

## New Municipal Bond Continuing Disclosure Rules Adopted January 2019

On August 15, 2018, the U.S. Securities and Exchange Commission (“SEC”) adopted amendments to enhance Rule 15c2-12 (“Rule”) which, among other things, requires underwriters of municipal bonds to obtain from municipal bond issuers a written agreement to make ongoing disclosures concerning certain financial information and to report specific material events. The amendments apply to any new “primary offering” closing on or after February 27, 2019. The amendments are intended to provide additional transparency in the municipal bond market, specifically, to “facilitate investors’ and other market participants’ access to timely disclosure of important information related to [a municipal bond] issuer’s... material financial obligations that could impact an issuer’s...liquidity, overall creditworthiness, or an existing security holder’s rights....” SEC Amendments to Municipal Securities Disclosure, 17 CFR Part 240.15c2-12 (Release No. 34-83885; File No. S7-01-17) (<https://www.sec.gov/rules/final/2018/34-83885.pdf>) (“SEC Release”), p.37.

**The Amendments.** As the SEC can only regulate municipal bond issuers through the antifraud provisions of the Securities Exchange Act of 1934, the Rule prohibits municipal bond underwriters from purchasing or selling municipal securities unless the municipal bond issuer enters into what are known as “continuing disclosure agreements” or “continuing disclosure undertakings”. The Rule currently requires that municipal bond issuer provide ongoing disclosure to the Municipal Securities Rulemaking Board (“MSRB”) with respect to 14 different types of material events within 10 business days of the occurrence thereof, including but not limited to events affecting the financial status of the issuer, the obligor or the municipal bonds. The amendments adds two further disclosure obligations, also to be provided within the 10-business day timeframe, as follows:

- (a) Incurrence of a material financial obligation of the issuer or obligated person or agreement to covenants, events of defaults, 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
- (b) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the issuer or obligated person, any of which reflect financial difficulties. [emphasis added].

**Definition of “Financial Obligation” for Purposes of the Rule.** The Rule’s definition of the term “financial obligation” was revised by the amendments to mean: (a) a debt obligation (i.e. bonds); (b) a derivative instrument (i.e. interest rate swap) entered into in connection with, or pledged as security or a source of payment for and existing or planned debt obligation; or; (c) a guarantee of either (a) or (b). The SEC has characterized these financial obligations as a bond issuer’s “debt, debt-related and debt-like obligations”. SEC Release, p.37. Thus, the term “financial obligation” does not include ordinary financial and operating liabilities incurred in the normal course of a municipal issuer’s business, but is instead intended to focus on “the types of obligations that could

impact an issuer’s...liquidity, overall creditworthiness, or an existing security holder’s rights.” *Id.*, p. 38. While leases are generally not going to be considered “financial obligations” under the Rule, they could be regarded as such if they are debt or debt-like, such as with lease purchase agreements. Be further aware that municipal securities as to which a final official statement has been provided to the MSRB consistent with the Rule are not “financial obligations” for purposes of the Rule.

**Definition of “Materiality” for Purposes of and Exemptions from the Rule.** Although the term “materiality” was not defined in the Rule, the SEC Release, at pages 22-23, indicates that the term, consistent with past precedent, should be measured by, “whether the information would be important to the total mix of information made available to the reasonable investor”. Note further that the Rule provides certain exemptions from continuing disclosure undertakings, including but not limited to circumstances where the entire bond issue is less than \$1,000,000, if the bonds are sold in units of no less than \$100,000 and to no more than 35 “sophisticated investors”, and if the bonds are sold in \$100,000 minimum denominations and mature in nine months or less from the date of initial issuance. See 17 CFR Part 240.15c2-12(d).

**Summary of Implications.** For these reasons, for bonds issued on or after February 27, 2019, continuing disclosure agreements for any “primary issue” will include a requirement that disclosures be filed within 10 days of the incurrence of additional debt, if material, execution or extension of a lease purchase agreement, or in the event of any type of default on any financial obligation, defined as set forth in the Rule.

These new disclosure events will require municipal bond issuers to anticipate increases in administrative resources needed to ensure proper compliance with the Rule from the date of sale and throughout the time that the underlying obligation is outstanding. For example, prior to making a primary offering, issuers will need to identify existing debt, debt-related and debt-like obligations, i.e., “financial obligations”, and determine whether such are material. This determination will require a close review of all bonds issued and debt to be issued, and, as applicable, key terms and events in connection therewith will need to be identified and noted so that they can be timely reported to MSRB upon occurrence. Moreover, such an analysis will need to be conducted on an ongoing basis to ensure compliance with the municipal bond issuer’s reporting obligations.

According to the SEC, the amendments to the Rule are intended to reduce the likelihood of antifraud violations by ensuring the public and market participants have timely access to information about the financial status and wellbeing of a municipal bond issuer. Government issuers will want to consult with their bond counsel to ensure that their continuing disclosure agreements and related policies are updated appropriately.

If you have any questions concerning the recent amendments to Rule 15c2-12 or any other public finance related issues, please contact Attorney Matthew G. Feher ([mfeher@k-plaw.com](mailto:mfeher@k-plaw.com)) at 617.556.0007.

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