Federal Securities Law: Amendments to Rule 15c2-12

Paul S. Maco, Bracewell LLP, Washington, D.C.

Previously published by **The Bond Lawyer**® *The Journal of the National Association of Bond Lawyers* - Summer 2018

Overview

On August 20, 2018, the Securities and Exchange Commission approved amendments (the "Amendments") to Rule 15c2-12 (the "Rule"), the Municipal Securities Disclosure Rule under the Securities Exchange Act of 1934, in a release adopted *by unanimous vote of the four sitting Commissioners (the "Adopting Release").*[1] The Amendments, described below, add two events—(15) and (16)--and the defined term "financial obligation" to the existing 14 events for which municipal securities obligors must commit to provide timely notice filings to the Municipal Securities Rulemaking Board's EMMA system. The compliance date for the Amendments, i.e., the date on or after which a continuing disclosure agreement (the "CDA") must include the two new events, is February 27, 2019 (the "Compliance Date").

Issuers and obligated persons should be aware that the new events apply to certain changes to and events under financial obligations entered into before the Compliance Date. Event (16) requires knowledge of their respective provisions to determine whether an event requiring a notice filing has occurred. The Adopting Release provides: "an event under the terms of a financial obligation pursuant to paragraph (b)(5)(i)(C)(16) that occurs on or after the compliance date must be disclosed regardless of whether such obligation was incurred before or after the compliance date."[2] Even though event (16), like all other events, follows the words "with respect to the securities being offered in the Offering,"[3] the Adopting Release does not acknowledge this phrase, but rather discusses the Amendments as if the phrase does not apply. As a result, an event may occur requiring notice under event (16) at any time after an issuer or obligated person executes a CDA on or after the Compliance Date. Before executing a CDA on or after the Compliance Date, issuers and obligated persons should prepare for such an eventuality. The Commission doubled the time originally proposed for compliance from 90 to 180 days to provide "sufficient time for Participating Underwriters to revise their procedures to comply with the Rule, and for issuers and obligated persons to become aware of the Amendments and plan for their implementation."[4]

The Amendments will be less burdensome on issuers, obligated persons, and underwriters than the proposed amendments,[5] but will nevertheless burden issuers and obligated persons offering bonds subject to the Rule with an *initial and ongoing monitoring and compliance* regimen unlike any required by the Rule's existing 14 events. Unless issuers and obligated persons implement effective controls and procedures to manage compliance with post effective date CDAs, they will face potentially time consuming and costly due diligence reviews prior to subsequent offerings subject to the Rule and risk access to the public debt markets. The extended time prior to the Compliance Date provides an opportunity to prepare and for industry groups to produce best practices and forms to assist with compliance.

The compliance burden for all parties is complicated further by the way in which the Commission has adopted the Amendments. Early on the SEC made clear that "undertakings with respect to material events should list all events in the same language as is contained in the rule, without any qualifying words or phrases, except as the

---

[1] 83 FR 44700 (Aug. 31, 2018).
[2] 83 FR 44717.
[3] 17 CFR 240.15c2-12(b)(5)(i)(C). The phrase remains in the Rule and presumably will appear in all CDAs intended to comply with the Rule on or after the Compliance Date.
[4] Id at 44717.
[5] 82 FR 14282 (Mar. 17, 2017).

staff has indicated otherwise with respect to mandatory redemption of bonds."[6] An underwriter accepting a CDA not following this instruction may risk sanction for violating the Rule, so a post Compliance Date CDA would presumably follow the instructions and use the language of the Rule without embellishment or qualification. Previously this was not a problem, because existing reportable events requiring further explanation include clarifying text within the Rule.[7] The language of the Amendments is sparse and direct, *however the disclosure expected by the Commission is nuanced and contingent upon terms not defined in the Amendments but in* the Adopting Release. Officials of an issuer or obligated person earnestly seeking to comply with the CDA may not be aware of guidance in the Adopting Release as to what the words in the Amendments are intended to mean, let alone how to access the guidance. Moreover, CDAs that parrot the Rule language without embellishment, when interpreted in accordance with state law, may impose contractual commitments that vary from the intent of the Amendments. In some circumstances "the same language as is contained in the rule" may not be problematic, such as intuitively reading in "a financial obligation as described in" into "Guarantee of paragraph (f)(11)(i)(A) or (B)." In other circumstances, such as understanding that "debt obligation" includes "a lease operating as a vehicle to borrow money" as well as revenue obligations, the meaning will be more difficult to intuit. More on this below. The Adopting Release suggests that many challenges posed by the Amendments may be addressed by enhanced disclosure policies and procedures, which Sarbanes-Oxley provided the Commission with authority to impose upon the corporate world and the SEC has required in settling municipal enforcement proceedings with most issuers since San Diego.[8]

