 days from the date of publication in the Federal Register. This may seem far in the future, but the SEC acknowledged it doubled the time originally contemplated in order to allow issuers, obligated persons and underwriters needed time to prepare for implementation. As described below, the work required of issuers and obligated persons to identify, analyze, and file notices and underwriters to conduct due diligence for the new events far exceeds that required for any of the fourteen listed in the current rule, in terms of both initial compliance with the amendments as well as continuing compliance thereafter.

Issuers and Obligated Persons

The SEC lacks the authority to regulate state and local government issuers and obligated persons of municipal securities other than by application of the antifraud provisions. Underwriters are regulated by the SEC through Rule 15c2-12 and, with limited exceptions, underwriters may not underwrite municipal securities unless an issuer or obligated person enters into a CDA conforming to the requirements of Rule 15c2-12. In order to ensure compliance with Rule 15c2-12, CDAs executed on and after the Compliance Date must include the two new events. To be able to comply with a CDA upon execution tasks within the allotted ten business days, issuers and obligated persons will need to accomplish two basic (and likely laborious):

1. Before the first offering including a CDA executed on or after the Compliance Date to be prepared to comply with Event 16 upon sale:
    - Identify all *existing* financial obligations. Financial obligation includes (i) debt obligations; (ii) derivative instruments 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 "debt obligation" includes leases "that operate as vehicles to borrow money." The term "financial obligation" does not include "ordinary financial and operating liabilities incurred in the normal course of an issuer's or obligated person's business," or municipal securities as to which a final official statement has been provided to the MSRB consistent with Rule 15c2-12.

    - Review to determine whether the financial obligation is material.

    - Review the agreements associated with the financial obligation to identify covenants, events of default, remedies, priority rights, or other similar terms to determine whether they are material.

    - Consider creating a spreadsheet or building a database (or other accessible and reviewable collection) of existing financial obligations determined to be material, together with their respective agreements to covenants, events of default, remedies, priority rights, or other similar terms determined to affect security holders and be material, as well as maintaining records of the reviews. This database will assist in compliance with Event 16 upon sale of the securities in the first offering and, if continuously updated as provided below, thereafter.

2. After the first offering including a CDA executed on or after the Compliance Date, to comply with Event 15:

    - Assess each new financial obligation prior to or upon incurrence (parties may find the process more manageable if initiated well before incurrence):

        i. Using (a) and (b) above, to determine whether the financial obligation is material and requires the filing of a notice.

        ii. Using (c) above, to determine whether the agreements associated with the financial obligation affect security holders and are material and require filing of a notice.

        iii. Prepare and file a notice with EMMA reflecting either or both instances, including a description of the material terms of the financial obligation, within 10 business days of incurrence.

        iv. Add to the spreadsheet or database any new material financial obligations or material agreements to covenants, event of default, remedies, priority rights, and other similar terms that affect security holders.

- Continuously review the spreadsheet or analyze the database (or other accessible and reviewable collection) for the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation and:

    i. Upon occurrence, determine whether such event reflects financial difficulties, and, if so;

    ii. Within 10 business days of occurrence, file notice of the event with EMMA.

While otherwise declining to provide guidance as to what constitutes materiality, the Commission states that determination of materiality under the events applies "*TSC v. Northway*" [2] materiality, which it describes as "the same analysis regularly made by [an issuer or obligated person] when preparing disclosure documents," stating "an issuer or obligated person 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." In the place of guidance, after acknowledging "there will be costs incurred by issuers, obligated persons, and dealers when evaluating whether a financial obligation is material," the SEC suggests several steps issuers and obligated persons could take to manage their new burdens of time and cost:

- "[T]he Commission understands that most material terms of a financial obligation are typically known to the issuer or obligated person prior to the date of its incurrence. Accordingly, issuers and obligated persons could begin the process of assessing whether a particular obligation should be disclosed … in advance of its incurrence," and

- "[I]ssuers and obligated persons could consider amending existing disclosure policies and procedures to address the process for evaluating the disclosure of material financial obligations. Amended policies and procedures, in addition to industry practices that may develop, could help issuers and obligated persons streamline the process of disclosing material financial obligations to EMMA, and ease time and cost burdens associated with identifying, assessing, and disclosing material financial obligations."

Brokers, Dealers, and Municipal Securities Dealers

Rule 15c2-12 regulates brokers, dealers, and municipal securities dealers (collectively, "dealers") who underwrite municipal securities and serve as dealers in secondary market trading of municipal securities. The new events have four principal effects upon them:

1. On and after the Compliance Date, underwriters will be prohibited from underwriting municipal securities without a compliant CDA other than in an offering that is exempt under the Rule.

2. Once an issuer or obligated person has issued municipal securities with a CDA including the new events, underwriters in subsequent offerings will need to conduct due diligence of the new events (in addition to the existing fourteen) in their review of prior CDAs

executed after the Compliance Date of the issuer or obligated person to determine failure to comply in all material respects with the CDAs. This may be a formidable task, made less burdensome where the issuer or obligated person has adopted effective policies and procedures including records of the reviews conducted under the procedures available for the underwriter's review.

3. On and after the Compliance Date, dealers who recommend purchases or sales of municipal securities will need to include the two events to the procedures they are required to have in place under Rule 15c2-12(c) to provide reasonable assurance that it will receive prompt notice of the events and failure to file notices regarding the recommended security.

4. Dealers may wish to evaluate appropriate modification of existing policies and procedures to reflect these additional requirements.

The two new events simply stand apart from the existing fourteen in the complexity of assessing the need for an event notice in the first place and, if required, preparation of the required content of the notice filing. Indeed, "the Commission acknowledges that some issuers may retain outside counsel to assist in the evaluation and preparation of some of the more complex notices as a result of the amendments of the Rule." The reciprocal review by underwriters may be likewise arduous, particularly in the absence of effectively implemented policies and procedures by issuers and obligated persons.

The tasks described above are ongoing and will require dedication of resources -- internal, external, or both—for municipal securities issued on or after the Compliance Date, for so long as such municipal securities remain outstanding.

Should you require additional information, please contact ***Paul Maco***, ***Ed Fierro***, ***Britt Steckman***, or any member of our ***public finance group***.

Note: this article was previously published by *The Bond Buyer.*

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1 Paul Maco, Ed Fierro, and Britt Steckman are attorneys at Bracewell. Both Paul and Ed worked on amendments to Rule 15c2-12 while at the SEC, Paul on the original continuing disclosure amendments in 1994 and Ed most recently on the March 1, 2017 proposing release for the adopted amendments discussed in this article.

2 426 U.S. 438, 440 (1976).