

## **SECURITIES AND EXCHANGE COMMISSION**

### **17 CFR Part 240**

**[Release No. 34-80130; File No. S7-01-17]**

**RIN 3235-AL97**

### **Proposed Amendments to Exchange Act Rule 15c2-12**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule amendments.

**SUMMARY:** The Securities and Exchange Commission (“Commission” or “SEC”) is publishing for comment proposed amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 (“Exchange Act”) that would amend the list of event notices that a broker, dealer, or municipal securities dealer (collectively, “dealers”) acting as an underwriter in a primary offering of municipal securities must reasonably determine that an issuer or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the municipal securities, to provide to the Municipal Securities Rulemaking Board (“MSRB”). Specifically, the proposed amendments would amend the list of events for which notice is to be provided to include (i) 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 (ii) 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 (collectively, the “proposed events”).

**DATES:** Comments should be received on or before [insert date 60 days after date of publication in the Federal Register].

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. S7-01-17 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-01-17. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion -

in the comment file of any such materials will be made available on the Commission’s website. To ensure direct electronic receipt of such notifications, sign up through the “Stay Connected” option at [www.sec.gov](http://www.sec.gov) to receive notifications by e-mail.

**FOR FURTHER INFORMATION CONTACT:** Jessica Kane, Director; Rebecca Olsen, Deputy Director; Edward Fierro, Senior Counsel to the Director; Mary Simpkins, Senior Special Counsel; Hillary Phelps, Senior Counsel; or William Miller, Attorney-Adviser; Office of Municipal Securities, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628 or at (202) 551-5680.

**SUPPLEMENTARY INFORMATION:** The Commission is requesting public comment on the proposed amendments to Rule 15c2-12<sup>1</sup> under the Securities Exchange Act of 1934.<sup>2</sup>

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<sup>1</sup> 17 CFR 240.15c2-12.

<sup>2</sup> The Commission is not proposing any other changes to Rule 15c2-12, nor is the Commission otherwise reopening Rule 15c2-12 for comment.

Obligation of the Obligated Person, Any of Which Reflect  
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**I. Introduction**

The Commission is publishing for comment proposed amendments to Exchange Act Rule 15c2-12 (“Rule” or “Rule 15c2-12”).<sup>3</sup> The proposed amendments would amend the list of events for which notice is to be provided to the MSRB to include the proposed events. The Commission believes the proposed amendments would facilitate investors’ and other market participants’ access to important information in a timely manner and help to enhance transparency in the municipal securities market and improve investor protection.

Under Rule 15c2-12, a dealer that acts as an underwriter (a “Participating Underwriter” when used in connection with an Offering) in a primary offering of municipal securities with an aggregate principal amount of \$1,000,000 or more (an “Offering”) is prohibited from purchasing or selling municipal securities in connection with an Offering unless the Participating Underwriter has reasonably determined, among other things, that an issuer of municipal

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<sup>3</sup> See 17 CFR 240.15c2-12(a), (b)(5)(i), (b)(5)(i)(C).

securities, or an obligated person<sup>4</sup> for whom financial or operating data is presented in the final official statement<sup>5</sup> has undertaken in a written agreement or contract for the benefit of holders of such securities to provide to the MSRB in a timely manner not in excess of ten business days after the occurrence of the event, notice of certain events listed in Rule 15c2-12. Participating Underwriters comply with this provision of Rule 15c2-12 by requiring that an issuer of municipal securities or an obligated person undertakes in a written agreement or contract (“continuing disclosure agreement”) to provide event notices to the MSRB in a manner that is consistent with the requirements of Rule 15c2-12.

Additionally, under Rule 15c2-12,<sup>6</sup> it is unlawful for any dealer to recommend the purchase or sale of a municipal security unless such dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of event notices. Dealers typically

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<sup>4</sup> 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). See 17 CFR 240.15c2-12(f)(10).

<sup>5</sup> An “official statement” is a document or set of documents prepared by an issuer of municipal securities or an obligated person, or its representatives, in connection with a primary offering of municipal securities that discloses material information about the offering of such securities. Official statements include information concerning the terms of the proposed securities, financial information or operating data concerning such issuers of municipal securities and those entities, funds, accounts, and other persons material to an evaluation of the Offering, a description of the undertakings to be provided pursuant to the Rule, and if applicable, any instances in the previous five years of any failures to comply, in all material respects, with any previous undertakings. A version of the official statement referred to as the “preliminary official statement” is prepared by or for an issuer of municipal securities or obligated person for dissemination to potential customers prior to the availability of the “final official statement”. Rule 15c2-12 specifically defines the terms “preliminary official statement” and “final official statement” for purposes of Rule 15c2-12. See 17 CFR 240.15c2-12(f)(3) and (6).

<sup>6</sup> See 17 CFR 240.15c2-12(c).

comply with this provision by ensuring that they have procedures in place that, among other things, require their registered representatives who recommend municipal securities transactions to customers in the secondary market to have access to the MSRB's Electronic Municipal Market Access ("EMMA") system, the single centralized repository for the electronic collection and availability of continuing disclosure information about municipal securities.<sup>7</sup>

Beginning in 2009, issuers and obligated persons have increasingly used direct purchases of municipal securities<sup>8</sup> and direct loans<sup>9</sup> (collectively, "direct placements")<sup>10</sup> as alternatives to publicly offered municipal securities.<sup>11</sup>

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<sup>7</sup> See Exchange Act Release No. 34-59062 (Dec. 5, 2008), 73 FR 76104 (Dec. 15, 2008) ("2008 Amendments Adopting Release"); see also Exchange Act Release No. 34-58255 (July 30, 2008), 73 FR 46138 (Aug. 7, 2008); see also Section II.B. herein for additional discussion about the requirements of Rule 15c2-12.

<sup>8</sup> For example, an investor purchasing a municipal security directly from an issuer or obligated person.

<sup>9</sup> For example, a lender entering into a bank loan, loan agreement, or other type of financing agreement with an issuer or obligated person.

<sup>10</sup> Standard and Poor's Ratings Services ("S&P") has estimated that as much as \$50 to \$60 billion in direct placement transactions may occur annually. See Mike Cherney, S&P Calls for More Disclosure of Municipal Bank Loans, Wall St. J. (Feb. 18, 2014), available at <http://www.wsj.com/articles/SB10001424052702304675504579391431039227484>.

<sup>11</sup> See e.g., Municipal Market Bank Loan Disclosure Task Force, Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans ("Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans") (May 1, 2013), available at <http://www.nfma.org/assets/documents/position.stmt/wp.direct.bank.loan.5.13.pdf>. The Task Force was comprised of representatives from the American Bankers Association, Bond Dealers of America, Government Finance Officers Association ("GFOA"), Investment Company Institute ("ICI"), National Association of Bond Lawyers, National Association of Health and Educational Facilities Finance Authorities, National Association of Independent Public Finance Advisors, National Federation of Municipal Analysts ("NFMA"), and Securities Industry and Financial Markets Association ("SIFMA").

The Commission understands that existing security holders and potential investors (collectively, “investors”) and other market participants may not have any access or timely access to disclosure about the incurrence of certain debt obligations, such as direct placements, and other financial obligations<sup>12</sup> by issuers of municipal securities and obligated persons. For example, investors 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,<sup>13</sup> 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. Even if investors and other market participants have access to disclosure about an issuer’s or obligated person’s incurrence of a financial obligation, such access may not be timely if, for example, the issuer or obligated person has not submitted annual financial information or audited financial statements to EMMA in a timely manner or does not frequently issue debt that results in a final official statement being provided to EMMA. Typically, investors and other market participants do not have access to an issuer’s or obligated person’s annual

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<sup>12</sup> For the purposes of this proposing release, “financial obligation” means a debt obligation, lease, guarantee, derivative instrument, or monetary obligation resulting from a judicial, administrative, or arbitration proceeding. See Section III.A.1.i. herein for further discussion of the term “financial obligation.”

<sup>13</sup> See e.g., Community Unit School District Number 18 (Blue Ridge), Securities Act of 1933 (“Securities Act”) Release No. 10155 (Aug. 24, 2016), available at <https://www.sec.gov/litigation/admin/2016/33-10155.pdf> (settled action) (finding that the school district made a materially false statement in the final official statement for a 2012 offering that it had not failed to comply in all material respects in the previous five years with any undertaking entered into pursuant to Rule 15c2-12, when in fact the school district had failed to file its audited financial statements for fiscal years 2008 through 2011 by the time of the 2012 offering and filed its 2007 audited financial statements late by 811 days).

financial information or audited financial statements until several months<sup>14</sup> or up to a year after the end of the issuer's or obligated person's applicable fiscal year,<sup>15</sup> and a significant amount of time could pass before the issuer's or obligated person's next primary offering subject to Rule 15c2-12. In many cases, this lack of access or delay in access to disclosure means that investors

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<sup>14</sup> See MSRB, Timing of Annual Financial Disclosures by Issuers of Municipal Securities (Feb. 2017), available at <http://www.msrb.org/msrb1/pdfs/MSRB-CD-Timing-of-Annual-Financial-Disclosures-2016.pdf> (stating that, excluding disclosures received by the MSRB more than one year after the end of the fiscal year, the timing of audited financial statements submissions in 2016 averaged 199 calendar days after the end of the applicable fiscal year and the timing of annual financial information submissions in 2016 averaged 189 calendar days after the end of the applicable fiscal year). See also Richard A. Ciccarone, Change Doesn't Come Easy for Municipal Bond Audit Timing, Merritt Research Services (Oct. 25, 2015), available at <http://muninetguide.com/change-doesnt-come-easy-for-municipal-bond-audit-timing/> (stating that, in a study examining a total of 73,586 municipal issuer audited financial statements submissions from 2008 to 2014, audits typically take close to six months to complete, while revenue bond borrowers generally take closer to four months to complete their audits).

<sup>15</sup> In March 2014, the Division of Enforcement announced the Municipalities Continuing Disclosure Cooperative Agreement (“MCDC Initiative”), a voluntary program to encourage underwriters and issuers and obligated persons to self-report federal securities law violations involving inaccurate certifications in primary offerings where issuers and obligated persons represented in their final official statements that they had complied with previous continuing disclosure agreements when they had not. The Commission brought settled actions against 71 issuers and obligated persons under the MCDC Initiative. See SEC Charges 71 Municipal Issuers in Muni Bond Disclosure Initiative (Aug. 24, 2016), available at <https://www.sec.gov/news/pressrelease/2016-166.html>. See e.g., Boulder County, Colorado, Securities Act Release No. 10135 (Aug. 24, 2016), available at <https://www.sec.gov/litigation/admin/2016/33-10135.pdf> (settled action) (Respondent stated it was in compliance with earlier continuing disclosure agreements, but had in fact filed its annual financial information and audited financial reports to the MSRB between 140 and 230 days late for fiscal years 2007 through 2009); Wyoming Community Development Authority, Securities Act Release No. 10196 (Aug. 24, 2016), available at <https://www.sec.gov/litigation/admin/2016/33-10196.pdf> (settled action) (Respondent stated it was in compliance with earlier continuing disclosure agreements, but had in fact provided its fiscal years 2006, 2008, and 2009 audited financial statements to the MSRB approximately 50, 26, and 13 months late, respectively); and City of Devils Lake, North Dakota, Securities Act Release No. 10144 (Aug. 24, 2016), available at <https://www.sec.gov/litigation/admin/2016/33-10144.pdf> (settled action) (Respondent stated it was in compliance with earlier continuing disclosure agreements, but had in fact provided its fiscal years 2007, 2008, 2009, and 2010 audited financial statements to the MSRB 228, 153, 149, and 64 days late, respectively).

could be making investment decisions, and other market participants could be undertaking credit analyses, without important information.

Additionally, the Commission understands that to the extent information about financial obligations is disclosed and accessible to investors and other market participants, such information currently may not include certain details about the financial obligations. For example, disclosure about a financial obligation in an issuer's or obligated person's audited financial statements or in an official statement may be limited to the amount of the financial obligation and may not provide certain details, such as whether the financial obligation contains covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, if material.<sup>16</sup> In these cases, investors could be making investment decisions, and other market participants could be undertaking credit analyses, without important information, including the debt payment priority structure.

Furthermore, the Commission understands that investors and other market participants may not have any access or timely access to disclosure regarding the occurrence of events reflecting financial difficulties, including a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation.<sup>17</sup> For example, if an issuer or obligated person defaults under the terms of a financial obligation,

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<sup>16</sup> See MSRB Notice 2012-18, infra note 20 (stating that information about certain financings undertaken by issuers is not readily available to holders of an issuer's outstanding debt until the release of an issuer's audit, and such information is typically quite limited). See also 2012 Municipal Report, infra note 58, at 65-66 (stating that commenters have expressed concern about the lack of detailed information in official statements about municipal issuers' outstanding debt, including liens, security, collateral pledges, etc., and stating that market participants also have raised concerns that municipal entities may not properly disclose the existence or the terms and conditions 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).

<sup>17</sup> See Section II.D. herein for additional discussion.

investors either may not ever have access or may not have timely access to information about the event. This lack of access or delay in access to disclosure means investors could be making investment decisions, and other market participants could be undertaking credit analyses, without important information.

The MSRB<sup>18</sup> and certain market participants<sup>19</sup> have raised concerns about the lack of secondary market disclosure about certain financial obligations. While some market participants have encouraged issuers and obligated persons to voluntarily disclose information about certain financial obligations,<sup>20</sup> the MSRB has stated that the number of actual disclosures made is

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<sup>18</sup> See Letter from Kym Arnone, Chair, MSRB, to Pamela Dyson, Chief Information Officer, Securities and Exchange Commission (Jan. 20, 2015) (“MSRB Letter to SEC CIO”), available at <http://www.msrb.org/msrb1/pdfs/MSRB-Comment-Letter-on-SEC-Rule-15c2-12-January-2015.pdf>. The MSRB noted that bank loans and direct-purchase debt are not subject to Rule 15c2-12 and, therefore, are not required to be reported through filings on EMMA. The MSRB also noted its concern that bank loans or other debt-like obligations such as swap transactions, guarantees, and lease financing arrangements, that create significant financial obligations and which do not get currently reported, could impair the rights of existing bondholders, including the seniority status of such bondholders, or impact the credit or liquidity profile of an issuer.

<sup>19</sup> See e.g., Letter from Lisa Washburn, Chair, NFMA to Mary Jo White, Chair, Securities and Exchange Commission (Aug. 10, 2016) (“NFMA Letter to SEC Chair”), available at [http://www.nfma.org/assets/documents/position.stmt/ps\\_stateofdisclosure\\_aug2016white.pdf](http://www.nfma.org/assets/documents/position.stmt/ps_stateofdisclosure_aug2016white.pdf). NFMA noted that certain events and/or circumstances that are material are omitted from reporting under continuing disclosure agreements, such as the incurrence of additional long and short-term debt, early swap terminations, swap collateral postings, and defaults under other contractual agreements. NFMA also expressed the view that the lack of such disclosure – or the delay in providing such information – impairs secondary market pricing and liquidity and can affect bond ratings.