While expanding the regulatory burden upon municipal issuers which it does not directly regulate and continuing to ignore municipal market requests for simplification,[9] the Commission was easing the regulatory burden upon those it does regulate, corporate registrants. Nearly simultaneous with approval of the Amendments, the Commission both approved rule amendments[10] and proposed other rule amendments[11] to simplify and lessen the disclosure burden for public corporate issuers[12] to reverse the drift away from registered offerings to private transactions.[13] In response to the Amendments, and as predicted by commenters on the

---

[6] Letter from Catherine McGuire to National Association of Bond Lawyers, Response to Question 2 (Sept. 19, 1995) ("NABL II").

[7] *See, e.g.* Rule 15c2-12(b)(5)(i)(C)(*12*) Bankruptcy, insolvency, receivership or similar event of the obligated person; NOTE TO PARAGRAPH (b)(5)(i)(C)(*12*): For the purposes of the event identified in paragraph (b)(5)(i)(C)(12) of this section, the event is considered to occur when any of the following occur: The appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

[8] In the Matter of *City of San Diego, California*, Sec. Act Rel. No. 8751 (Nov. 14, 2006).

[9] *See, e.g.* SIFMA Rule 15c2-12 Whitepaper (April 2016), available at: https://www.sifma.org/resources/submissions/rule-15c2-12-and-potential-updates-to-the-rule/.

[10] Disclosure Update and Simplification, Release No. 33-10532 (Aug. 17, 2018).

[11] Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities, Release No. 33-10526 (Jul. 24, 2018).

[12] *See* SEC Press Release, *SEC Proposes Rules to Simplify and Streamline Disclosures in Certain Registered Debt Offerings* (Jul. 24, 2018), announcing Release No. 33-10562, n. 7, *supra.*

[13] "Over the last year, the SEC has taken meaningful steps to reduce regulatory burdens on pre-IPO and smaller public companies, while maintaining and, in some cases, enhancing, investor protections. The importance of this focus is highlighted by the significant decline in public companies over the last two decades, particularly amongst emerging companies." Chairman Jay Clayton, *Remarks on Capital Formation at the Nashville 36/86 Entrepreneurship Festival* (Aug. 29, 2018).

proposed amendments,[14] some municipal issuers and obligated persons may elect to follow the path trod by their corporate counterparts to private markets through offerings exempt under the Rule or means of financing not involving securities. Municipal issuers contemplating non-exempt offerings on or after the Compliance Date would be prudent to begin preparations to comply with the Rule as soon as possible.

Amendments

The Amendments amend Rule 15c2-12(f), the definition section, by adding Paragraph 15c2-12(f)(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 (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 Municipal Securities Rulemaking Board consistent with this rule.

The Amendments amend Rule 15c2-12(b)(5)(i)(C) to add the following events:

(*15*) 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; and

(*16*) 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; and

While removing "and" from Rule paragraph (b)(5)(i)(C)(*14*), the Amendments do not change the opening of Rule paragraph (b)(5)(i)(C), which continues to read "In a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the following events with respect to the securities being offered in the Offering," nor does the Adopting Release discuss the interaction of the limiting phrase "with respect to the securities being offered in the Offering" with the two new events.

The two events are adopted as proposed. What has narrowed the scope of the events has occurred in the adopted definition of *financial obligation*, now reduced to three categories from five. Gone from the definition is "monetary obligation resulting from a judicial, administrative, or arbitration proceeding." "Lease" would appear to be gone as well, but that would be an inaccurate conclusion. Although removed from the proposed definition of financial obligation and no longer in the plain words of the Rule, to the extent leases would "operate as vehicles to borrow money," they are included as "debt obligations." "Debt obligation" is not defined in the text of the Rule, but in the guidance provided in the Adopting Release. As the Adopting Release explains, "the Commission believes that it is appropriate to (i) remove the term 'lease' from the definition of the term 'financial obligation;' and (ii) provide guidance that the term 'debt obligation' generally should be considered to include lease arrangements entered into by issuers and obligated persons that operate as vehicles to borrow

