HAWKINS ADVISORY

RULE 15c2-12 AMENDMENTS

Introduction

On August 20, 2018, the Securities and Exchange Commission ("SEC" or "Commission") adopted amendments to Securities Exchange Act of 1934 Rule 15c2-12 (17 CFR § 240.15c2-12)[1] ("Rule 15c2-12" or the "Rule"). The amendments add two events that must be included in any continuing disclosure agreement[2] that is entered into after the compliance date (approximately six months from now; see "Compliance Date" below). The two additional events are the following:

Rule 15c2-12(b)(5)(i)(C)(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.

Rule 15c2-12(b)(5)(i)(C)(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.

The disclosures that would be required by the amendments are already being made. The amendments address *when* such disclosures must be made. In general, material financial information of the type described in new paragraphs (15) and (16) is included in official statements and/or audited financial statements. The SEC, however, wanted to have such disclosures made closer to the time of the incurrence or event, to provide greater transparency to the market. The Adopting Release notes:

> [I]nvestors and other market participants may not learn that the issuer or obligated person has incurred a financial obligation if the issuer or obligated person does not provide annual financial information or audited financial statements to EMMA or does not subsequently issue debt in a primary offering subject to Rule 15c2-12 that results in the provision of a final official statement to EMMA.

The impetus for the amendments was the increasing use of direct purchases of municipal securities and direct loans as alternatives to public offerings of municipal securities. Although market participants had encouraged over the years voluntary disclosure of such financial obligations, the SEC concluded that "despite these ongoing efforts, few issuers or obligated persons have made voluntary disclosures of financial obligations, including direct placements, to the MSRB [Municipal Securities Rulemaking Board]."

Analysis of Provisions

The two new provisions reference "financial obligation of the obligated person."[3] Note that, pursuant to existing paragraph (b)(5)(i), the party to the continuing disclosure agreement may be either the issuer or the obligated person (even if the issuer is not an obligated person).

The term "financial obligation" would be added by the amendments as new paragraph (f)(11), as follows:

> The term financial obligation means 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.

The amendments in proposed form had included "lease" as a distinct financial obligation. The SEC did not include "lease" in the definition as adopted on the rationale that item (11)(i), "debt obligation," would include those leases the SEC considered to be financial obligations:

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[1] SEC Rel. No. 34-83885 (Aug. 20, 2018) (the "Adopting Release").

[2] "Continuing disclosure agreement" references the "written agreement or contract" required by and set forth in detail in Rule 15c2-12(b)(5)(i).

[3] "Obligated person" is defined in Rule 15c2-12(f)(10) as follows:

> The term *obligated person* means any person, including an issuer of municipal securities, who is either generally or through an enterprise, fund, or account of such person committed by contract or other arrangement to support payment of all, or part of the obligations on the municipal securities to be sold in the Offering (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities).

> The Commission agrees with commenters that, as proposed, the term "lease" was too broad. Accordingly, the Commission believes that it is appropriate to limit the Rule's coverage of leases to those that operate as vehicles to borrow money. The Commission believes that this is appropriate because a lease entered into as a vehicle to borrow money could represent competing debt of the issuer or obligated person.
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> With respect to leases that do not operate as vehicles to borrow money . . . the Commission also believes that such lease arrangements do not warrant inclusion in the Commission's definition of "financial obligation" because they generally do not represent competing debt of the issuer or obligated person.

In addition, the amendments in proposed form had included as a "financial obligation" a "monetary obligation resulting from a judicial, administrative, or arbitration proceeding." The SEC determined to not include such monetary obligation on the reasoning that any such obligation is typically covered by reserve funding or insurance, and further that any initial judgment in such a proceeding may not reflect the ultimate disposition of the proceeding.

With respect to item (11)(i), "debt obligation," the SEC noted that whether an obligation was "debt" for state law purposes was not determinative:

> [I]n the context of Rule 15c2-12, the Commission is not limiting the term "debt obligation" to debt as it may be defined for state law purposes, but instead is applying it more broadly to circumstances under which an issuer or obligated person has borrowed money. . . The Commission believes that, for the purposes of Rule 15c2-12, a narrow interpretation of "debt" would be under-inclusive because issuers and obligated persons can, and often do, borrow money through a variety of transactions, many of which would not qualify as "debt" under relevant state laws.

In connection with the phrase "reflect financial difficulties" in paragraph (16), the SEC reasoned that such phrase does not need further clarification because the same phrasing is used in paragraphs 15c2-12(b)(5)(i)(C)(3) and (4), as in effect since 1995.

For purposes of a material event notice of an event described in paragraph (b)(5)(i)(C)(15), the SEC advised that such notice:

> [G]enerally should include a description of the material terms of the financial obligation. 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.

Compliance Date

The compliance date is 180 days after publication of the SEC Release in the Federal Register. The SEC notes that the amendments would apply to "continuing disclosure agreements that are entered into in connection with Offerings occurring on or after the compliance date of the amendments." The use of the term "Offerings" could create some ambiguity because, for purposes of Rule 15c2-12(b)(1), the SEC had tied such term to the use of a Preliminary Official Statement.[4] In the Adopting Release, the SEC provided the needed clarification: "For the purposes of these amendments, the Commission believes that an Offering generally should be considered to occur on the date the continuing disclosure agreement is executed." Such execution will generally occur on the settlement date. The SEC notes, however, that:

> [I]f a preliminary official statement is distributed before the compliance date, with an expectation that the Offering will occur on or after the compliance date, the preliminary official statement should generally attach a form of continuing disclosure agreement that reflects the adopted amendments.

The SEC also advised that "an event under the terms of a financial obligation pursuant to (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." Thus, for example, assuming a compliance date of February 25, 2019, and a continuing disclosure agreement executed after such date that incorporates new paragraph (16), notice of an event as described in such paragraph (e.g., default or termination event) must be posted on EMMA, even if the associated financial obligation was entered into prior to February 25, 2019.

[4] SEC No-Action Letter (Mudge Rose letter) dated April 4, 1990: "The term 'offer' traditionally has been defined broadly under the federal securities laws and, for purposes of Rule 15c2-12, would encompass the distribution of a Preliminary Official Statement by the underwriter."

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New York
7 World Trade Center
250 Greenwich Street
New York, NY 10007
Tel: (212) 820-9300

Washington, D.C.
601 Thirteenth Street, N.W.
Washington, D.C. 20005
Tel: (202) 682-1480

Newark
One Gateway Center
Newark, NJ 07102
Tel: (973) 642-8584

Hartford
20 Church Street
Hartford, CT 06103
Tel: (860) 275-6260

Ann Arbor
2723 South State Street
Ann Arbor, MI 48104
Tel: (734) 794-4835

Sacramento
1415 L Street
Sacramento, CA 95814
Tel: (916) 326-5200

Los Angeles
333 South Grand Avenue
Los Angeles, CA 90071
(213) 236-9050

San Francisco
One Embarcadero Center
San Francisco, CA 94111
Tel: (415) 486-4200

Portland
200 SW Market Street
Portland, OR 97201
Tel: (503) 402-1320

Hawkins
DELAFIELD & WOOD LLP