<sup>20</sup> See e.g., MSRB, Notice Concerning Voluntary Disclosure of Bank Loans to EMMA, MSRB Notice 2012-18 (Apr. 3, 2012) (“MSRB Notice 2012-18”), available at <http://msrb.org/Rules-and-Interpretations/Regulatory-Notices/2012/2012-18.aspx>. See also GFOA, GFOA Alert: Bank Loan Disclosure (May 12, 2016) (recommending that municipal issuers should voluntarily disclose information about bank loans), available at <http://www.gfoa.org/gfoa-alert-bank-loan-disclosure>.

limited.<sup>21</sup> To address concerns that investors and other market participants may not have any access or timely access to information about the incurrence of a financial obligation by an issuer or obligated person, the Commission proposes amendments to Rule 15c2-12. The proposed amendments would require a Participating Underwriter in an Offering to reasonably determine that an issuer or obligated person has undertaken in a written agreement or contract to provide to the MSRB, within ten business days after the occurrence of the events, notice of the proposed events.

## II. Background

### A. History

The Securities Act and the Exchange Act exempt municipal securities from certain registration and reporting requirements,<sup>22</sup> but not the antifraud provisions of Securities Act Section 17(a),<sup>23</sup> or Exchange Act Section 10(b)<sup>24</sup> and Rule 10b-5<sup>25</sup> promulgated thereunder. Congress, as part of the Securities Acts Amendments of 1975 (“1975 Amendments”),<sup>26</sup> created a limited regulatory scheme for the municipal securities market at the federal level<sup>27</sup> in response to

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<sup>21</sup> See MSRB Request For Comment, infra note 76 at 3. Issuer representatives have indicated that challenges associated with posting and locating information about financial obligations on EMMA have led to the appearance of under-disclosure by issuers. See infra note 83.

<sup>22</sup> 15 U.S.C. 77c(a)(2); 15 U.S.C. 78c(a)(12), (29).

<sup>23</sup> 15 U.S.C. 77q(a).

<sup>24</sup> 15 U.S.C. 78j(b).

<sup>25</sup> 17 CFR 240.10b-5.

<sup>26</sup> The Securities Acts Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975).

<sup>27</sup> See, e.g., Exchange Act Sections 15(c)(1), 15(c)(2), 15B(c)(1), 15B(c)(2), 17(a), 17(b), and 21(a)(1) (15 U.S.C. 78o(c)(1), 78o(c)(2), 78o-4(c)(1), 78o-4(c)(2), 78q(a), 78q(b), and 78u(a)(1)).

the growth of the market, market abuses, and the increasing participation of retail investors.<sup>28</sup> The 1975 Amendments required firms transacting business in municipal securities to register with the Commission as broker-dealers, required banks dealing in municipal securities to register with the Commission as municipal securities dealers,<sup>29</sup> and gave the Commission broad rulemaking and enforcement authority<sup>30</sup> over such broker-dealers and municipal securities dealers. The 1975 Amendments did not establish a regulatory scheme for, or impose any new requirements on, issuers of municipal securities.<sup>31</sup> In addition, the 1975 Amendments authorized the creation of the MSRB and granted it authority to promulgate rules concerning transactions in municipal securities by dealers.

The 1975 Amendments provided a system of regulation for both municipal securities professionals and the municipal securities market, but limited the Commission's and the MSRB's authority to require issuers, either directly or indirectly, to file any application, report,

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<sup>28</sup> S. Rep. No. 94-75, at 3-4, 37-43 (1975) (Conf. Rep.).

<sup>29</sup> The Exchange Act defines a "municipal securities dealer" as any person (including a separately identifiable department or division of a bank) engaged in the business of buying and selling municipal securities for his own account, as a part of regular business, through a broker or otherwise. See 15 U.S.C. 78c(a)(30).

<sup>30</sup> See, e.g., Exchange Act Sections 15(c)(1), 15(c)(2), 15B(c)(1), 15B(c)(2), 17(a), 17(b), and 21(a)(1) (15 U.S.C. 78o(c)(1), 78o(c)(2), 78o-4(c)(1), 78o-4(c)(2), 78q(a), 78q(b), and 78u(a)(1)). Enforcement activities regarding municipal securities dealers must be coordinated by the Commission, the Financial Industry Regulatory Authority, and the appropriate bank regulatory agency. See Exchange Act Sections 15B(c)(6)(A), 15B(c)(6)(B), and 17(c) (15 U.S.C. 78o-4(c)(6)(A), 78o-4(c)(6)(B), 78q(c)). The term "appropriate regulatory agency," when used with respect to a municipal securities dealer, is defined in Section 3(a)(34)(A) of the Exchange Act. See 15 U.S.C. 78c(a)(34)(A). The Commission also has the authority to examine all registered municipal securities dealers. See 15 U.S.C. 78q(b)(1).

<sup>31</sup> The 1975 Amendments amended the definition of "person" under Exchange Act Section 3(a)(9) to include issuers of municipal securities, thus clarifying that state and local government issuers were not exempt from the antifraud provisions of the federal securities laws.

or document with the Commission or the MSRB prior to any sale of municipal securities by an issuer.<sup>32</sup> Exchange Act Section 15B(d)(2),<sup>33</sup> however, states that “[n]othing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this title.”<sup>34</sup> Further, in Exchange Act Section 15(c)(2), Congress expanded the Commission’s authority by providing it with broad rulemaking and enforcement authority over dealers. Thus, while Congress limited the Commission’s ability to require issuers to file reports or documents prior to issuing municipal securities in Exchange Act Section 15B(d)(1),<sup>35</sup> Congress preserved and expanded the Commission’s mandate to adopt rules reasonably designed to prevent fraud in Exchange Act Sections 15B(d)(2) and 15(c)(2).

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<sup>32</sup> Exchange Act Section 15B(d), commonly referred to as the “Tower Amendment,” states: “(1) Neither the Commission nor the Board is authorized under this title, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities. (2) The Board is not authorized under this title to require any issuer of municipal securities, directly or indirectly through a municipal securities broker, municipal securities dealer, municipal advisor, or otherwise, to furnish to the Board or to a purchaser or a prospective purchaser of such securities any application, report, document, or information with respect to such issuer: Provided, however, That the Board may require municipal securities brokers and municipal securities dealers or municipal advisors to furnish to the Board or purchasers or prospective purchasers of municipal securities applications, reports, documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer. Nothing in this paragraph shall be construed to impair or limit the power of the Commission under any provision of this title.”

<sup>33</sup> 15 U.S.C. 78o-4(d)(2).

<sup>34</sup> 15 U.S.C. 78o-4(d)(2).

<sup>35</sup> 15 U.S.C. 78o-4(d)(1).

B. Rule 15c2-12

In 1988, to address concerns about the quality of disclosure in certain municipal offerings and timely dissemination of disclosure documents,<sup>36</sup> the Commission proposed a limited rule designed to prevent fraud in the municipal securities market by enhancing the timely access of official statements to underwriters, investors, and other interested persons.<sup>37</sup> In 1989, the Commission adopted Rule 15c2-12 as a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices in the municipal securities market.<sup>38</sup> A dealer that acts as a Participating Underwriter in an Offering is required, subject to certain exemptions: (i) to obtain and review an official statement that an issuer of the securities “deems final”, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (ii) in non-competitively bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (iii) to send, upon request, a copy of the final official statement to potential customers for a specified period of time; and (iv) to contract with the issuer to receive, within a specified time, sufficient copies

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<sup>36</sup> The Commission also stated that the practices revealed in the 1988 Commission Staff Report on the Investigation in the Matter of Transactions in Washington Power Supply System Securities underscored the need to explore the benefits that would result from a specific regulatory requirement for underwriters to be uniformly subject to a requirement to obtain and review a nearly final disclosure document and make disclosure documents available to investors in both negotiated and competitive offerings. See Exchange Act Release No. 34-26100 (Sept. 22, 1988), 53 FR 37778, 37781 (Sept. 28, 1988) (“1988 Proposing Release”). The Commission also highlighted the changes that had occurred in the municipal securities market since securities laws were first enacted, including the nationwide scope of the municipal securities market, size of the municipal securities market, broader range of types of investors in municipal securities (including a significant number of household investors), and increasing complexity of municipal financing structures. Id. at 37779.

<sup>37</sup> Id. at 37782.

<sup>38</sup> See Exchange Act Release No. 34-26985 (June 28, 1989), 54 FR 28799 (July 10, 1989) (“1989 Adopting Release”).

of the final official statement to comply with the Rule's delivery requirement, and the requirements of the rules of the MSRB.<sup>39</sup>

In November 1994, the Commission adopted amendments to Rule 15c2-12 ("1994 Amendments") to deter fraud and manipulation in the municipal securities market by prohibiting the underwriting and subsequent recommendation of securities for which adequate information is not available.<sup>40</sup> Specifically, Rule 15c2-12, as amended by the 1994 Amendments, prohibits Participating Underwriters from purchasing or selling municipal securities in connection with an Offering unless the Participating Underwriter has "reasonably determined" that an issuer or an obligated person has undertaken in a written agreement or contract for the benefit of holders of such securities<sup>41</sup> to provide continuing disclosure information regarding the security and the issuer or obligated person for the life of the municipal security.<sup>42</sup> The continuing disclosure information consists of: (i) certain annual financial and operating information and audited financial statements, if available ("annual filings");<sup>43</sup> (ii) notices of the occurrence of certain events ("event notices");<sup>44</sup> and (iii) notices of the failure of an issuer or obligated person to

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<sup>39</sup> See 17 CFR 240.15c2-12(b).

<sup>40</sup> See Exchange Act Release No. 34-33742 (Mar. 9, 1994), 59 FR 12759 (Mar. 17, 1994) ("1994 Amendments Proposing Release"); Exchange Act Release No. 34-34961 (Nov. 10, 1994), 59 FR 59590, 59591 (Nov. 17, 1994) ("1994 Amendments Adopting Release").

<sup>41</sup> In some instances, continuing disclosure undertakings may be set forth in other deal documents (e.g., the bond resolution or trust indenture).

<sup>42</sup> See 17 CFR 240.15c2-12(b)(5)(i). This provision now requires submission of annual information and event notices to a single repository maintained by the MSRB. See 2008 Amendments Adopting Release, *supra* note 7.

<sup>43</sup> See 17 CFR 240.15c2-12(b)(5)(i)(A) and (B).

<sup>44</sup> See 17 CFR 240.15c2-12(b)(5)(i)(C). Currently, the following events require notice in a timely manner not in excess of ten business days after the occurrence of the event: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if

provide required annual financial information, on or before the date specified in the continuing disclosure agreement (“failure to file notices”).<sup>45</sup> The 1994 Amendments also prohibit a dealer from recommending the purchase or sale of a municipal security unless it has procedures in place that provide reasonable assurance that such dealer will promptly receive any event notices and failure to file notices with respect to that security.<sup>46</sup> The Commission stated that as a result of the 1994 Amendments dealers would be better able to satisfy both their obligation under the federal securities laws to have a reasonable basis on which to recommend municipal securities in the secondary market and their obligations under MSRB rules.<sup>47</sup> The Commission further stated that the availability of secondary market disclosure to all market participants would enable investors to better protect themselves from misrepresentations or other fraudulent activities by

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material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security; (7) modifications to rights of security holders, if material; (8) bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the securities, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership or similar event of the obligated person; (13) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of a trustee, if material. In addition, Rule 15c2-12(d) provides full and limited exemptions from the requirements of Rule 15c2-12. See 17 CFR 240.15c2-12(d).

<sup>45</sup> See 17 CFR 240.15c2-12(b)(5)(i)(D). Annual filings, event notices, and failure to file notices are referred to collectively herein as “continuing disclosure documents.”

<sup>46</sup> See 1994 Amendments Adopting Release, supra note 40, at 59602; 17 CFR 240.15c2-12(c).

<sup>47</sup> See 1994 Amendments Adopting Release, supra note 40, at 59591.

dealers.<sup>48</sup> The Commission emphasized that a lack of consistent secondary market disclosure impairs investors' ability to acquire information necessary to make informed investment decisions, and thus, protect themselves from fraud.<sup>49</sup>

In December 2008, in connection with its longstanding interest in reducing the potential for fraud and manipulation in the municipal securities market by facilitating greater availability of information about municipal securities, the Commission adopted amendments to Rule 15c2-12 ("2008 Amendments") to provide for the EMMA system.<sup>50</sup> EMMA is established and maintained by the MSRB and provides free public access to disclosure documents. The 2008 Amendments require the Participating Underwriter to reasonably determine that the issuer or obligated person has undertaken in its continuing disclosure agreement to provide continuing disclosure documents: (i) solely to the MSRB; and (ii) in an electronic format and accompanied by identifying information, as prescribed by the MSRB.<sup>51</sup> In adopting the 2008 Amendments, the Commission stated that it was furthering its efforts to deter fraud and manipulation in the municipal securities market.<sup>52</sup> The Commission further stated that public access to all continuing disclosure documents on the Internet, as required by the 2008 Amendments, would

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<sup>48</sup> Id.

<sup>49</sup> Id.

<sup>50</sup> See 2008 Amendments Adopting Release, supra note 7.

<sup>51</sup> See id. See also Exchange Act Release No. 34-59061 (Dec. 5, 2008), 73 FR 75778 (Dec. 12, 2008) (order approving the MSRB's proposed rule change to establish as a component of its central municipal securities document repository, the EMMA system, the collection and availability of continuing disclosure documents over the Internet free of charge).

<sup>52</sup> See 2008 Amendments Adopting Release, supra note 7, at 76105.

promote market efficiency and deter fraud by improving the availability of information to investors, market professionals, and the public generally.<sup>53</sup>

In May 2010, the Commission adopted further amendments to Rule 15c2-12 (“2010 Amendments”).<sup>54</sup> The 2010 Amendments (a) require Participating Underwriters to reasonably determine that an issuer or obligated person has agreed to provide event notices in a timely manner not in excess of ten business days after the event’s occurrence; (b) include new events<sup>55</sup> for which a notice is to be provided; (c) modify the events that are subject to a materiality determination before triggering a requirement to provide notice to the MSRB;<sup>56</sup> and (d) revise an exemption for certain offerings of municipal securities with put features.<sup>57</sup>

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<sup>53</sup> Id. at 76110.

<sup>54</sup> See Exchange Act Release No. 34-62184A (May 26, 2010), 75 FR 33100 (June 10, 2010) (“2010 Amendments Adopting Release”).

<sup>55</sup> The amendments added the following events to paragraph (b)(5)(i)(C) of Rule 15c2-12: (a) tender offers; (b) bankruptcy, insolvency, receivership or similar event of the issuer or obligated person; (c) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (d) appointment of a successor or additional trustee, or the change of name of a trustee, if material. Id. at 33102.