[14] *See, e.g.*, Letter from Leslie M. Norwood, Managing Director and Associate General Counsel, Securities Industry Financial Markets Association, to Brent J. Fields, Secretary, Commission, dated May 15, 2017, at p. 2; Letter from Clifford M. Gerber, President, National Association of Bond Lawyers, to Brent J. Fields, Secretary, Commission, dated May 15, 2017, at p. 23.

money."[15] The broad term "derivative instrument" is narrowed in the adopted definition by addition of the words of limitation "entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation." Similarly the broad term "guarantee" is narrowed by the addition of the limiting words "of (f)(11)(i)(A) or (B)," presumably meaning a "guarantee of a financial obligation as described in paragraphs (f)(11)(i)(A) or (B)."

Guidance

The guidance provided in the Adopting Release is critical to understanding what the SEC considers "financial obligation," "material," "debt obligation," "derivative instrument," "guarantee," "default," "modification of terms" and "other similar events" to mean, in order to understand what issuers and obligated persons are expected to undertake to disclose and then to disclose, and what underwriters are expected to due diligence in order to form a reasonable belief in statements regarding the CDA and CDA compliance in offering documents of issuers and obligated persons.

Event (15)

Materiality. "Material" is used twice in event (15) but is not used in event (16) or in the definition of financial obligation. As to commenters' concerns about use of materiality as a standard, the Adopting Release states "the Commission continues to believe that materiality determinations should be based on whether the information would be important to the total mix of information made available to the reasonable investor."[16] Under the heading "Guidance,"[17] this phrasing from *TSC Industries, Inc. v. Northway, Inc.*,[18] which may be referred to as "disclosure or *Northway* materiality," is distinguished by the Commission from what may be called "MCDC materiality." *Northway* materiality is the Commission's response to a commenter's concern as to how to determine the materiality of a "financial obligation" and "covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation."[19]

As to MCDC materiality, "[t]he Commission believes that the type of analysis undertaken in connection with the MCDC Initiative is distinct from the analysis required to determine whether a piece of information is material and must be publicly disclosed to investors in offering materials."[20] "The inquiry undertaken in connection with the MCDC Initiative required an assessment of whether the issuer or obligated person materially fulfilled its contractual obligations under its continuing disclosure agreement, which required a consideration of applicable state law and basic principles of contract law."[21] In a footnote, the Commission states "[t]he principles behind this [*Northway*] inquiry are consistent each time the question of whether a piece of information is material is presented, but the factors considered by issuers and obligated persons while undertaking such an inquiry are not uniform because it is a facts and circumstances driven analysis. This inquiry is distinct from the inquiry issuers, obligated persons, and underwriters conducted as part of the MCDC Initiative, which required an assessment of the issuer's or obligated person's performance of its contractual continuing disclosure obligations."[22]

---

[15] 83 FR 44711.
[16] Id, 44705-44706, adding in 67, *See Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others,* Exchange Act Release No. 34–33741 (Mar. 9, 1994), 59 FR 12748 (Mar. 17, 1994) (''1994 Interpretive Release'').
[17] Id, 44706.
[18] 426 U.S. 438, 440 (1976).
[19] Id, n. 54.
[20] Id.
[21] Id, n.74.
[22] Id, n. 75.

After providing guidance purporting to clear up the MCDC confusion, the Commission affirms the Amendments are measured by *Northway* materiality: "Accordingly, under the Rule, as amended, 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."[23] The Commission acknowledges that when considering disclosure about financial obligations, opinions may differ as to what is material, but it "does not believe it is necessary to provide further guidance at this time."

As to the burdens of time and expense of the Amendments, "The Commission acknowledges that there will be costs incurred by issuers, obligated persons, and dealers when evaluating whether a financial obligation is material."[24] The Commission believes its narrower definition of financial obligation reduces the types of transactions to assess for materiality and, by planning ahead and beginning assessment in advance of incurrence, meeting the 10 business day notice requirement should not be a problem. Amended disclosure policies and procedures may ease the burden of summarizing the terms of material financial obligations and "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."[25]

As to materiality assessment in a series of related financial obligations, "Materiality is determined upon the incurrence of each distinct financial obligation, taking into account all relevant facts and circumstances." However, related transactions incurred closely in time might have to be evaluated for materiality in the aggregate,, unless separated for legitimate business reasons. "Relevant factors that could indicate that a series of financial obligations incurred close in time are related include the following: (i) Share an authorizing document, (ii), have the same purpose, or (iii) have the same source of security." Among possible legitimate business reasons to separate is to avoid an integration as one "issue" for tax purposes.[26]

