

# Client Alert

March 2019

## New Event Notices for Municipal Bond Disclosure

February 27, 2019 is the compliance date for newly adopted Securities and Exchange Commission (the "SEC") amendments to Rule 15c2-12, adding two new event notices. The event notices are aimed at prompting timely, continuing disclosures by issuers and other obligated persons of direct purchases, direct loans or bank placements and other private placements. Along with the new event notices, the amendments define "financial obligation" to capture debt obligations of issuers that are not municipal securities for which a final official statement has been provided to the Municipal Security Rulemaking Board's electronic portal, the Electronic Municipal Market Access ("EMMA") system.

**The amendments may affect you if your organization DOES the following:**

- Places Bonds directly with Banks (i.e., direct purchases) without an Official Statement;
- Enters into Lease-Purchase Financings directly with Equipment Vendors;
- Enters into interest rate management agreements (swaps, interest rate loans, etc.); or
- Enters into Intergovernmental Agreements or Interlocal Agreements in respect of, directly or indirectly, debt obligations.

Specifically, the amendments require issuers or other obligated persons to provide event notices to EMMA reporting the:

- 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; 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.

The amendments define "financial obligation" to include (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) a guarantee of (i) or (ii). The definition of "financial obligation" does not include municipal securities for which a final official statement has been provided on EMMA.

### Which "financial obligations"?

The amendments only affect continuing disclosure undertakings entered into on or after the compliance date of the amendments, as specified below. Issuers and obligated persons with a continuing disclosure undertaking entered into on or after the compliance date must file event notices for material "financial obligations" incurred on or after the date such continuing disclosure undertaking is entered into. However, the SEC has made clear that 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 or after the compliance date of the amendments.

## Background

In its 2012 Report on the Municipal Securities Market, the SEC expressed concern that issuers and obligated persons were not properly disclosing the existence or the terms of bank loans, particularly when the terms of the bank loans may affect the payment priority from revenues in a way that adversely affects bondholders. In the 2012 Report, the SEC indicated that it was considering amending Rule 15c2-12 to mandate disclosures of new indebtedness not otherwise reported under the Rule. In SEC Release No. 34-80130 (the "Proposing Release"), the SEC noted that, since 2009, issuers and obligated persons have increasingly used direct purchases of municipal securities and direct loans as alternatives to publicly offered municipal securities. The SEC cited its concern that existing bondholders, potential investors and other market participants (analysts, rating agencies) may not have any access or timely access to disclosure about direct placements or other financial obligations. The SEC's objective is ensuring transparency because investors and market participants may lack access or experience delay in access to disclosures about material financial obligations like direct loans or bank placements.

Below, we provide a more detailed description of the new event notices and examine the definition of "financial obligation."

## New Event Notice — Incurrence of Financial Obligation or Agreements — "If Material"

A materiality determination must be made by the reporting entity in deciding whether a financial obligation requires an event notice. Similarly, a materiality determination must be made to each of the agreed upon terms — agreement to covenants, events of default, remedies, priority rights or other similar terms — in evaluating whether the agreement requires an event notice. The SEC offers very little guidance as to what constitutes "materiality." Consequently, issuers and obligated persons will need to consult with legal counsel and advisers regarding new financial obligations and whether such obligations are important to current bondholders and potential investors. Similarly, issuers will need to evaluate the materiality of covenants, events of default, remedies, priority rights or other similar terms that they may typically agree to in a bank loan or direct placement to decide if such agreements should be disclosed on EMMA. The SEC offers some examples of what constitutes "material" and triggers event notice: agreeing to covenants that are more restrictive than outstanding bond covenants; agreeing to events of default in a bank loan that differ from those in an issuer's municipal securities; agreeing to acceleration provisions that may create a priority over existing bondholders; entering into a direct placement with a balloon payment at maturity creating refinancing risk that could affect an issuer's creditworthiness.

The amendments require that an event notice of the incurrence of a financial obligation or an agreement to the listed events above should include a description of the material terms of the financial obligation or agreement. The SEC provides the following examples of material terms: date of incurrence, principal amount, maturity and amortization, interest rate, if fixed, or method of computation, if variable (and any default rates), and other terms, depending on the circumstances. Depending on the facts and circumstances, this requirement may be satisfied by submitting a summary of the material terms, a term sheet or other applicable transaction documents such as a continuing covenant agreement.