<sup>56</sup> The amendments removed the materiality determination for the following events: (a) principal and interest payment delinquencies with respect to the subject securities; (b) unscheduled draws on debt service reserves or on credit enhancements for the subject securities reflecting financial difficulties; (c) substitution of credit or liquidity providers, or their failure to perform; (d) defeasances; (e) rating changes; (f) tender offers; and (g) bankruptcy events. The amendments clarified the materiality determination for the event notice related to the tax status of the subject securities. Id. at 33111-12, 33118-19.

<sup>57</sup> Id. at 33100.

C. Commission's Report on the Municipal Securities Market

In July 2012, the Commission issued its Report on the Municipal Securities Market following a broad review of the municipal securities market that included a series of public field hearings and numerous meetings with market participants.<sup>58</sup> The 2012 Municipal Report provides an overview of the municipal securities market and addresses two key areas of concern: disclosure and market structure.<sup>59</sup> The 2012 Municipal Report includes a series of recommendations for potential further consideration, including legislative changes, Commission rulemaking, MSRB rulemaking, and enhancement of industry best practices.<sup>60</sup> These recommendations were designed to address concerns raised by market participants and others and provide avenues to improve the municipal securities market, including transparency for municipal securities investors.<sup>61</sup>

The 2012 Municipal Report states, among other things, that the Commission could consider further amendments to Rule 15c2-12 to mandate more specific types of secondary market event disclosures, including disclosure relating to new indebtedness (whether or not such debt is subject to Rule 15c2-12 and whether or not arising as a result of a municipal securities issuance).<sup>62</sup> The Commission further noted that market participants raised concerns that issuers and obligated persons may not properly disclose the existence or the terms of bank loans,

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<sup>58</sup> Securities and Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) (“2012 Municipal Report”).

<sup>59</sup> Id.

<sup>60</sup> Id. at 133-50.

<sup>61</sup> Id. at 4.

<sup>62</sup> Id. at 139-40.

particularly when the terms of the bank loans may affect the payment priority from revenues in a way that adversely affects bondholders.<sup>63</sup>

D. Market Developments and the Need for Further Amendments to Rule 15c2-12

The municipal securities market is a significant part of the United States credit markets, with over \$3.83 trillion in principal amount outstanding.<sup>64</sup> At the end of the third quarter 2016, individuals or retail investors held, either directly or indirectly through mutual funds, money market mutual funds, closed-end funds, and exchange-traded funds, approximately \$2.545 trillion of outstanding municipal securities.<sup>65</sup> According to the MSRB, approximately \$2.42 trillion of municipal securities were traded in 2015 in approximately 9.26 million trades.<sup>66</sup> There are approximately 44,000<sup>67</sup> state and local issuers of municipal securities, ranging from villages, towns, townships, cities, counties, territories, and states, as well as special districts, such as school districts and water and sewer authorities.<sup>68</sup> Historically, municipal securities have had significantly lower rates of default than corporate and foreign government bonds.<sup>69</sup>

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<sup>63</sup> Id. at 66.

<sup>64</sup> See Federal Reserve Board, Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, at 121 Table L.212 (Third Quarter 2016) (Dec. 8, 2016) (“Flow of Funds”), available at <https://www.federalreserve.gov/releases/z1/current/z1.pdf>.

<sup>65</sup> Id. As of the third quarter 2016, the amount of municipal securities held directly by the household sector was \$1.591 trillion and mutual funds, money market mutual funds, closed-end funds, and exchange-traded funds collectively held \$954.5 billion.

<sup>66</sup> See MSRB, 2015 Fact Book, at 7-8 (Mar. 3, 2016), available at <http://www.msrb.org/msrb1/pdfs/msrb-fact-book-2015.pdf>.

<sup>67</sup> See 2012 Municipal Report, supra note 58, at 1.

<sup>68</sup> See Registration of Municipal Advisors, Exchange Act Release No. 34-70462 (Sept. 20, 2013), 78 FR 67468, 67472 (Nov. 12, 2013).

<sup>69</sup> See 2012 Municipal Report, supra note 58, at 22-23 & n.113 (citing Moody’s Investors Service (“Moody’s”), The U.S. Municipal Bond Rating Scale: Mapping to the Global Rating Scale and Assigning Global Scale Ratings to Municipal Obligations (Mar. 2007),

Nevertheless, issuers and obligated persons have defaulted on their municipal bonds, and these defaults may negatively impact investors in ways other than non-payment, including delayed payments and pricing disruptions in the secondary market.<sup>70</sup> Since 2011, the municipal securities market has experienced four of the five largest municipal bankruptcy filings in U.S. history,<sup>71</sup> and some issuers and obligated persons continue to experience declining fiscal situations and steadily increasing debt burdens.<sup>72</sup>

Beginning in 2009, issuers and obligated persons have increasingly used direct placements as alternatives to public offerings of municipal securities.<sup>73</sup> According to the MSRB, direct placements, when used as an alternative to public offerings, could provide potential

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available at [https://www.moodys.com/sites/products/DefaultResearch/102249\\_RM.pdf](https://www.moodys.com/sites/products/DefaultResearch/102249_RM.pdf); and Report to Accompany H.R. 6308, H.R. Rep. No. 110-835, at § 205 (Feb. 14, 2008), available at <https://www.gpo.gov/fdsys/pkg/CRPT-110hrpt835/html/CRPT-110hrpt835.htm>).

<sup>70</sup> See 2012 Municipal Report, *supra* note 58, at 23.

<sup>71</sup> The five largest municipal bankruptcies, to date, ranked by amount of debt, are Detroit, Michigan, in 2013 (\$18 billion in debt); Jefferson County, Alabama, in 2011 (\$4.2 billion in debt); Orange County, California, in 1994 (\$2.0 billion in debt); Stockton, California, in 2012 (\$1.0 billion in debt); and San Bernardino, California, in 2012 (\$492 million in debt). See *Detroit's Bankruptcy Is the Nation's Largest*, N.Y. Times (July 18, 2013), available at <http://www.nytimes.com/interactive/2013/07/18/us/detroit-bankruptcy-is-the-largest-in-nation.html>.

<sup>72</sup> For example, the government of Puerto Rico failed to pay more than half of more than \$1 billion in general obligation bond payments due on July 1, 2016, marking the first time that a state or territory has failed to pay general obligation bonds since the early 1930s. See *The Commonwealth of Puerto Rico Amended Event Notice* (July 12, 2016), available at <http://emma.msrb.org/ER980533-ER766970-ER1168826.pdf> (providing notice of Puerto Rico's first default of its general obligation bond payments). See also Heather Gillers & Nick Timiraos, *Puerto Rico Defaults on Constitutionally Guaranteed Debt*, Wall St. J. (July 1, 2016), available at <http://www.wsj.com/articles/puerto-rico-to-default-on-constitutionally-guaranteed-debt-1467378242>.

<sup>73</sup> See Section I and Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans, *supra* note 11. See also MSRB Bank Loan Notice, *infra* note 76, at 2. See also Section V.A. herein.

advantages for issuers, such as, among other things, lower interest and transaction costs, reduced exposure to bank regulatory capital requirements, simpler execution process, greater structuring flexibility, no requirement for a rating or offering document, and direct interaction with the lender instead of multiple bondholders.<sup>74</sup> However, the MSRB and certain market participants have raised concerns about lack of secondary market disclosure regarding financial obligations that are direct placements, as well as other financial obligations.<sup>75</sup> Numerous market participants, including the MSRB,<sup>76</sup> the Financial Industry Regulatory Authority (“FINRA”),<sup>77</sup>

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<sup>74</sup> See MSRB Bank Loan Notice, *infra* note 76, at 1 n.2.

<sup>75</sup> See *supra* notes 18 and 19. In addition, the ICI recommended, in its comment letter addressing the 2010 amendments to Rule 15c2-12, that the Commission implement a disclosure requirement regarding the creation of any material financial obligation (including contingent obligations) whether in the form of direct debt, hedge, swap or other derivative instrument, capital lease, operating lease or otherwise, because of the implications these obligations may have on the credit risk and value of associated bonds. See Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (Sept. 8, 2009), available at <https://www.sec.gov/comments/s7-15-09/s71509-23.pdf>.

<sup>76</sup> In April 2012, the MSRB published a regulatory notice encouraging issuers to voluntarily post information about bank loan financings to the MSRB’s EMMA website. See MSRB Notice 2012-18, *supra* note 20. In January 2015, the MSRB published a regulatory notice regarding the importance of voluntary disclosure of bank loans, defining bank loans as a direct purchase of a bond directly from the issuer or a direct loan or other type of financing agreement with the issuer. The MSRB also noted that many of the principles described in its notice would be equally applicable to other types of indebtedness, including direct loans from other investors. The MSRB noted that the availability of timely disclosure of additional debt in any form, including debt-like obligations, is beneficial to foster market transparency and to ensure a fair and efficient market. See MSRB, Bank Loan Disclosure Market Advisory, MSRB Notice 2015-03 (Jan. 29, 2015) (“MSRB Bank Loan Notice”), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/Announcements/2015-03.ashx>. Also in January 2015, the MSRB submitted a comment letter in response to the Commission’s request, pursuant to the Paperwork Reduction Act of 1995, for comment on the existing collection of information provided for in Rule 15c2-12. In this letter, the MSRB stated its concern about the lack of disclosure of bank loans and other debt and debt-like obligations (e.g., swap transactions, guarantees and lease financing arrangements that create significant financial obligations). The MSRB stated that bank loans or other debt-like obligations could impair the rights of existing bondholders or

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impact the credit or liquidity profile of an issuer. See MSRB Letter to SEC CIO, supra note 18. In October 2015, in response to a request from the Commission’s Office of the Investor Advocate to identify products and practices within the municipal securities market that may have an adverse impact on retail investors, the MSRB submitted a letter that identified the lack of bank loan disclosures as an area of particular concern. See Letter from Lynnette Kelly, Executive Director, MSRB, to Rick Fleming, Investor Advocate, Securities and Exchange Commission (Oct. 30, 2015) (“MSRB 2015 Letter to SEC’s Investor Advocate”), available at <http://www.msrb.org/msrb1/pdfs/MSRB-Letter-to-Investor-Advocate-October-2015.pdf>. In March 2016, the MSRB published a request for comment seeking public input on whether and how the MSRB could improve disclosure of direct purchases and bank loans entered into by issuers of municipal securities. The comment period closed on May 27, 2016, and the MSRB received 30 letters in response to the request for comment. See MSRB, Request for Comment on a Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans, MSRB Notice 2016-11 (Mar. 28, 2016) (“MSRB Request For Comment”), available at <http://www.msrb.org/~media/Files/Regulatory-Notices/RFCs/2016-11.ashx?n=1>. Many commenters on the MSRB’s proposal to require municipal advisors to disclose their municipal issuer clients’ direct placements noted that the best way to ensure disclosure of direct placements is to amend Rule 15c2-12. See MSRB, Comment Letters in Response to MSRB Request for Comment (2016) (“Comment Letters in Response to MSRB Request for Comment (2016)”), available at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2016/2016-11.aspx?c=1>. See also Jack Casey, Why MSRB Is Giving a \$5.5M Rebate to Dealers, The Bond Buyer (Aug. 1, 2016), available at <http://www.bondbuyer.com/news/washington-securities-law/why-msrb-is-giving-a-55m-rebate-to-dealers-1109888-1.html>. In August 2016, the MSRB announced that, in light of comments received in response to the MSRB Request for Comment, it would not pursue a rulemaking at this time. The MSRB, however, noted their continuing belief that disclosure of alternative financings is important for assessing a municipal entity’s creditworthiness and evaluating the impact of these financings on existing and potential investors. The MSRB further stated that they would continue to raise awareness about the issue among regulators and market participants, and encourage industry-led initiatives that support voluntary disclosure best practices. MSRB, MSRB Holds Quarterly Meeting (Aug. 1, 2016), available at <http://www.msrb.org/News-and-Events/Press-Releases/2016/MSRB-Holds-Quarterly-Board-Meeting-July-2016.aspx>. In November 2016, in response to a request from the Commission’s Office of the Investor Advocate to identify products and practices within the municipal securities market that may have an adverse impact on retail investors, the MSRB submitted a letter that reemphasized the lack of bank loan disclosures as a continuing area of concern. See Letter from Lynnette Kelly, Executive Director, MSRB, to Rick Fleming, Investor Advocate, Securities and Exchange Commission (Nov. 3, 2016) (“MSRB 2016 Letter to SEC’s Investor Advocate”), available at <http://www.msrb.org/msrb1/pdfs/MSRB-Response-to%20Investor-Advocate-November-2016.pdf>.

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In April 2016, the MSRB and FINRA published a joint regulatory notice reminding firms of their obligations in connection with privately placing municipal securities with a single

and industry groups<sup>78</sup> have encouraged issuers and obligated persons to voluntarily disclose information about certain financial obligations that are not currently included in the list of events for which a Participating Underwriter must reasonably determine that an issuer or obligated person has undertaken in a written agreement or contract to provide notice under Rule 15c2-12. The MSRB has suggested that voluntary disclosure submissions include the loan or financing agreement or a summary of some or all of the features of the debt obligation, including, for example, principal amount, maturity and amortization dates, prepayment provisions, security for repayment, source of repayment, and events of default and remedies.<sup>79</sup> GFOA, representing more than 18,000 federal, state, and local finance officials, has recommended that if municipal entities choose to disclose information regarding certain financial obligations, those entities should disclose information that may be relevant to current or prospective bondholders either by submitting the entire financing agreement to EMMA or preparing a summary of material terms, including, for example, the loan amount; debt service schedule; legal security and/or source of payment; covenants; events of defaults and remedies; term-out provisions, acceleration provisions or other non-standard payment considerations; and any other information the issuer

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purchaser and the use of bank loans in the municipal securities market. The regulatory notice encouraged the voluntary disclosure of bank loans in a timely manner. See FINRA, Direct Purchases and Bank Loans as Alternatives to Public Financing in the Municipal Securities Market, FINRA Regulatory Notice 16-10 (Apr. 2016), available at [http://www.finra.org/sites/default/files/notice\\_doc\\_file\\_ref/Regulatory-Notice-16-10.pdf](http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-16-10.pdf).

<sup>78</sup> See e.g., GFOA, Best Practice: Understanding Bank Loans (Sept. 2013) (“Understanding Bank Loans”), available at <http://www.gfoa.org/understanding-bank-loans>; NFMA, Recommended Best Practices in Disclosure for Direct Purchase Bonds, Bank Loans, and Other Bank-Borrower Agreements (June 2015) (“NFMA 2015 Recommended Best Practices”), available at [http://www.nfma.org/assets/documents/RBP/rbp\\_bankloans\\_615.pdf](http://www.nfma.org/assets/documents/RBP/rbp_bankloans_615.pdf); Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans, *supra* note 11.

<sup>79</sup> See MSRB Notice 2012-18, *supra* note 20.

believes to be important.<sup>80</sup> Moreover, at least one rating agency currently requires, and other rating agencies strongly encourage, issuers and obligated persons to notify the rating agency of the incurrence of certain financial obligations, including direct placements, and to provide all relevant documentation related to such indebtedness.<sup>81</sup> Despite continued efforts by market participants to encourage disclosure of certain financial obligations, the MSRB has stated that the number of actual disclosures made is limited.<sup>82</sup> In response, issuer representatives have indicated that challenges associated with posting and locating information about financial obligations on EMMA have led to the appearance of under-disclosure by issuers.<sup>83</sup> While the

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<sup>80</sup> See Understanding Bank Loans, supra note 78. See also Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans, supra note 11.