Incurrence of a Financial Obligation. "The Commission believes that a financial obligation generally should be considered to be incurred when it is enforceable against an issuer or obligated person."[27]

Form of Event Notice. While acknowledging that "market participants are best suited to consider developing best practices … to assist issuers and obligated persons and their advisors in carrying out the objective of the amendments," the Commission repeats its proposing release description of the material terms of a financial obligation to be included in an event (15) notice:

> Examples of some material terms may be the date of incurrence, principal amount, maturity and amortization, interest rate, if fixed, or method of computation, if variable (and any default rates); other terms may be appropriate as well, depending on the circumstances. A description of the material terms would help further the availability of information in a timely manner to assist investors in making more informed investment decisions. The Commission believes that, depending on the facts and circumstances, it could be consistent with the requirements of the Rule for issuers and obligated persons to either submit a description of the material terms of the financial obligation, or alternatively, or in addition, submit related materials, such as transaction documents, term sheets prepared in connection with the financial obligation, or continuing covenant agreements or financial covenant

[23] 83 FR 44706.
[24] Id, 44707.
[25] Id.
[26] Id, text and n. 85.
[27] Id, 44708. In n. 89, the Adopting Release adds: This is consistent with similar concepts in Exchange Act Form 8–K. Specifically, the instructions for Item 2.03 of Form 8–K provide that ''[a] registrant has no obligation to disclose information under this Item 2.03 until the registrant enters into an agreement enforceable against the registrant, whether or not subject to conditions, under which the direct financial obligation will arise or be created or issued.'' *See* 17 CFR 249.308

reports to EMMA. Any such related materials, if submitted as an alternative to a description of the material terms of the financial obligation, should include the material terms of the financial obligation.[28]

Financial Obligation

As discussed above, the surgery performed upon the proposed amendments to produce the Amendments was applied to the definition of "financial obligation."

Debt Obligation. The term "debt obligation" has increased importance in the Amendments' definition of "financial obligation." The guidance provided by the Adopting Release clarifies what is and is not a "debt obligation" under the Rule. While the term "lease" has been dropped from "financial obligation," leases operating as vehicles to borrow money are back in as "debt obligations." The guidance also clarifies that temporal consideration is not part of the analysis. "As adopted, the term 'debt obligation' includes short-term and long-term debt obligations of an issuer or obligated person under the terms of an indenture, loan agreement, lease, or similar contract."[29] Of course, the term of a debt obligation could affect whether it is material.

Derivative Instrument. The formerly broad-reaching term "derivative instrument" is limited to those "entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation." The Commission explains: "The term … is not limited to derivative instruments incurred by issuers or obligated persons solely to hedge the interest rate of a debt obligation or to hedge the value of a debt obligation to be incurred in the future. Instead, the term covers any type of derivative instrument that could be entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation. … This includes, under certain circumstances, instruments that are related to an existing or planned debt obligation of a third party."[30]

The Adopting Release explains that "a debt obligation is 'planned' at the time the issuer or obligated person incurs the related derivative instrument if, based on the facts and circumstances, a reasonable person would view it likely or probable that the issuer or obligated person will incur the related yet-to-be-incurred debt obligation at a future date. In the Commission's view, it would be likely or probable … if, for example, the relevant derivative instrument would serve no economic purpose without the future debt obligation (regardless of whether the future debt obligation is ultimately incurred)."[31]

Like the elimination of "leases" from the definition of "financial obligation," the limitation of derivatives to those connected with or pledged to debt obligations may not have accomplished as much as is apparent on first blush. Fuel hedges and similar derivatives may be picked up, if part of the revenue pledge securing revenue bonds, unless excluded by the guidance relating to ordinary course obligations, discussed below.

Guarantee. As with "derivative instrument," the former, broadly reaching term "guarantee" has likewise been limited to guarantees of financial obligations that are either "debt obligations" or "a derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation." The Adopting Release makes clear that the scope of the term "guarantee" includes "any guarantee provided by an issuer or obligated person (as a guarantor) for the benefit of itself or a third party, which guarantees payment of a financial obligation."[32] Such a guarantee "could raise two disclosure issues under the

[28] Id, 44708.
[29] Id, 44712.
[30] Id, 44713.
[31] Id.
[32] Id, 44714.