## Definition of "Financial Obligation"

The SEC's definition of "financial obligation," while excluding municipal securities for which final official statements are posted on EMMA under Rule 15c2-12, is broad in its coverage.

- *Debt Obligation* is intended to capture short-term and long-term debt obligations under the terms of an indenture, loan agreement, lease or similar contract, such as a direct purchase or a direct loan by a bank. This includes leases entered into as a vehicle to borrow money.

- *Derivative Instrument Entered into in Connection with, or Pledged as Security or a Source of Payment for, an Existing or Planned Debt Obligation* captures any swap, security-based swap, futures contract, forward contract, option, any combination of these instruments or any similar instrument to which an issuer or obligated person is a counterparty, provided that such instrument(s) is related to an existing or planned debt obligation. This includes instruments that are related to an existing or planned debt obligation of a third party if such instruments are designed to hedge against the risks of a related debt obligation.

Issuers should consult with their counsel regarding developing, or amending, municipal securities disclosure policies and procedures to provide how an issuer may determine which of its obligations may constitute a “financial obligation” under the Rule amendments.

### **New Event Notice for Events “Reflecting Financial Difficulties” Under “Financial Obligation”**

Current Rule 15c2-12 already contains two event notices “reflecting financial difficulties”: unscheduled draws on debt service reserve funds and unscheduled draws on credit enhancements. However, the SEC points out that investors and market participants may lack access to information regarding defaults, acceleration, termination, modification of terms or other similar events under the terms of a financial obligation (i.e., other than a municipal security) that reflect financial difficulties.

- **Default** includes monetary defaults, such as a failure to pay debt service, and non-payment defaults, such as a failure to comply with specified covenants.
- **Event of acceleration** in tandem with a default if reflecting financial difficulties could impact an issuer's liquidity and creditworthiness.
- **Termination event** could include a termination fee payable by the issuer or obligated person under a swap agreement.
- **Modification of terms** includes modifications that reflect financial difficulties of the issuer or obligated person, including negotiation of covenant changes that may provide priority rights with respect to existing bondholders. This event is intended to be broad and includes a written or verbal waiver of a deal provision.
- **Other similar events** includes events arising under the terms of a financial obligation that reflect financial difficulties of the issuer or obligated person. These events, although not specifically set forth elsewhere in the Rule, are still relevant to investors and other market participants in making an assessment of the current financial condition of the issuer or obligated person.

Such event notices should include a description of the event and the consequences of the event, if any.

### **Compliance Date**

The compliance date for the new amendments is February 27, 2019. Issuers and obligated persons should expect heightened due diligence by underwriters, municipal advisers, analysts and rating agencies regarding the disclosure of bank loans, direct placements and other financial obligations described above.

Hunton Andrews Kurth LLP is prepared to respond to any questions you may have regarding compliance with continuing disclosure requirements and municipal securities generally.

## Contacts

### Atlanta

Douglass P. Selby  
dselby@HuntonAK.com  
(404) 888-4207

Caryl Greenberg Smith  
carylsmith@HuntonAK.com  
(404) 888-4025

### Charlotte

William H. McBride  
wmcbride@HuntonAK.com  
(704) 378-4745

### Houston

Thomas A. Sage  
tomsage@HuntonAK.com  
(713) 220-3833

Mark B. Arnold  
markarnold@HuntonAK.com  
(713) 220-3938

Clayton T. Holland  
clayholland@HuntonAK.com  
(713) 220-3868

### New York

Steven C. Friend  
sfriend@HuntonAK.com  
(212) 309-1065

### Richmond

John D. O'Neill, Jr.  
joneill@HuntonAK.com  
(804) 788-8406

Christopher G. Kulp  
ckulp@HuntonAK.com  
(804) 788-8742

### Washington, DC

Andrew R. Kintzinger  
akintzinger@HuntonAK.com  
(202) 955-1837

© 2019 Hunton Andrews Kurth LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.