<sup>81</sup> In 2014, S&P sent letters to approximately 24,000 issuers of municipal securities that it rated, citing concerns over hidden debt exposure in the municipal securities market and related credit implications. S&P informed issuers that to maintain its ratings and possibly assign future ratings the rating agency now required notification and documentation related to any direct placements, including bank loan financings. S&P further stated that it may suspend or withdraw its ratings if issuers or obligated persons do not provide such notification in a timely manner. See Letter from S&P to Clients (May 6, 2014), available at <http://cdn.bondbuyer.com/pdfs/SMLetter5-15-14.pdf>. Other ratings agencies have articulated the importance of the disclosure of direct placements to their ability to maintain ratings on an issuer's public debt. See e.g., Fitch Ratings, Special Report: Direct Bank Placements Credit Implications (Oct. 25, 2011); Moody's, Growth of Bank Loans and Private Placements Increases Risk and Reduces Transparency in the Municipal Market (Oct. 16, 2014).

<sup>82</sup> See MSRB Request for Comment, supra note 76, at 3. In footnote 8 of that document, the MSRB describes the search methodology it used to identify bank loan disclosures on EMMA. The MSRB noted that as of March 28, 2016, a search of EMMA for the term "bank loan" produced 143 results. Of these results, 79 included the words "bank loan" in the issue description and were filed under the subcategory suggested by the MSRB. Another 23 submissions included the words "bank loan" in the issue description, but the document reported under a subcategory other than that suggested by the MSRB may not be related to a bank loan. The remaining 41 results, while including the words "bank loan" in the document, did not include any document under the subcategory suggested by the MSRB.

<sup>83</sup> See Jack Casey, Why the Issuer Bank Loan Disclosure System Needs an Overhaul, The Bond Buyer (May 22, 2016), available at [26](http://www.bondbuyer.com/news/washington-</a></u></p></div><div data-bbox=)

MSRB's estimate of the number of voluntary disclosure submissions may understate the actual number of voluntary disclosure submissions, the Commission preliminarily believes that a rule requiring a Participating Underwriter in an Offering to reasonably determine that an issuer or an obligated person has undertaken, in a continuing disclosure agreement, to provide to the MSRB within 10 business days the event notices specified in the proposed rule amendments is nevertheless necessary for the reasons discussed throughout this proposing release.

Rule 15c2-12 is designed to address fraud and manipulation in the municipal securities market by prohibiting the underwriting of municipal securities and subsequent recommendation of those municipal securities by dealers for which adequate information is not available. The Commission has long emphasized that, under the antifraud provisions of the federal securities laws, a dealer recommending securities to investors implies by its recommendation that it has an adequate basis for making the recommendation.<sup>84</sup> The Commission has stated that if, based on publicly available information, a dealer discovers any factors that indicate the disclosure is inaccurate or incomplete or signal the need for further inquiry, a dealer may need to obtain additional information or seek to verify existing information.<sup>85</sup> Accordingly, the Commission

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[securities-law/why-the-issuer-bank-loan-disclosure-system-needs-an-overhaul-1104388-1.html](https://www.msrb.org/press-releases/2016/msrb-improves-bank-loan-disclosure-on-emma-1104388-1.html). At a May 2016 GFOA debt committee meeting, an issuer representative noted that many issuers do not know where to post, and market participants do not know where to find, bank loan disclosure information on EMMA. In response to feedback from issuer representatives, the MSRB enhanced the bank loan disclosure submission process and the display of these documents on EMMA. See MSRB, MSRB Improves Bank Loan Disclosure on EMMA Website (Sept. 26, 2016), available at <http://msrb.org/News-and-Events/Press-Releases/2016/MSRB-Improves-Bank-Loan-Disclosure-on-EMMA-Website>.

<sup>84</sup> See 1988 Proposing Release, *supra* note 36, at 37787.

<sup>85</sup> See Statement of the Commission Regarding Disclosure Obligations of Municipal Securities Issuers and Others, Securities Act Release No. 33-7049, Exchange Act Release No. 34-33741 (Mar. 9, 1994), 59 FR 12748, 12758 (Mar. 17, 1994) (“1994 Interpretive Release”).

has stated that when dealers make recommendations in the secondary market, they must be based on information that is up-to-date and accessible.<sup>86</sup>

In addition, the MSRB has emphasized that secondary market disclosure information publicized by the issuer must be taken into account by dealers to meet the investor protection standards imposed by the MSRB's investor protection rules (e.g., MSRB Rule G-17 requiring dealers to deal fairly with all persons and to not engage in any deceptive, dishonest, or unfair practice; MSRB Rule G-19 requiring dealers to have a reasonable basis to believe that a recommended transaction or investment strategy is suitable for a customer; MSRB Rule G-30 requiring dealers to ensure that prices for customer transactions are fair and reasonable; and MSRB Rule G-47 requiring dealers to provide all material information known about a transaction, including material information that is reasonably accessible to the market).<sup>87</sup>

Under Rule 15c2-12(c), a dealer recommending the purchase or sale of a municipal security is required to have procedures in place that provide reasonable assurance that it will receive prompt notice of event notices. The availability of this information to investors would enable them to make more informed investment decisions and should reduce the likelihood that investors would be subject to fraud facilitated by inadequate disclosure. Furthermore, this information would assist dealers in satisfying their obligation to have a reasonable basis to recommend municipal securities to investors.

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<sup>86</sup> See 1994 Amendments Proposing Release, supra note 40, at 12760.

<sup>87</sup> See 1994 Amendments Adopting Release, supra note 40, at 59602. See also MSRB Reminds Firms of their Sales Practice and Due Diligence Obligations when Selling Municipal Securities in the Secondary Market, MSRB Notice 2010-37 (Sept. 20, 2010), available at <http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2010/2010-37.aspx>.

In keeping with the objectives set forth in the Exchange Act, including Section 15(c)(2),<sup>88</sup> and the antifraud provisions of the federal securities laws, the Commission preliminarily believes the proposed amendments are reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices in the municipal securities market. Accordingly, the Commission proposes to amend Rule 15c2-12. The Commission believes the proposed amendments to Rule 15c2-12 are consistent with the limitations set forth in Exchange Act Section 15B(d)(1) because the proposed amendments do not require an issuer of municipal securities to make any filing with the Commission or MSRB prior to the sale of municipal securities.

### **III. Description of the Proposed Amendments to Rule 15c2-12**

#### **A. Overview of Proposed Amendments**

The Commission proposes to amend paragraph (b)(5)(i)(C) to add notices for the proposed events that a Participating Underwriter must reasonably determine that the issuer or obligated person has agreed to provide in its continuing disclosure agreement. Similar to the other events listed in Rule 15c2-12, the proposed events reflect on the creditworthiness of the issuer or obligated person and the terms of the securities that they issue.<sup>89</sup> In addition, the Commission proposes an amendment to Rule 15c2-12(f) to add a definition for “financial obligation” and a technical amendment to subparagraph (b)(5)(i)(C)(14).

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<sup>88</sup> 17 CFR 240.15c2-12 was adopted under a number of Exchange Act provisions, including Section 15(c); 15 U.S.C. 78o(c).

<sup>89</sup> See e.g., 1994 Interpretive Release, supra note 85; 1994 Amendments Adopting Release, supra note 40; 2010 Amendments Adopting Release, supra note 54.

1. 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

The Commission proposes to add an event notice for 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, to the list of events in paragraph (b)(5)(i)(C) of the Rule for which notice is to be provided. The actual incurrence of the financial obligation, or agreement to covenants, events of default, remedies, priority rights, or other similar terms would trigger the obligation to provide the event notice. The event notice would be due in a timely manner not in excess of ten business days.<sup>90</sup>

The Commission preliminarily believes that including a materiality determination would strike an appropriate balance. As proposed, the materiality determination applies to the incurrence of a financial obligation and each of the agreed upon terms listed (i.e., covenants, events of default, remedies, priority rights, or other similar terms). For example, an issuer or obligated person may incur a financial obligation for an amount that, absent other circumstances, would not raise the concerns the proposed amendments are intended to address. On the other hand, if an issuer or obligated person agrees to provide a counterparty to a financial obligation with a senior position in the debt payment priority structure, and that agreement affects existing security holders, the event likely does rise to the level of importance that it should be disclosed to investors and other market participants.

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<sup>90</sup> See 17 CFR 240.15c2-12(b)(5)(i)(C).

As described above, investors and other market participants may not have access to disclosure that an issuer or obligated person has incurred a material financial obligation, or agreed to certain terms that affect security holders, unless or until disclosure is made in the issuer's or obligated person's annual financial information or audited financial statements or in an official statement in connection with the issuer's or obligated person's next primary offering subject to Rule 15c2-12 that results in the provision of a final official statement to EMMA.

Timely access to disclosure about the incurrence of a material financial obligation by an issuer or obligated person would provide potentially important information about the current financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness. A material financial obligation that results in an increase or change in the issuer's or obligated person's outstanding debt can weaken the measures (e.g., debt service as a percentage of expenditures or debt service coverage ratio) used to assess an issuer's or obligated person's liquidity and creditworthiness and may result in a reevaluation of the issuer's or obligated person's overall credit quality.<sup>91</sup> For example, an increase in outstanding debt could affect an issuer's or obligated person's level of debt service as a percent of expenditures, which industry commenters view as an important indicator of credit quality for general obligation bonds, or such an increase in debt could affect the amount of revenues available to pay debt service for revenue bonds, which is considered in connection with rate covenants or additional bonds tests.<sup>92</sup> If an issuer's or obligated person's liquidity and creditworthiness is impacted, the credit quality of the issuer's or obligated person's outstanding

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<sup>91</sup> See NFMA 2015 Recommended Best Practices, supra note 78, at 6-7; See also Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans, supra note 11.

<sup>92</sup> See NFMA 2015 Recommended Best Practices, supra note 78, at 6-7.

municipal securities could be adversely affected which could impact an investor's investment decision or other market participant's credit analysis.<sup>93</sup>

Timely access to disclosure about a material agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, could potentially provide important information about the creation of contingent liquidity risk, credit risk, and refinancing risk that could impact the issuer's or obligated person's liquidity and overall creditworthiness, and affect security holders' rights to assets or revenues. If an issuer's or obligated person's liquidity and creditworthiness is impacted and/or the rights of security holders are affected, the credit quality and price of the issuer's or obligated person's outstanding municipal securities could be affected.<sup>94</sup>

We propose to include in the rule a list of events – specifically, covenants, events of default, remedies, priority rights, or other similar terms – which are typically agreed to in connection with the incurrence of a financial obligation and analyzed by market participants.<sup>95</sup> These terms of a financial obligation could result in, among other things, contingent liquidity and credit risks, refinancing risk, and reduced security for existing security holders.<sup>96</sup> For example, the issuer or obligated person may agree to covenants that are more restrictive than those applicable to the issuer's or obligated person's outstanding municipal securities such as a

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<sup>93</sup> See MSRB Bank Loan Notice, supra note 76, at 4 (stating that the inability to timely assess a bank loan's impact on an issuer's credit profile could inadvertently distort valuation related to the buying or selling of an issuer's bonds in both the primary and secondary markets). See also Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans, supra note 11.

<sup>94</sup> Id.

<sup>95</sup> See e.g., NFMA 2015 Recommended Best Practices, supra note 78.

<sup>96</sup> Id.

requirement to maintain a higher debt service coverage ratio.<sup>97</sup> The more restrictive covenant would potentially trigger an event of default more easily and as a result the counterparty to the financial obligation would be able to assert remedies prior to existing security holders. For further example, the issuer or obligated person may agree to events of default that differ from those that are applicable to an issuer's or obligated person's outstanding municipal securities such as a failure to observe any term of the financial obligation (as opposed to specifically identified terms) that would enable the counterparty to the financial obligation to assert remedies prior to existing security holders. In addition, the issuer or obligated person may agree to different remedies than the issuer or obligated person has provided to existing security holders. For example, an acceleration provision could provide that any unpaid principal becomes immediately due to the counterparty upon the occurrence of a specified event of default without any grace period, which would effectively prioritize the payment of the financial obligation to the counterparty if the security holders do not have the benefit of the same provision. By agreeing to such a term, the counterparty to the financial obligation could benefit by being repaid prior to existing security holders. By agreeing to a material covenant, event of default or remedy under the terms of a financial obligation, such as the examples provided above, security holders could be affected, and the issuer or obligated person may create contingent liquidity and credit risks that could potentially impact the issuer's or obligated person's liquidity and overall creditworthiness.<sup>98</sup>

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<sup>97</sup> See MSRB, Glossary of Municipal Securities Terms: Coverage, available at <http://www.msrb.org/Glossary/Definition/COVERAGE.aspx> (defining "coverage" as the "ratio of available revenues available annually to pay debt service over the annual debt service requirement. This ratio is one indication of the availability of revenues for payment of debt service.").

<sup>98</sup> See e.g., NFMA 2015 Recommended Best Practices, supra note 78.

In addition, issuers and obligated persons may agree to material priority rights which provide the counterparty with better terms than existing security holders and, as a result, adversely affect the rights of security holders. For example, an issuer or obligated person may agree to provide superior rights to the counterparty in assets or revenues that were previously pledged to existing security holders and, as a result, reduce security for existing security holders. Lastly, there are other material terms similar to covenants, events of default, remedies, and priority rights that an issuer or obligated person may agree to that could, among other things, create liquidity, credit, or refinancing risks that could affect the liquidity and creditworthiness of an issuer or obligated person or the terms of the securities they issue. For example, an investor may make an investment decision without knowing the issuer or obligated person has entered into a financial obligation structured with a balloon payment at maturity creating refinancing risk that could compromise the issuer or obligated person's liquidity and creditworthiness and their ability to repay their outstanding municipal securities.<sup>99</sup> The provision requiring the balloon payment may not be typically identified as a covenant, event of default, remedy, or priority right, however, such a term could potentially impact the issuer's or obligated person's liquidity and overall creditworthiness and adversely affect security holders.

Lack of access or delay in access to continuing disclosure information about material financial obligations means that there are more opportunities for investors to make investment decisions, and other market participants to undertake credit analyses, without access to this important information. Timely access to information about the incurrence of a material financial obligation of the issuer or obligated person would allow investors and other market participants to learn important information about the current financial condition of the issuer or obligated

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<sup>99</sup> Id.

person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness. Timely access to information about the 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, would allow investors and other market participants to learn important information about the creation of contingent liquidity risk, credit risk, and refinancing risk, including these risks' potential impact to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected. Timely access to this information would help reduce the likelihood that market participants would have insufficient information to make informed investment decisions and to undertake informed credit analyses and would enhance investor protection.