Rule – one for the guarantor and one for the beneficiary of the guarantee."[33] In such an instance, "the Commission believes that, generally, such beneficiary issuer or obligated person should assess whether such guarantee is a material term of the underlying debt obligation or derivative instrument and, if so (and if the underlying debt obligation or derivative instrument is material), disclose the existence of such guarantee under the Rule."[34]

Ordinary Course Obligations. As explained in the Adopting Release, "the definition of 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, only an issuer's or obligated person's debt, debt-like, and debt related obligations."[35]

Any of Which Affect Securities Holders. The Adopting Release does not discuss or otherwise provide guidance as to the meaning of "any of which affect securities holders."

Event (16)

As noted previously, no materiality qualifier exists in event 16. The limiting factor for defaults and other listed events is whether or not they reflect financial difficulties. The Commission rejects narrowing "default" to "event of default" as it "believes that there are defaults that may reflect financial difficulties even if they do not qualify as 'events of default' under transaction documents."[36] The Commission also rejected suggestions to provide additional guidance or narrow the term, stating it "believes that the term is not vague, as the concept of 'reflecting financial difficulties' has been used in paragraphs (b)(5)(i)(C)(3) [unscheduled draws on debt service reserves reflecting financial difficulties] and (4) [unscheduled draws on credit enhancements reflecting financial difficulties] since the 1994 amendments to Rule 15c2-12, and, as such, market participants should be familiar with the concept as it relates to the operation of Rule 15c2-12. Furthermore, the Commission also believes that additional guidance on the term would be difficult to provide, due to the diversity of issuers and obligated persons as well as the financial conditions affecting them."[37]

Observations

Efficacy of the Amendments. This last sentence underscores a theme that runs throughout the Amendments: while some circumstances requiring filing of an event notice may be obvious, many will require the considered judgment of issuer or obligated person officials who are sufficiently familiar with the details of their financial obligations and materiality standards to identify the need to file, and do so with a proper notice, within 10 business days. Use of outside advisors or counsel may be required, particularly by those with minimal staff or familiarity with what is important to investors. Unlike in public offerings, they will not have the advice of experienced underwriters and their counsel. This task is complicated by the apparent simplicity of the events as presented within the CDAs with which they will seek to abide.

In the world of corporate public offerings, the answers to such questions are found in SEC regulations, such as Form 8-K and Regulation S-K, easily found in the Code of Federal Regulations. For purposes of the Amendments, the answers are found in guidance provided in the Adopting Release, of which the officials may or may not be aware and which may or may not be found in the CFR, but even then only to the extent that Rule guidance is

[33] Id.
[34] Id.
[35] Id, 44709.
[36] Id, 44715.
[37] Id. 44716.

relevant to the meaning of their CDAs.[38] Readers of a CDA incorporating the event notices as stated in the Rule would have no way of knowing the need to access interpretive materials unless they have disclosure policies and procedures providing the connection. For example, officials of a school district signing a CDA and in good faith seeking to comply with the undertaking might have no idea what they or their predecessors agreed to disclose after closing, such as certain lease financings entered to borrow money and a technical default under one such lease, until several years later when they go to market with a new borrowing, and an underwriter conducting due diligence tells them they failed to make required filings, unless they had controls and procedures in place and hired counsel or a municipal advisor to help them assess whether they need to disclose new financial obligations or related events as they arise.

Nothing in the Rule requires a CDA to state that terms used in the CDA shall have the meaning provided in the Adopting Release or future Commission guidance. As the Adopting Release reminds us when discussing materiality, obligations under a CDA require "a consideration of applicable state law and basic principles of contract law."[39] Under state contract law, the intent of a CDA obligor to enable its underwriter to comply with the Rule might be relevant to the meaning of CDA terms only if they are ambiguous, and a breach of a CDA might be "material" only if so substantial that it would excuse performance by the other party to the contract. While the SEC might argue that the Rule regulates broker-dealer conduct and as such underwriters should follow the guidance in the Adopting Release in due diligence review, such activity is after the fact and perhaps moot if there is no material breach as a matter of state law. Without express incorporation into the CDA, the guidance may not be enforceable as part of the CDA, with any assertion of failure to comply in a disclosure context open to dispute as a matter of state contract law and in an enforcement context of dubious merit. Importantly, it should be noted that some guidance in the Adopting Release narrows the Amendments, and some expands them, compared to the common usage of the express terms of the Amendments.

Should municipal market participants choose to agree that, as a matter of best practice, model CDAs will incorporate by reference guidance in the Adopting Release, this problem might be avoided, at least with regard to CDAs following the best practice. There is much to do for industry groups with regard to best practices. Perhaps a "NABL III" letter with the Office of Municipal Securities as well. Let's see where we are six months from now.

Through the Amendments the Commission continues to impose indirectly what it lacks authority to do directly: in this instance, to require, as a practical matter, an issuer to implement disclosure controls and procedures monitoring and assessing its financial obligations first on intake (and, if necessary, prepare and file the required extensive descriptive disclosure) and ongoing monitoring thereafter for default (in the case of default, for financial obligations in existence at the time of the first entry into a CDA on or after the effective date), assess their respective materiality, and report the same to the MSRB within ten business days of occurrence. The SEC expects issuers and obligated persons to plan in advance for the implementation of the amendments. The incentive to implement enhanced disclosure procedures, together with the attendant cost in applying them, might create a counterincentive to avoid the new requirements of the Rule by financing only through bond

[38] For example, "Modifying and confirming the interpretation of municipal underwriter securities responsibilities" 54 FR 5603 (June 28, 1989) and "Amendment to Municipal Securities Disclosure" 75 FR 62973 (May 26, 2010) are found in 17 CFR. 241—Interpretative Releases Relating to the Securities Exchange Act of 1934 and General Rules and Regulations Thereunder, because the rulemakings expressly provide, as in the case of 75 FR 6293 by stating "Part 241 is amended by adding Release No. 34–62184A and the release date of May 26, 2010, to the list of interpretative releases." Nothing in the Adopting Release provides for amendment of Part 241 to include the guidance provided in the CFR. Similarly, Release No. 34-34961, Municipal Securities Disclosure, 59 FR 59590 (Nov. 17, 1994), the amendments originally providing for continuing disclosure, is not in 17 CFR 241. The consequences of exclusion or inclusion of guidance is beyond the scope of this article.

[39] Id at 44706, n.74.

transactions exempt from Rule 15c2-12 or loans or other transactions that do not involve securities, mirroring behavior in the corporate market. The markets will respond as markets always do, through their behavior.

Materiality. Throughout the 1994 amendments to the Rule, when discussing interpretation or application of continuing disclosure undertakings, the Commission referenced state contract law. For example:

> Though a failure to comply with the undertaking would be a breach of contract, the rule does not specify the consequences of an issuer's breach of its undertakings to provide secondary market disclosure. As called for by the Joint Response, as well as other commenters, remedies for breach of any undertaking under applicable state law are a subject for negotiation between the parties to the Offering. To avoid uncertainties of enforcement, the parties to a transaction are encouraged to enumerate the consequences in the undertaking, including the available remedies, for breach of the information undertaking.[40]

So, under MCDC materiality, an issuer or obligated person would assess the materiality of CDA noncompliance under state contract law, but any resulting disclosure required in the offering document would be measured under *Northway* materiality. That's at least what the Commission seems to be saying and was my understanding as an SEC staff member when working on the 1994 Amendments, but it is hard to discern in the text of the MCDC settlements.

The MCDC initiative involved self-reporting of potential violations by issuers, obligated persons and underwriters who, if selected and wished to take advantage of the terms offered, would then submit an offer to settle, which the staff then recommended the Commission accept. With respect to issuers and obligated persons, the resulting cease and desist orders summarized the Commission's findings regarding an issuer's misstatements and omissions in an official statement about compliance with continuing disclosure agreements and consequent violations of law, to which the issuer consented without admitting or denying the findings. None of the MCDC orders reference the dichotomy between MCDC materiality and Disclosure materiality. Given the nature of the settlement process it is impossible to discern whether the process involved consideration of whether the allegedly undisclosed instances of material non-compliance with an undertaking were in the first instance a material breach of the undertaking under state contract law.

It is unfortunate that this dichotomy was not drawn before now, since as stated, it echoes the prior statements of the Commission without in any way intruding upon "Northway" or statutory materiality and could have as easily been stated prior to the filing deadlines when most of the municipal market was requesting just such guidance. As to whether this will quell the concerns of underwriters in assessing future non-compliance and issuers and obligated persons preparing statements regarding compliance in future offering documents, I suspect prudence will prevail and disclosure of non-compliance will continue to be influenced by the detailed findings of the MCDC settlements.