The MSRB and certain market participants have been focused on the potential negative impacts associated with the lack of secondary market disclosure regarding debt obligations that are direct placements, as well as other financial obligations,<sup>100</sup> and certain of the examples discussed above are focused on the potential adverse effects to an issuer's or obligated person's liquidity and creditworthiness and valuation of their municipal securities. However, the Commission recognizes that the information disclosed about financial obligations may have a positive impact on an issuer's or obligated person's liquidity and creditworthiness, and the credit quality of the issuer's or obligated person's outstanding municipal securities could be positively affected.

The Commission believes the proposed amendments would facilitate investor access to important information in a timely manner and help to enhance transparency. If an issuer or obligated person provides an event notice to the MSRB, it would be displayed on the MSRB's

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<sup>100</sup> See supra notes 76, 77, and 78.

EMMA website. EMMA provides free public access to continuing disclosure documents, including event notices. In addition, EMMA includes a feature that allows market participants to sign up to receive automatic alerts from EMMA when information becomes available with respect to individual or groups of municipal securities, including notice of the submission of an event notice with respect to such individual or groups of municipal securities. The Commission further preliminarily believes that the event notice generally 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. 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 requests comment regarding all aspects of the proposed addition of subparagraph (b)(5)(i)(C)(15) concerning the event notice for 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. When responding to the requests for comment, please explain your reasoning.

- The Commission requests comment relating to the frequency of such event and the utility of this information by investors and other market participants in the secondary market.
- Is the triggering of the obligation to provide the event notice clear?

- Should the rule or guidance explicitly address where an issuer or obligated person incurs a series of related financial obligations, where a single incurrence may not be material but in the aggregate the incurrences would be material? In such a scenario, when should the trigger of the obligation to provide the event notice occur?
- Are there other events that should be included in subparagraph (b)(5)(i)(C)(15) of the Rule? Should any of the events proposed to be included be eliminated or modified?
- The Commission further requests comment as to whether the materiality conditions are appropriate conditions for subparagraph (b)(5)(i)(C)(15) of the Rule. Should any or all of the items included in the proposed rule text not be subject to the proposed materiality condition?
- Are there any events that should be added to subparagraph (b)(5)(i)(C)(15) of the Rule, but should not be subject to a materiality condition?
- The Commission further requests comment as to whether “any of which affect security holders” is an appropriate condition to include with respect to “agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or obligated person” in subparagraph (b)(5)(i)(C)(15) of the Rule. Should any of the items included in the proposed rule text not be subject to the “any of which affect security holders” condition? Should the proposed condition be modified to only capture events which adversely affect security holders?

- Should the Commission provide additional guidance on the types of information issuers and obligated persons should consider in drafting event notices?
- The Commission also requests comment regarding the benefits and costs of adding this proposed event.
  - i. Definition of a Financial Obligation

The Commission proposes to amend Rule 15c2-12(f) to add a definition for “financial obligation.” Under the proposed definition, the term financial obligation means a debt obligation, lease, guarantee, derivative instrument, or monetary obligation resulting from a judicial, administrative, or arbitration proceeding. The term financial obligation does not include municipal securities as to which a final official statement has been provided to the MSRB consistent with Rule 15c2-12.

As discussed above, some market participants are concerned not only about the lack of access or delay in access to disclosure regarding financial obligations that are direct placements, but also about the lack of access or delay in access to disclosure of the existence of other financial obligations. Similar to the concerns that market participants raised about financial obligations that are direct placements, an issuer’s or obligated person’s incurrence of other financial obligations could impair the rights of existing security holders, including the seniority status of such security holders, or impact the creditworthiness of an issuer or obligated person.<sup>101</sup> For example, the MSRB is concerned about other financial obligations that are lease financing arrangements, guarantees, and swap transactions.<sup>102</sup> Additionally, the Commission understands that there are instances where monetary obligations resulting from judicial, administrative, or

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<sup>101</sup> See e.g., MSRB Letter to SEC CIO, supra note 18.

<sup>102</sup> Id.

arbitration proceedings created significant financial obligations for issuers and obligated persons.<sup>103</sup> The proposed definition of financial obligation includes an issuer's or obligated person's debt obligations, leases, guarantees, derivative instruments, and monetary obligations resulting from judicial, administrative, or arbitration proceedings.

As proposed, the term debt obligation is intended to capture short-term and long-term debt obligations of an issuer or obligated person under the terms of an indenture, loan agreement, or similar contract that will be repaid over time. Under the proposed amendments, for example, a direct purchase of municipal securities by an investor and a direct loan by a bank would be debt obligations of the issuer or obligated person. As proposed, the term lease is intended to capture a lease that is entered into by an issuer or obligated person, including an operating or capital lease. Under the proposed amendments, for example, if an issuer or obligated person enters into a lease-purchase agreement to acquire an office building or an operating lease to lease an office building for a stated period of time, both would be a lease under the proposed amendments. Debt obligations and leases are included in the proposed definition of financial obligation because the incurrence of a material debt obligation or lease and agreement to the material terms of a debt obligation or lease, which affect security holders, and the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a debt obligation or lease, any of which reflect financial difficulties, could provide important information about the current financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders could be affected.

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<sup>103</sup> See infra note 111.

The term guarantee<sup>104</sup> is intended to capture a contingent financial obligation of the issuer or obligated person to secure obligations of a third party or obligations of the issuer or obligated person. Under certain circumstances, in order to facilitate a financing by a third party, an issuer or obligated person may provide a guarantee to reduce risks to the provider of the financing and lower the cost of borrowing for the third party. That guarantee may assume different forms including a payment guarantee or other arrangement that could expose the issuer or obligated person to a contingent financial obligation. For example, an issuer that is a county could agree to guarantee the repayment of municipal securities issued by a town located in the county. In this instance, the county could be required to use its own funds to repay the town's municipal securities. Furthermore, an issuer or obligated person may provide a guarantee with respect to its own financial obligation. For example, an issuer or obligated person could, in connection with the issuance of variable rate demand obligations, agree to repurchase, with its own capital, bonds that have been tendered but are unable to be remarketed. In this instance, the issuer or obligated person uses its own funds to purchase the bonds instead of a third party liquidity facility. A guarantee provided for the benefit of a third party or a self-liquidity facility or other contingent arrangement would be a guarantee under the proposed amendments. Like debt obligations and leases, guarantees are included in the proposed definition because the incurrence of such material guarantees and the agreements to the material terms of such guarantees, which affect security holders, and the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a guarantee, any of which reflect financial difficulties, could provide important information about the current

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<sup>104</sup> The description of a “guarantee” set forth in this proposing release is solely for purposes of the Rule.

financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected.

As proposed, the term derivative instrument is intended to capture any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument to which an issuer or obligated person is a counterparty.<sup>105</sup> The Commission preliminarily believes that the proposed definition should include derivative instruments that would be entered into by an issuer or obligated person because a derivative instrument could impact the issuer's or obligated person's liquidity and overall creditworthiness or the terms may affect security holders. For example, a common derivative instrument that issuers and obligated persons may enter into is an interest rate swap (i.e., a swap used to hedge interest rate risk), which allows issuers and obligated persons to fix all or part of their exposure to variable interest rates. The use of a derivative instrument, such as a swap or security-based swap, can provide issuers and obligated persons with benefits, including the ability to reduce borrowing costs and/or manage interest rate risk. However, the use of a derivative instrument can also expose the issuer or obligated person to a variety of risks, some of which may be significant.<sup>106</sup> The

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<sup>105</sup> The Commission recognizes that certain of the items intended to be captured under the term derivative instrument may not currently be used by many issuers and obligated persons. However, this list is intended to be sufficiently comprehensive to cover the use of derivative instruments that may develop in the future.

<sup>106</sup> See e.g., Yvette Shields, Chicago's Market Foray Triggers Bleak Disclosures, The Bond Buyer (May 12, 2015), available at <http://www.bondbuyer.com/news/regionalnews/chicagos-market-foray-triggers-bleak-disclosures-1073129-1.html> (discussing the City of Chicago's payment of \$31 million in termination fees to get out of certain interest rate swaps). See also Elizabeth Campbell, Chicago Settling \$390 Million Tab When City Can Least Afford It, Bloomberg (Mar. 17, 2016), available at <https://www.bloomberg.com/news/articles/2016-03-17/chicago-settling-390-million-tab-when-city-can-least-afford-it> (stating that the City of Chicago

agreement to material terms of a derivative instrument, which affect security holders, and the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a derivative instrument, any of which reflect financial difficulties, could adversely impact the issuer's or obligated person's liquidity and overall creditworthiness or adversely affect security holders.<sup>107</sup> For example, if an issuer or obligated person enters into a derivative instrument with terms that may create contingent liquidity risk for the issuer or obligated person, such as a requirement to post collateral or pay a termination fee upon the occurrence of certain events, then such terms could adversely impact the issuer or obligated person's overall liquidity and overall creditworthiness.<sup>108</sup> Further, for example, the occurrence of a termination event under the terms of a derivative instrument reflecting financial difficulties could adversely impact the issuer's or obligated person's overall creditworthiness. Accordingly, the incurrence of a material derivative instrument or the agreement to material terms of a derivative instrument, which affect security holders, and the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a derivative instrument, any of which reflect financial difficulties, could provide important information about the current financial condition of the issuer or obligated person, including potential adverse impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected.

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had already paid about \$290 million to exit various swaps and was planning to spend \$100 million more).

<sup>107</sup> See 2012 Municipal Report, supra note 58, at 91-92.

<sup>108</sup> See e.g., NFMA 2015 Recommended Best Practices, supra note 78.

Monetary obligations resulting from a judicial, administrative, or arbitration proceeding are included in the proposed definition<sup>109</sup> because the requirement to pay<sup>110</sup> such an obligation could adversely impact the issuer's or obligated person's overall creditworthiness and liquidity and adversely affect security holders. For example, a monetary obligation resulting from a judicial, administrative, or arbitration proceeding could be imposed upon an issuer or obligated person that could immediately and adversely impact an issuer's or obligated person's creditworthiness, including its ability to repay its outstanding municipal securities, because of its overall financial condition.<sup>111</sup> While information about monetary obligations resulting from

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<sup>109</sup> A settlement order or consent decree that includes a monetary obligation would be included under this proposed definition.

<sup>110</sup> The Commission preliminarily believes that notice of the incurrence of a monetary obligation resulting from a judicial, administrative, or arbitration proceeding, should be provided within 10 business days of the initial imposition of the monetary obligation.

<sup>111</sup> In 2012, a court awarded a trucking school an \$11.4 million judgment against the City of Hillview, Kentucky which prompted the city of 9,000, which typically brings in less than \$3 million a year in taxes and revenues, to enter into bankruptcy proceedings when it was initially unable to negotiate a repayment deal. While the City of Hillview posted a notice of the commencement of the bankruptcy to EMMA in 2015, the monetary judgment was imposed on the city in 2012, leaving investors without timely access to important information about the incurrence of a debt obligation that affected the city's creditworthiness and terms of the securities that they issue. This information may have impacted an investor's investment decision regarding the city's municipal securities. See Notice: To All Creditors of City of Hillview, Kentucky and Other Parties in Interest (Sep. 2, 2015), available at <http://emma.msrb.org/EP869434-EP673418-EP1075085.pdf>. See also Katy Stech, *How a \$15 Million Legal Bill Put a Kentucky Town in Bankruptcy*, Wall St. J. (Sep. 30, 2015), available at <http://blogs.wsj.com/bankruptcy/2015/09/30/how-a-15-million-legal-bill-put-a-kentucky-town-in-bankruptcy/>. See also Katy Stech, *Bankrupt Kentucky City Reaches Repayment Deal*, Wall St. J. (Mar. 30, 2016), available at <http://www.wsj.com/articles/bankrupt-kentucky-city-reaches-repayment-deal-1459366153>. For further example, in 2008, a court awarded a developer a \$43 million judgment against the Town of Mammoth Lakes, California. The judgment, which was three times the size of the town's operating budget, prompted the town to enter into bankruptcy when it was initially unable to negotiate a settlement with the developer. While the town posted notice of the commencement of the bankruptcy to EMMA in 2012, the monetary judgment was imposed on the town in 2008, leaving investors without timely access to important information about the incurrence of

judicial, administrative, or arbitration proceedings may be publicly available, having this information available on EMMA would help provide investors and other market participants with ready and prompt access to this information in an electronic format and in one central location. Further, while information about a monetary obligation resulting from judicial, administrative, or arbitration proceedings may be disseminated through the media or otherwise in the issuer's or obligated person's immediate community, such information may not be circulated to investors and other market participants who reside outside of the issuer's or obligated person's locality. Accordingly, the material incurrence of a monetary obligation resulting from judicial, administrative, or arbitration proceedings and the agreements to the material terms of such obligation, which affect security holders, and the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of such obligation, any of which reflect financial difficulties, could provide important information about the current financial condition of the issuer or obligated person, including potential adverse impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected.

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a debt obligation that affected the town's creditworthiness and terms of the securities they issue. This information may have impacted an investor's investment decision regarding the town's municipal securities. See Notice of Commencement of Case and Objection Deadline (July 19, 2012), available at <http://emma.msrb.org/EP670581-EP522435-EP923717.pdf>. See also Louis Sahagun, Mammoth Lakes Files for Bankruptcy Over \$43 Million Judgment, L.A. Times (July 2, 2012), available at <http://articles.latimes.com/2012/jul/02/local/la-me-mammoth-lakes-20120703>. See also Robert Holmes, Mammoth Lakes: Back From the Brink, Urban Land (June 10, 2013), available at <http://urbanland.uli.org/industry-sectors/mammoth-lakes-back-from-the-brink/>. See also Dakota Smith, L.A. Needs to Borrow Millions to Cover Legal Payouts, City Report Says, L.A. Times (Jan. 9, 2017), available at <http://www.latimes.com/local/lanow/la-me-ln-legal-payouts-20170109-story.html>; Jessica DiNapoli, Hillview's Bankruptcy Negative for Small Town Government – Moody's, Reuters (Aug. 31, 2015), available at <http://www.reuters.com/article/usa-kentucky-hillview-idUSL1N112RP20150831>.

The proposed definition would help improve the timely availability of important information to investors and other market participants regarding financial obligations and provide investors the ability to take such information into account when making investment decisions and other market participants the ability to take such information into account when undertaking credit analyses.

The Commission requests comment regarding all aspects of the proposed definition of financial obligation. When responding to the requests for comment, please explain your reasoning.

- Are there any more appropriate alternative definitions? For example, would it be more appropriate to include a definition that does not identify each type of financial obligation?
- Should each type of financial obligation included in the proposed definition be defined? Or is there an existing definition of financial obligation that the Commission could instead use?
- Are there any financial obligations that would not be covered in the proposed definition that should be?
- Should other contracts that create future payment obligations (e.g., a contract for waste disposal services) be included in the proposed definition?
- Should any of the terms included in the definition be modified? Should any terms be added to the definition to achieve the stated goal?
- Comment is also requested on whether including a definition in the Rule is necessary.

2. 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 Commission proposes to add an event notice for the occurrence of a 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, provided the occurrence reflects financial difficulties, to the list of events in paragraph (b)(5)(i)(C) of the Rule. As with the other event notice, a Participating Underwriter would need to reasonably determine that the issuer or obligated person has agreed to provide notice of such events in its continuing disclosure agreement.

The Commission preliminarily believes that qualifying the event notice trigger with “any of which reflect financial difficulties,” would strike an appropriate balance. As proposed, the term “any of which reflect financial difficulties” applies to all of the events listed in the proposed event notice (*i.e.*, a default, event of acceleration, termination event, modification of terms, or other similar events). For example, an issuer or obligated person may covenant to provide the counterparty with notice of change in its address and may not promptly comply with the covenant. A failure to comply with such a covenant may not reflect financial difficulties; therefore, absent other circumstances, this event likely does not raise the concerns the proposed amendments are intended to address. On the other hand an issuer or obligated person could agree to replenish a debt service reserve fund if draws have been made on such fund. In this example, if an issuer or obligated person fails to comply with such covenant, then such an event likely should be disclosed to investors and other market participants. The concept of “reflecting financial difficulties” has been used since the adoption of Rule 15c2-12 in paragraph

(b)(5)(i)(C)(3) and in paragraph (b)(5)(i)(C)(4), and, as such, market participants should be familiar with the concept as it relates to the operation of Rule 15c2-12.<sup>112</sup>

As described above, investors and other market participants may not have any access or timely access to disclosure regarding the occurrence of a default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, and any of which reflect financial difficulties. For example, if an issuer or obligated person defaults and such default reflects financial difficulties, investors either may not ever become aware of the default or may not become aware of the default in a timely manner. In both these cases, investors could be making investment decisions, and other market participants could be undertaking credit analyses, without important information regarding the current financial condition of the issuer or obligated person that could potentially adversely impact the issuer's or obligated person's liquidity and overall creditworthiness. If an issuer's or obligated person's liquidity and creditworthiness are adversely impacted, the credit quality and price of the issuer's or obligated person's outstanding municipal securities could be affected which could impact an investor's investment decision or a market participant's credit analysis.

A default could be a monetary default, where an issuer or obligated person fails to pay principal, interest, or other funds due, or a non-payment related default, which occurs when the issuer or obligated person fails to comply with specified covenants.<sup>113</sup> Generally, under standard

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<sup>112</sup> See 1994 Amendments Proposing Release, *supra* note 40; 1994 Amendments Adopting Release, *supra* note 40; See also Securities and Exchange Act Release No. 34-60332 (July 17, 2009), 74 FR 36832 (July 24, 2009); 2010 Amendments Adopting Release, *supra* note 54.

<sup>113</sup> See, e.g., MSRB, Glossary of Municipal Securities Terms: Default, available at <http://www.msrb.org/Glossary/Definition/DEFAULT.aspx>.

contract terms, if a monetary default occurs, or a non-payment related default is not cured within a specified period, such default becomes an “event of default” and the trustee or counterparty to the financial obligation may exercise legally available rights and remedies for enforcement, including an event of acceleration. An event of acceleration typically provides the outstanding balance becomes immediately due and payable upon the occurrence of one or more specified events of default.<sup>114</sup> Both the occurrence of a default and an event of acceleration if reflecting financial difficulties are included in the proposed amendments because both types of events provide current information regarding the financial condition of the issuer or obligated person and the occurrence of either event could adversely impact an issuer’s or obligated person’s liquidity and overall creditworthiness.<sup>115</sup> For example, the occurrence of a monetary default caused by the issuer or obligated person’s failure to make a payment due likely would be relevant to evaluating the current financial condition of the issuer or obligated person. Further, for example, an event of acceleration of the financial obligation and the issuer or obligated person’s obligation to pay the outstanding balance of the financial obligation immediately could have an impact on the issuer’s or obligated person’s liquidity and overall creditworthiness. Investors could be making investment decisions, and other market participants could be undertaking credit analyses, without important information about these types of events.

A termination event typically allows either party to a financial obligation to terminate the agreement subject to certain conditions, including in some cases payment of a termination fee by

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<sup>114</sup> See, e.g., MSRB, Glossary of Municipal Securities Terms: Acceleration, [available at http://www.msrb.org/Glossary/Definition/ACCELERATION.aspx](http://www.msrb.org/Glossary/Definition/ACCELERATION.aspx).

<sup>115</sup> See NFMA 2015 Recommended Best Practices, [supra](#) note 78.

the issuer or obligated person.<sup>116</sup> Industry commenters have noted that the occurrence of a termination event, that results in an increase in outstanding debt, could affect an issuer's or obligated person's level of debt service as a percent of expenditures, which is an important indicator of credit quality for general obligation bonds, or such increase in debt could affect the amount of available revenues to pay debt service for revenue bonds which is considered in connection with rate covenants or additional bonds tests. If an issuer's or obligated person's liquidity and overall creditworthiness is impacted, the credit quality and price of the issuer's or obligated person's outstanding municipal securities could be affected, which could impact an investor's investment decision.<sup>117</sup> For example, if the terms of a derivative instrument such as a swap require, upon the occurrence of a termination event (e.g., a credit rating downgrade), that an issuer or obligated person pay a termination fee, such termination event may have an immediate impact on the issuer's or obligated person's liquidity and creditworthiness and may cause investors to reevaluate their investment decisions and other market participants to reevaluate their credit analyses.

A modification of terms of a financial obligation may occur when an issuer or obligated person is in a distressed financial situation. For example, there may be circumstances where an issuer or obligated person, due to financial difficulties, anticipates not meeting the terms of a financial obligation, such as a covenant to maintain a specified debt service coverage ratio,<sup>118</sup> and the issuer or obligated person is able to negotiate the modification of the terms of the

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<sup>116</sup> See, e.g., Liz Farmer, Cities Paying Millions to Get Out of Bad Bank Deals, *Governing* (Mar. 6, 2015), available at <http://www.governing.com/topics/finance/gov-chicago-paying-millions-bad-swap-deals.html> (discussing payments of termination fees by several municipalities and municipal entities to exit unfavorable interest rate swaps).

<sup>117</sup> See NFMA 2015 Recommended Best Practices, *supra* note 78.

<sup>118</sup> See *supra* note 97.

financial obligation with the counterparty. Furthermore, in addition to negotiating a change to certain covenants in the financial obligation with the counterparty to avoid default under the terms of the financial obligation, the issuer or obligated person could agree to new terms including providing the counterparty with superior rights to assets or revenues that were previously pledged to existing security holders. Modifications agreed to could provide important information about the current financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected.

Other similar events under the terms of a financial obligation of the obligated person reflecting financial difficulties share similar characteristics to one of the listed events (a default, event of acceleration, termination event, or modification of terms). An issuer or obligated person could fail to perform a covenant not related to payment required under a financial obligation that does not result in the occurrence of a default, but the occurrence of this other event does reflect financial difficulties of the issuer or obligated person. For example, an issuer could fail to meet a construction deadline with respect to a facility being financed by the proceeds of a financial obligation due to financial difficulties. As a result of the failure to meet this deadline, a default does not occur, but the lender is entitled to take possession of the facility and complete construction. Like the events described above, the occurrence of the failure to meet a performance covenant reflecting financial difficulties could provide information relevant in making an assessment of the current financial condition of the issuer or obligated person, including potential adverse impacts to the issuer's or obligated person's liquidity and overall creditworthiness, and whether security holders have been affected.

Although the occurrence of defaults<sup>119</sup> and other events under the terms of a financial obligation of the obligated person reflecting financial difficulties listed in proposed subparagraph (b)(5)(i)(C)(16) may not be common in the municipal market, the Commission notes that the occurrence of such events can significantly and adversely impact the value of an issuer's or obligated person's outstanding municipal securities. The Commission also believes the proposed amendments would facilitate investor access to important information in a timely manner and help to enhance transparency in the municipal securities market and enhance investor protection. If an issuer or obligated person provides an event notice to the MSRB, it would be displayed on the MSRB's EMMA website and the public would be provided with free public access to the event notice and, if wanted, automatic alerts from EMMA regarding the occurrence of the event. In order to apprise investors of information, the Commission further preliminarily believes an event notice for the occurrence of a 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, generally should include a description of the event and the consequences of the event, if any. A description of the event and the consequences of the event, if any, would help further the availability of information in a timely manner to further assist investors in making more informed investment decisions.

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<sup>119</sup> According to Moody's, between 1970 and 2014, 95 municipal issuers rated by Moody's have defaulted on their bonded debt or related guarantees. In particular, only eight general obligation bond issuers, including cities, counties, and other districts, defaulted during this 45-year period. However, Moody's notes that municipal issuers can experience financial distress without triggering a default. For example, they state that there were no Moody's rated municipal defaults in 2014 despite a sharp deterioration in credit quality by a number of public finance credits. See Moody's, US Municipal Bond Defaults and Recoveries, 1970-2014 (July 24, 2015).

The Commission requests comment regarding all aspects of the proposed addition of subparagraph (b)(5)(i)(C)(16) concerning the event notice for an occurrence of a 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. When responding to the requests for comment, please explain your reasoning.

- Are there additional events that should be specified in the rule text? Is “other similar event” broad enough to capture all events that upon their occurrence may reflect that an issuer or obligated person is in financial difficulty? Are there events included in the proposed rule text that should be omitted?
- The Commission further requests comment as to whether the qualification “reflecting financial difficulties” is appropriate for subparagraph (b)(5)(i)(C)(16) of the Rule. Should any or all of the items included in the proposed rule text not be subject to the proposed qualification? Although the concept of “reflecting financial difficulties” has been used since the adoption of Rule 15c2-12, the Commission asks whether it should provide guidance regarding the use of this concept in the context of these proposed amendments to Rule 15c2-12.
- In addition, commenters should address the benefits and costs of this aspect of the proposed amendments.

B. Technical Amendment

The Commission proposes a technical amendment to paragraph (b)(5)(i)(C)(14) of the Rule to remove the term “and” since new events are proposed to be added to paragraph (b)(5)(i)(C) of the Rule.

C. Compliance Date and Transition

If the Commission adopts the proposed amendments to Rule 15c2-12, they would apply to continuing disclosure agreements that are entered into in connection with primary offerings occurring on or after the compliance date of such proposed amendments. The Commission recognizes that continuing disclosure agreements entered into prior to the compliance date of any final amendments likely would not reflect changes made to the Rule by such amendments. As a result, event items covered by a continuing disclosure agreement entered into prior to the compliance date of any amendments may be different from those event items covered by a continuing disclosure agreement entered into on or after the compliance date.

The Commission preliminarily believes that if the proposed amendments to Rule 15c2-12 were adopted it would be preferable to implement them expeditiously. If the Commission were to approve the proposed amendments, the Commission preliminarily is considering a compliance date that would be three months after any final adoption of the proposed amendments to allow sufficient time for the MSRB to make necessary modifications to the EMMA system, and for Participating Underwriters to comply with the new Rule.<sup>120</sup> The Commission requests comment

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<sup>120</sup> The 2010 Amendments became effective on August 9, 2010, six months after Commission approval, with the exception of the Commission interpretive guidance (Part 241) which became effective June 10, 2010. Due to the limited scope of the proposed amendments as compared to the 2010 Amendments, the Commission proposes that the compliance date of the proposed amendments discussed herein would be no earlier than

on such a compliance date and whether another compliance date might be preferable. In particular, comment is requested regarding any transition issues with respect to the proposed amendments, such as whether there would be any conflicts with respect to terms in existing continuing disclosure agreements.

The Commission notes that currently under paragraph (c) of the Rule, a dealer cannot recommend the purchase or sale of a municipal security unless such dealer has procedures in place that provide reasonable assurance that it will receive prompt notice of any event disclosed pursuant to paragraphs (b)(5)(i)(C) and (D) and paragraph (d)(2)(ii)(B) of the Rule with respect to the security. In the case of municipal securities subject to a continuing disclosure agreement entered into prior to the compliance date of any final amendments, the recommending dealer would receive notice solely of those events covered by that continuing disclosure agreement, namely, the events specified in the Rule when the continuing disclosure agreement was entered into. Because, in such case, the continuing disclosure agreement likely would not cover any of the items proposed to be added to the Rule, the recommending dealer would not be required to have procedures in place that provide reasonable assurance that it would receive prompt notice of events proposed to be added to the Rule.<sup>121</sup>

The Commission requests comment on the impact of the proposed amendments with respect to dealers that recommend the purchase or sale of municipal securities. The Commission

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three months after any final approval of the proposed amendments, should the Commission adopt these proposed rule amendments.

<sup>121</sup> 17 CFR 240.15c2-12(c) requires a dealer to have procedures in place that provide reasonable assurance that the dealer will receive prompt notice of any event that the Rule requires to be disclosed. Dealers are also required to comply with MSRB fair practice rules (*i.e.*, rules that relate primarily to customer protection, fair dealing and supervision), including, for example, MSRB Rule G-47 that requires dealers transacting in municipal securities to provide all material information known about the transaction, including material information about the security that is reasonably accessible to the market.

also requests comment on what changes, if any, dealers would have to make to their procedures in connection with any final amendments that the Commission may adopt relating to the receipt of event notices. The Commission further seeks comment on any other transition issues in connection with the proposed amendments to Rule 15c2-12.

D. Request for Comment

The Commission seeks comment on all aspects of the proposed amendments to the Rule. In addition to the comments requested throughout this proposing release, comment is requested on whether the proposed amendments would further enhance the availability of important information to investors, and whether the proposed amendments would help facilitate investors' ability to obtain such information. Further, the Commission seeks comment regarding the impact of the proposed amendments on Participating Underwriters, dealers, issuers, obligated persons, investors, the MSRB, information vendors, and others that may be affected by the proposed amendments. In addition, the Commission seeks comment on whether there are alternative approaches or modifications to the Commission's proposed approach to achieve our objectives with regard to the two events proposed here to be included in Rule 15c2-12(b)(5)(i)(C). Commenters are requested to indicate their views and to provide any other suggestions that they may have.

**IV. Paperwork Reduction Act**

Certain provisions of the proposed amendments to the Rule contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>122</sup> In accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, the Commission has submitted revisions to the currently approved collection of information titled "Municipal

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<sup>122</sup> 44 U.S.C. 3501 et. seq.