A Quarter Century (almost) of Continuing Disclosure. Twenty five years ago, the then recently sworn-in SEC Chairman sent a report to Congressman John Dingell, then Chairman of the House Committee of Energy and Commerce. The September 1993 Staff Report on the Municipal Securities Market had been prepared by the Division of Market Regulation at Chairman Dingell's request. The Staff Report noted that in "the Staff's view, comprehensive improvement of the existing system [of municipal issuer disclosure] would require Congressional action"[41] and discussed several options. The Staff report concluded with:

---

[40] Municipal Securities Disclosure, 59 FR 59590, 59602 (Nov. 17, 1994).

[41] Staff Report on the Municipal Securities Market, Division of Market Regulation U.S. Securities and Exchange Commission, p. 39 (Sept. 1993).

> If Congress chooses not to provide the Commission with full authority to address the adequacy and consistency of disclosure in this market, the Staff believes that the Commission could explore ways to improve initial and secondary market disclosure under its existing authority. Specifically, the Staff will prepare a memorandum and draft release recommending that the Commission use its interpretive authority to provide guidance regarding the disclosures required by the antifraud provisions of the federal securities laws. Similarly, the Staff will recommend amending Rule 15c2-12, or adopting similar rules, to prohibit municipal securities dealers from recommending outstanding municipal securities unless the municipal issuer makes available ongoing information regarding the financial condition of the issuer of the type required in initial offerings. Given these alternatives for increased disclosure, the Staff does not believe that the legislative grant of additional authority to the MSRB, which would enable the Board to establish offering document standards for municipal issuers, is necessary.
>
> The Staff strongly believes, however, that any Commission action in this area could not fully address the lack of complete disclosure in the municipal securities market. As noted above, comprehensive improvements to the existing system would require legislation.[42]

Shortly after the release of the Staff Report, in anticipation of the described Staff recommendations, representatives of municipal market participants coordinated dialogue with the Staff prior to the March 1993 proposed amendments to the Rule and subsequently filed comments on the proposed amendments referenced in the 1994 Adopting Release as the "Joint Response."[43] The dialogue among the market representatives, who were at the time referred to colloquially as "the gang of 10," produced general agreement among market participants on acceptance of the scope of continuing disclosure under the Rule as the "footprint." That is, the disclosure required under a CDA would not exceed the footprint of the offering document. "Thus, the information required to be provided annually was the 'financial and operating data' included by the issuer in the official statement for the primary offering."[44] Event notices were qualified by the addition of the phrase "with respect to the securities being offered" to the text in the proposing release.[45]

Several commenters called the attention of the Commission to the bargain struck with the municipal market in 1994—limiting disclosure to the "footprint" of the official statement--and the failure of the proposing release to acknowledge the significant change to existing regulation that would result from adoption of the proposals,[46] as in effect a *sub silentio* change to Commission policy in effect for nearly a quarter century of a type subject to challenge under the Administrative Procedure Act.[47] The Commission ignored the comments. The Amendments may be vulnerable to challenge under the APA or other grounds, perhaps in some future enforcement action against a respondent with a pocket book and a reason not to settle.

Perhaps the Commission is pushing its authority as far as it can before turning to, and in support of, a legislative solution as described in its 2012 Report on the Municipal Securities Market:

---

[42] Id, at 40.
[43] 59 FR 59590, 59591, n. 17 (Nov. 17, 1994).
[44] *See* NABL Letter p. 18, *supra* n. 15.
[45] *See* SIFMA Letter p. 8, *supra* n. 15.
[46] NABL Letter, SIFMA Letter, Tracy Ginsburg, Executive Director, Texas Association of School Business Officials (May 9, 2017), Kevin M. Burke, President and CEO, Airports Council International, North America (May 15, 2017).
[47] *See, e.g., FCC v. Fox Television Stations, Inc*., 556 U.S. 502, 514-515 (2009) ("To be sure, the requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it is changing position.").

> [t]o provide a mechanism to enforce compliance with continuing disclosure agreements and other obligations of municipal issuers to protect municipal securities bondholders, authorize the Commission to require trustees or other entities to enforce the terms of continuing disclosure agreements.[48]

Perhaps not. A good many people thought the Commission had reached that point in November 1994.

[48] U.S. Securities and Exchange Commission, *Report on the Municipal Securities Market* (July 31, 2012).