Securities Disclosure” (17 CFR 240.15c2-12) (OMB Control No. 3235-0372) to the Office of Management and Budget (“OMB”). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Summary of Collection of Information

Under paragraph (b) of Rule 15c2-12, a Participating Underwriter currently is required: (1) to obtain and review an official statement deemed final by an issuer of the securities, except for the omission of specified information, prior to making a bid, purchase, offer, or sale of municipal securities; (2) in non-competitively bid offerings, to send, upon request, a copy of the most recent preliminary official statement (if one exists) to potential customers; (3) to contract with the issuer to receive, within a specified time, sufficient copies of the final official statement to comply with the Rule’s delivery requirement, and the requirements of the rules of the MSRB; (4) to send, upon request, a copy of the final official statement to potential customers for a specified period of time; and (5) before purchasing or selling municipal securities in connection with an offering, to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide annual filings, event notices, and failure to file notices (i.e., continuing disclosure documents) to the MSRB in an electronic format as prescribed by the MSRB.<sup>123</sup> In addition, under paragraph (c) of the Rule, a dealer that recommends the purchase or sale of a municipal security must have procedures in place that provide reasonable assurance that it will receive prompt notice of any

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<sup>123</sup> 17 CFR 240.15c2-12(b).

event specified in paragraph (b)(5)(i)(C) of the Rule and any failure to file annual financial information regarding the security.<sup>124</sup>

Under paragraph (b)(5)(i)(C) of the Rule, Participating Underwriters are required to reasonably determine that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide event notices to the MSRB, in an electronic format as prescribed by the MSRB, in a timely manner not in excess of ten business days, when any of the following events with respect to the securities being offered in an offering occurs: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the I.R.S. of proposed or final determinations of taxability, Notices of Proposed Issue or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security; (7) modifications to rights of security holders, if material; (8) bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of securities, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership or similar event of the obligated person; (13) the consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement

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<sup>124</sup> 17 CFR 240.15c2-12(c).

relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of a name of a trustee, if material.<sup>125</sup>

Under the proposed amendments, the Commission proposes to add two additional event notices that a Participating Underwriter in an Offering must reasonably determine that an issuer or an obligated person has undertaken, in a written agreement or contract for the benefit of holders of the municipal securities, to provide to the MSRB. Specifically, the proposed amendments would amend the list of events for which notice is to be provided to include the proposed events.

For purposes of the proposed amendments, the Commission is proposing to define the term “financial obligation” to mean a (i) debt obligation, (ii) lease, (iii) guarantee, (iv) derivative instrument, or (v) monetary obligation resulting from a judicial, administrative, or arbitration proceeding. As proposed to be defined, the term financial obligation does not include municipal securities as to which a final official statement has been provided to the MSRB consistent with Rule 15c2-12.

#### B. Proposed Use of Information

The proposed amendments would provide dealers with timely access to important information about municipal securities that they can use to carry out their obligations under the securities laws, thereby reducing the likelihood of antifraud violations. This information could be used by individual and institutional investors; underwriters of municipal securities; other market participants, including dealers; analysts; municipal securities issuers; the MSRB; vendors of information regarding municipal securities; the Commission and its staff; and the public

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<sup>125</sup> 17 CFR 240.15c2-12(b)(5)(i)(C).

generally.<sup>126</sup> The proposed amendments would enable market participants and the public to be better informed about material events that occur with respect to municipal securities and their issuers and would assist investors in making decisions about whether to buy, hold or sell municipal securities.

C. Respondents

In November 2015, OMB approved an extension without change of a currently approved collection of information associated with the Rule. The currently approved paperwork collection associated with Rule 15c2-12 applies to dealers, issuers of municipal securities, and the MSRB. The paperwork collection associated with these proposed amendments would apply to the same respondents.

The proposal would add two additional event disclosure items that a Participating Underwriter in an Offering is required to reasonably determine that the issuer or an obligated person has undertaken in a continuing disclosure agreement to submit event notices to the MSRB in a timely manner not in excess of ten business days of their occurrence. The Commission gathered updated information regarding the paperwork burden associated with Rule 15c2-12 in connection with the 2015 extension of its currently approved collection and is using these estimates in preparing the paperwork collection estimates associated with its current proposal because it believes they continue to be reasonable estimates as of the date of this proposal. In 2015, the Commission estimated that the number of respondents impacted by the paperwork collection associated with the Rule consists of approximately 250 dealers and 20,000 issuers.<sup>127</sup>

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<sup>126</sup> See supra, Section II.B.

<sup>127</sup> See Submission for OMB Review; Comment Request (Extension: Rule 15c2-12, SEC File No. 270-330, OMB Control No. 3235-0372), 80 FR 9758 (Feb. 24, 2015) (“PRA

The Commission expects that the proposed amendments would not change the number of dealer respondents described in the currently approved PRA collection. The Commission also expects that the proposed amendments would not change the number of issuer respondents in comparison to the Rule's currently approved PRA collection. The number of respondents would not change because the proposed amendments would not expand the types of securities covered under subparagraphs (b)(5) and (c) of the Rule, and thus would not increase the number of dealers or issuers having a paperwork burden. The Commission's currently approved PRA collection included a paperwork collection burden for the MSRB and, for purposes of the proposed amendments, the Commission expects that the MSRB also would be a respondent.

D. Total Annual Reporting and Recordkeeping Burden

In the currently approved PRA collection, the Commission included estimates for the hourly burdens that the Rule imposes upon dealers, issuers of municipal securities, and the MSRB. Because the proposed amendments do not change the structure of the rule or who it applies to, the Commission has relied on these estimates to prepare the analysis discussed below for each of the aforementioned entities.

The Commission estimates the aggregate information collection burden for the amended Rule would consist of the following:

1. Dealers

Consistent with the Commission's estimates in 2015, the Commission estimates that approximately 250 dealers potentially could serve as Participating Underwriters in an offering of

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Notice"). The number of issuers in the estimate reflects those issuers that are subject to a continuing disclosure agreement.

municipal securities. Therefore, the Commission estimates that, under the proposed amendments, the maximum number of dealer respondents would be 250.

Under the current Rule, the Commission has estimated that the total annual burden on all 250 dealers is 22,500 hours. This estimate includes an estimate of (1) 2,500 hours per year for 250 dealers (10 hours per year per dealer) to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB, and (2) 20,000 hours per year for 250 dealers (80 hours per year per dealer) serving as Participating Underwriters to determine whether issuers or obligated persons have failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of the Rule.<sup>128</sup>

i. Proposed Amendments to Events to be Disclosed under a Continuing Disclosure Agreement

Under the current Rule, the Commission has estimated that 250 dealers would spend an average of 10 hours per year per dealer to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB. The proposed amendments to paragraph (b)(5)(i)(C) of the Rule would not alter a dealer's obligation to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB.

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<sup>128</sup>

Id.

The Commission does not believe that the proposed amendments would change the number of issuers with municipal securities offerings that are subject to the Rule. The proposed changes to the Rule would result in a need for issuers to make changes to certain provisions of their continuing disclosure agreements,<sup>129</sup> and a need for dealers to reasonably determine that the issuer or obligated person in an offering subject to the Rule has undertaken, in a written agreement or contract that includes the changes required by the proposed amendments, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB. Because the continuing disclosure agreements that are reviewed by dealers as part of their obligation under the Rule tend to be standard form agreements and the proposed amendments would require targeted changes to those agreements to incorporate the proposed events, the Commission does not believe that the proposed amendments would increase the annual hourly burden for dealers to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB.<sup>130</sup>

Thus, the Commission estimates that pursuant to the Rule as proposed to be amended, 250 dealers would continue to incur an estimated average burden of 2,500 hours per year (10 hours per year per dealer) to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB.

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<sup>129</sup> See *infra*, Section IV.D.2. for a discussion of issuers' reporting and recordkeeping burden and Section IV.E.2. for a discussion of issuers' total annual cost, including the one-time costs for issuers to update their standard form continuing disclosure agreements to reflect the proposed amendments.

<sup>130</sup> See *infra*, Section IV.E.1. for a discussion of dealers' total annual cost associated with the proposed amendments.

Under the current Rule, the Commission has also estimated that each of the 250 dealers serving as a Participating Underwriter will expend an average of 80 hours per year per dealer to determine whether issuers or obligated persons have failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of the Rule. Determining whether an issuer or obligated person has filed continuing disclosure documents will usually include an examination of the filings made over a five-year period on the MSRB's EMMA system. An underwriter may also ask questions of an issuer, and, where, appropriate, obtain certifications from an issuer, obligated person, or other appropriate party about facts such as the occurrence of specific events listed in paragraph (b)(5)(i)(C) of the Rule and the timely filing of annual filings and any required event notices or failure to file notices.

The Commission does not believe that the proposed amendments would change the number of Participating Underwriters that are subject to the Rule. However, the Commission has estimated that the amendments to the Rule would result in an average expenditure of an additional 10 hours per year per dealer for each dealer to determine whether issuers or obligated persons have failed to comply, in all material respects, with any previous undertakings in a written contract or agreement specified in paragraph (b)(5)(i) of the Rule.

Accordingly, including the additional hourly burden resulting from the proposed amendments, the Commission estimates that 250 dealers would incur an estimated average burden of 25,000 hours per year to comply with the Rule, as proposed to be amended.<sup>131</sup>

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<sup>131</sup> (22,500 hours (total estimated annual hourly burden for all dealers under the current Rule) + 2,500 hours (total estimated additional annual hourly burden for all dealers under the proposed amendments to the Rule) = 25,000 hours.

ii. One-Time Paperwork Burden

The Commission estimates that a dealer would incur a one-time paperwork burden to have its internal compliance attorney prepare and issue a notice advising its employees about the proposed revisions to Rule 15c2-12, including any updates to policies and procedures affected by the proposed amendments. In the 2010 Amendments Adopting Release, the Commission estimated that it would take a dealer's internal compliance attorney approximately 30 minutes to prepare and issue a notice describing the dealer's obligations in light of the 2010 Amendments to the Rule.<sup>132</sup> The Commission believes that this 30 minute estimate to prepare a notice is also a reasonable estimate of the amount of time required for a dealer's internal compliance attorney to prepare such a notice for these proposed amendments to the Rule because the types of changes that would be necessitated by the proposed amendments are similar to the types of changes necessitated by the 2010 Amendments. The Commission believes that the task of preparing and issuing a notice advising the dealer's employees about the proposed amendments, including any updates to policies and procedures affected by the proposed amendments, is consistent with the type of compliance work that a dealer typically handles internally. Accordingly, the Commission estimates that 250 dealers would each incur a one-time, first-year burden of 30 minutes to prepare and issue a notice to its employees regarding the dealer's new obligations under the proposed amendments, including any updates to policies and procedures affected by the proposed amendments, for a total one-time, first-year burden of 125 hours.

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<sup>132</sup> See 2010 Amendments Adopting Release, supra note 54, at 33128.

### iii. Total Annual Burden for Dealers

Under the proposed amendments, the total burden on dealers would be 25,125 hours for the first year<sup>133</sup> and 25,000 hours for each subsequent year.<sup>134</sup>

### 2. Issuers

The proposed amendments would result in a paperwork burden on issuers of municipal securities. For this purpose, issuers include issuers of municipal securities described in paragraph (f)(4) of the Rule and obligated persons described in paragraph (f)(10) of the Rule.

In its currently approved collection, the Commission estimates that approximately 20,000 issuers will annually submit to the MSRB approximately 62,596 annual filings, 73,480 event notices, and 7,063 failure to file notices.<sup>135</sup>

#### i. Proposed Amendments to Event Notice Provisions of the Rule

The Commission proposes to modify paragraph (b)(5)(i)(C) of the Rule, which presently requires Participating Underwriters in an Offering to reasonably determine that an issuer or obligated person has entered into a continuing disclosure agreement that, among other things, contemplates the submission of an event notice to the MSRB in an electronic format upon the occurrence of any events set forth in the Rule. The current Rule contains fourteen such events. The proposed amendments to this paragraph of the Rule would add two new event disclosure items. In 2015, the Commission estimated that approximately 20,000 issuers of municipal

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<sup>133</sup> (250 (dealers impacted by the proposed amendments to the Rule) x 100 hours (10 hours + 80 hours +10 hours)) + (250 (dealers impacted by the proposed amendments to the Rule) x .5 hour (estimate for one-time burden to issue notice regarding dealer's obligations under the proposed amendments to the Rule)) = 25,125 hours.

<sup>134</sup> 250 (dealers impacted by the proposed amendments to the Rule) x 100 hours = 25,000 hours.

<sup>135</sup> See PRA Notice, supra note 127.

securities with continuing disclosure agreements would prepare and submit approximately 73,480 event notices annually. The Commission believes that the proposed amendments to paragraphs (b)(5)(i)(C) of the Rule would increase the current annual paperwork burden for issuers because they would result in an increase in the number of event notices to be prepared and submitted.

Under the proposed amendments, subparagraph (b)(5)(i)(C)(15) would be added to the Rule and would contain a new disclosure event in the case of the 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. The proposed addition to the Rule would expand the circumstances in which issuers would submit an event notice to the MSRB. The Commission estimates that the proposed amendment in subparagraph (b)(5)(i)(C)(15) of the Rule would increase the total number of event notices submitted by issuers annually by approximately 2,100 notices.<sup>136</sup>

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<sup>136</sup> The Commission based its estimate on the number of events that would result from an incurrence of a financial obligation of the obligated person, if material, on the following: (i) Estimates of the size of the municipal bank loan market vary, but range as high as \$80 billion per year. See Jack Casey, How the SEC Could Help with Issuer Bank Loan Disclosure, *The Bond Buyer* (May 25, 2016) (“How the SEC Could Help”), available at <http://www.bondbuyer.com/news/washington-securities-law/how-the-sec-could-help-with-issuer-bank-loan-disclosure-1104508-1.html> (“How the SEC Could Help”); (ii) In 2015, S&P evaluated 126 bank loans totaling \$5.2 billion. See Martin Z. Braun, Regulators Warn Banks about Compliance Risks for Muni Bank Loans, *Bloomberg* (Apr. 4, 2016), available at <http://www.bloomberg.com/news/articles/2016-04-04/regulators-warn-banks-about-compliance-risks-for-muni-bank-loans> (bank loans reviewed by S&P in 2015 averaged approximately \$41.3 million); and (iii) \$80 billion (estimated size of annual municipal bank loan market)/\$40 million average loan size of loans = 2,000 loans. In Section III.A. of this proposing release, the Commission notes that a particular municipal bank loan may not be material because of the bank loan’s relative size or other factors. However, to provide an estimate for the paperwork burden that would not be

Under the proposed amendments, subparagraph (b)(5)(i)(C)(16) of the Rule would be amended to include 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. The inclusion of such event in this subparagraph of the Rule would result in an expansion of the circumstances in which issuers would submit an event notice to the MSRB. The Commission estimates that proposed amendments to subparagraph (b)(5)(i)(C)(16) of the Rule would increase the total number of event notices to be submitted by issuers annually by approximately 100 notices.<sup>137</sup>

ii. Total Burden on Issuers for Proposed Amendments to Event Notices

In 2015, the Commission estimated that the process for an issuer to prepare and submit event notices to the MSRB in an electronic format, including time to actively monitor the need

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under-inclusive the Commission has elected to use this estimate. In addition, the Commission estimates that up to 100 additional notices per year may be attributable to the incurrence of other types of financial obligations. For example, two derivative or other transactions were reported to the MSRB's EMMA system during 2015 and three derivative or other transactions were reported to the MSRB's EMMA system during the first half of 2016. However, the Commission believes that many non-bank financial obligations of obligated persons currently are not reported to the MSRB and that many may not be made public at all. Therefore, 2,000 events related to material bank loans annually + 100 other types of material financial obligations annually = 2,100 total events annually for the incurrence of a material financial obligation of the obligated person.

<sup>137</sup> The Commission based this estimate on the following: (i) 420 principal/interest payment delinquencies and non-payment related defaults were reported to the MSRB's EMMA system in 2015; (ii) The bank loan market may be as much as 20 percent of the municipal securities market (see How the SEC Could Help, supra note 136); (iii)  $420 \times .2 = 84$ ; and (iv) some bank loans may not be material to securities subject to Rule 15c2-12. Based on these factors and industry sources, the Commission has estimated that there would typically be no more than 100 events annually. The Commission preliminarily believes that the actual number of events annually may be significantly less than 100 because defaults and other events reflecting financial difficulties are generally a rare occurrence in the municipal securities market. However, to provide an estimate for the paperwork burden that would not be under-inclusive the Commission has elected to use a higher estimate with respect to the number of events that occur each year.

for filing, would require an average of approximately two hours per filing. The Commission estimates that time required for an issuer to prepare and submit the proposed two additional types of event notices to the MSRB in an electronic format, including time to actively monitor the need for filing, would also require an average of approximately two hours per filing, because the two proposed types of event notices would require substantially the same amount of time to prepare as those prepared for existing events. The Commission considered the hourly burdens placed on both issuers that use designated agents to submit continuing disclosure filings to the MSRB and the burdens placed on issuers that do not use designated agents in computing this overall average. Under the proposed amendments to paragraph (b)(5)(i)(C) of the Rule, the Commission estimates that the 20,000 issuers of municipal securities with continuing disclosure agreements would prepare an additional 2,200 event notices annually,<sup>138</sup> raising the total number of event notices prepared by issuers annually to approximately 75,680.<sup>139</sup> This increase in the number of event notices would result in an increase of 4,400 hours in the annual paperwork burden for

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<sup>138</sup> 2,100 (estimated number of incurrence of a financial obligation event notices under proposed amendments) + 100 (estimated number of event notices reflecting financial difficulties under proposed amendments) = 2,200 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule).

<sup>139</sup> 73,480 (current estimated number of annual event notices) + 2,200 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) = 75,680 annual event notices. The Commission is therefore estimating that the proposed amendments would increase the number of issuers' annual event notices by approximately three percent.  $2,200$  (estimated additional annual event notices) /  $73,480$  (estimated current annual event notices) =  $.299$  = approximately three percent. The proposed amendments to the event notice provisions of the Rule would increase total filings submitted by approximately 1.5%:  $2,200$  (estimated additional event notices under the proposed event notice amendments) /  $143,139$  (estimated number of continuing disclosure documents submitted under current Rule ( $73,480$  (event notices) +  $62,596$  (annual filings) +  $7,063$  (failure to file notices) =  $143,139$ )) =  $.015$  = approximately 1.5%.

issuers to submit event notices.<sup>140</sup> This increase would result in an annual paperwork burden for issuers to submit event notices of approximately 151,360 hours (146,960 hours + 4,400 hours).

iii. Total Burden for Issuers

Accordingly, under the proposed amendments, the total burden on issuers to submit continuing disclosure documents would be 603,658 hours.<sup>141</sup>

3. MSRB

In its currently approved collection, the Commission estimated that the MSRB incurred an annual burden of approximately 12,699 hours to collect, index, store, retrieve, and make available the pertinent documents under the Rule.<sup>142</sup> The Commission staff understands from MSRB staff that MSRB staff currently estimates that 12,699 hours is still a reasonable estimate with respect to operating the primary market and continuing disclosure submission platform, managing those submissions securely and deploying educational resources and other tools that make the submissions meaningful and useful. The Commission estimates, based on preliminary consultations between Commission staff and MSRB staff, that it would require approximately 1,162 hours for the MSRB to implement the necessary modifications to EMMA to reflect the additional mandatory disclosures under Rule 15c2-12 in the proposed amendments. Thus, the Commission estimates that the total burden on the MSRB to collect, store, retrieve, and make

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<sup>140</sup> 2,200 (total number of additional event notices that would be prepared under the proposed amendments to the event notice provisions of the Rule) x 2 hours (estimated time to prepare an event notice under 2015 PRA Notice) = 4,400 hours.

<sup>141</sup> 438,172 hours (current estimated burden for issuers to submit annual filings) + 151,360 hours (estimated annual burden for issuers to submit event notices under the proposed amendments) + 14,126 hours (current estimated annual burden for issuers to submit failure to file notices) = 603,658 hours.

<sup>142</sup> See 2015 PRA Notice, supra note 127.

available the disclosure documents covered by the proposed amendments to the Rule would be 13,861 hours for the first year,<sup>143</sup> and 12,699 hours for each subsequent year.

#### 4. Annual Aggregate Burden for Proposed Amendments

The Commission estimates that the ongoing annual aggregate information collection burden for the Rule after giving effect to the proposed amendments would be 641,357 hours.<sup>144</sup>

#### E. Total Annual Cost

##### 1. Dealers and the MSRB

The Commission does not expect dealers to incur any additional external costs associated with the proposed amendments to the Rule because the proposed amendments do not change the obligation of dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB, and to determine whether the issuer or obligated person has failed to comply with such undertakings in all material respects. As previously noted, the Commission believes that the task of preparing and issuing a notice advising the dealer's employees about the proposed amendments is consistent with the type of compliance work that a dealer typically handles internally,<sup>145</sup> so that the Commission does not expect that dealers would incur any additional external costs.

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<sup>143</sup> First-year burden for MSRB: 12,699 hours (annual burden under currently approved collection) + 1,162 hours (estimate for one-time burden to implement the proposed amendments) = 13,861 hours.

<sup>144</sup> 25,000 hours (total estimated annual burden for dealers) + 603,658 hours (total estimated annual burden for issuers) + 12,699 hours (total estimated annual burden for MSRB) = 641,357 total estimated annual burden hours. The initial first-year burden would be 642,644 hours: 25,125 hours (total estimated burden for dealers in the first year) + 603,658 hours (total estimated burden for issuers) + 13,861 hours (total estimated burden for MSRB in the first year) = 642,644 hours.

<sup>145</sup> See infra Section IV.D.1.(ii).

The Commission does not expect the MSRB to incur any additional external costs associated with the proposed amendments to the Rule. In its currently approved collection, the Commission estimated that the MSRB would expend approximately \$10,000 annually in hardware and software costs for the MSRB's EMMA system.<sup>146</sup> The Commission believes that the MSRB would not incur additional external costs specifically associated with modifying the indexing system to accommodate the proposed changes to the Rule because the Commission expects that the MSRB would implement these changes internally; these internal costs have been accounted for in the hourly burden section in Section IV.D.3.

## 2. Issuers

The Commission believes that issuers generally will not incur external costs associated with the preparation of event notices filed under these proposed amendments because issuers will generally prepare the information contained in the continuing disclosures internally; these internal costs have been accounted for in the hourly burden section in Section IV.D.2.ii.

The Commission also expects that some issuers could be subject to some costs associated with the proposed amendments to the Rule if they pay third parties to assist them with their continuing disclosure responsibilities. In its currently approved collection, the Commission estimated that up to 65% of issuers may use designated agents to submit some or all of their continuing disclosure documents to the MSRB for a fee estimated to range from \$0 to \$1,500 per year depending on the designated agent an issuer uses.<sup>147</sup> The Commission estimated that the

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<sup>146</sup> See PRA Notice, supra note 127.

<sup>147</sup> See 2015 PRA Notice, supra note 127.

average total annual cost that would be incurred by issuers that use the services of a designated agent would be \$9,750,000.<sup>148</sup>

The Commission believes this estimate is still reasonable. In 2015, the Commission estimated that issuers would submit 62,596 annual filings, 73,480 event notices, and 7,063 failure to file notices, for a total of 143,139 continuing disclosure documents submitted annually. Under the proposed amendments to the Rule, some issuers would need to prepare additional event notices for submission to the MSRB. Some issuers could use the services of a designated agent to submit these additional event notices to the MSRB. Under the proposed amendments to the Rule, the Commission estimates that a high-end estimate of the number of additional event notices that issuers would need to submit annually under the proposed amendments would be 2,200.<sup>149</sup> The two proposed event disclosure items also would result in the submission of information regarding each event. The Commission believes that issuers that use the services of a designated agent for submission of event notices to the MSRB could incur additional costs of approximately six percent<sup>150</sup> associated with the proposed amendments to the Rule, so that the

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<sup>148</sup> Id. 20,000 (number of issuers) x .65 (percentage of issuers that may use designated agents) x \$750 (estimated average annual cost for issuer's use of designated agent) = \$9,750,000.

<sup>149</sup> See supra note 138.

<sup>150</sup> The Commission is estimating that the proposed amendments would increase the number of issuers' annual event filings by approximately three percent, and would increase the number of issuers' total annual filings by approximately 1.5 percent. See supra note 139. The six percent estimate for additional costs reflects these estimated increases in filings as well as an estimated reimbursement of approximately 4.5 percent of costs by issuers to designated agents for the agents' costs of making necessary changes to their systems.

average total annual cost that would be incurred by issuers that use the services of a designated agent under the Rule as proposed to be amended would be \$10,335,000.<sup>151</sup>

There likely would also be some costs incurred by issuers to revise their current template for continuing disclosure agreements to reflect the proposed amendments to the Rule. The Commission understands that models currently exist for continuing disclosure agreements that are relied upon by legal counsel to issuers and, accordingly, these documents would likely be updated by outside attorneys to reflect the proposed amendments. Based on a review of industry sources, the Commission believes that continuing disclosure agreements tend to be standard form agreements. In the 2010 Amendments Adopting Release, the Commission estimated that it would take an outside attorney approximately 15 minutes to revise the template for continuing disclosure agreements for an issuer in light of the 2010 Amendments to the Rule.<sup>152</sup> The Commission preliminarily believes that this 15 minute estimate to prepare a revised continuing disclosure agreement is also a reasonable estimate of the average amount of time required for an outside attorney to revise the template for continuing disclosure agreements for the proposed amendments to the Rule, because the proposed amendments would require changes similar to the types of changes necessitated by the 2010 Amendments. Thus, the Commission estimates that the approximate average cost of revising a continuing disclosure agreement to reflect the proposed amendments for each issuer would be approximately \$100,<sup>153</sup> for a one-time total cost

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<sup>151</sup> 20,000 (number of issuers) x .65 (percentage of issuers that may use designated agents) x \$795 (\$750 x 1.06) (estimated average annual cost for issuer's use of designated agent under the proposed amendments to the Rule) = \$10,335,000.

<sup>152</sup> See 2010 Amendments Adopting Release, supra note 54, at 33137.

<sup>153</sup> 1 (continuing disclosure agreement) x \$400 (hourly wage for an outside attorney) x .25 hours (estimated time for outside attorney to revise a continuing disclosure document in accordance with the proposed amendments to the Rule) = \$100. The Commission recognizes that the costs of retaining outside professionals may vary depending on the

of \$2,000,000<sup>154</sup> for all issuers, if an outside counsel were used by each issuer to revise the continuing disclosure agreement.

F. Retention Period of Recordkeeping Requirements

As an SRO subject to Rule 17a-1 under the Exchange Act,<sup>155</sup> the MSRB is required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place. Broker-dealers registered pursuant to Exchange Act Section 15 are required to comply with the books and records requirements of Exchange Act Rules 17a-3 and 17a-4.<sup>156</sup> Participating Underwriters and dealers transacting business in municipal securities are subject to existing recordkeeping requirements of the MSRB.<sup>157</sup> The proposed amendments to the Rule would contain no recordkeeping requirements for any other persons.

G. Collection of Information is Mandatory

Any collection of information pursuant to the proposed amendments to the Rule would be a mandatory collection of information.

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nature of the professional services, but for purposes of this PRA analysis we estimate that costs for outside counsel would be an average of \$400 per hour.

<sup>154</sup> \$100 (estimated cost to revise a continuing disclosure agreement in accordance with the proposed amendments to the Rule) x 20,000 (number of issuers) = \$2,000,000.

<sup>155</sup> 17 CFR 240.17a-1.

<sup>156</sup> 17 CFR 240.17a-3, 17a-4.

<sup>157</sup> See MSRB Rules G-8, G-9. Exchange Act Rules 17a-3 and 17a-4 state that, for purposes of transactions in municipal securities by municipal securities brokers and municipal securities dealers, such entities will be deemed in compliance with Exchange Act Rules 17a-3 and 17a-4 if they are in compliance with MSRB Rules G-8 and G-9, respectively.

#### H. Responses to Collection of Information Will Not Be Kept Confidential

The collection of information pursuant to the proposed amendments to the Rule would not be confidential and would be publicly available.<sup>158</sup> Specifically, the collection of information that would be provided pursuant to the continuing disclosure documents under the proposed amendments would be accessible through the MSRB's EMMA system and would be publicly available via the Internet.

#### I. Request for Comments

Pursuant to 44 U.S.C. 3506(c)(2), the Commission solicits comments regarding: (1) whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the Commission's estimate of the burden of the revised collections of information; (3) whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and (5) whether there are cost savings associated with the collection of information that have not been identified in this proposal.

The Commission has submitted to OMB for approval the proposed revisions to the current collection of information titled "Municipal Securities Disclosure." Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a

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<sup>158</sup> Continuing disclosure agreements may not be available if they are not subject to state Freedom of Information Act requirements. Internal dealer notices would not generally be publicly available but may be available to the Commission, the MSRB and FINRA.

copy of their comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-01-17, and be submitted to the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, should refer to File No. S7-01-17, and be submitted to the Securities and Exchange Commission, Public Reference Room, 100 F Street, NE, Washington, DC 20549.

## **V. Economic Analysis**

### **A. Introduction**

As discussed above, the Commission is proposing amendments to Rule 15c2-12 under the Exchange Act relating to municipal securities disclosure. The proposed amendments would amend the list of event notices the Participating Underwriter must reasonably determine that an issuer or obligated person has agreed to provide to the MSRB in its continuing disclosure agreement to include the proposed events. In addition, the Commission proposes an amendment to Rule 15c2-12(f) to add a definition for “financial obligation” and a technical amendment to subparagraph (b)(5)(i)(C)(14).<sup>159</sup> The Commission believes the proposed amendments would facilitate investors’ and other market participants’ access to more timely and informative disclosure and help to enhance transparency in the municipal securities market.

As discussed in Section II.D., the need for more timely disclosure of information in the municipal securities market about financial obligations is highlighted by market developments

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<sup>159</sup> See supra Section III.

beginning in 2009 which feature the increasing use of direct placements by issuers and obligated persons as financing alternatives to public offerings of municipal securities. According to FDIC Call Report data, the dollar amount of commercial bank loans to state and local governments has more than doubled since the financial crisis, increasing from \$66.5 billion as of the end of 2010 to \$153.3 billion by the end of 2015.<sup>160</sup> In comparison, the dollar amount of municipal securities outstanding remained relatively flat over the same time period.<sup>161</sup>

The use of direct placements, as well as other financial obligations, may benefit issuers and obligated persons in the form of convenience or lower borrowing costs relative to a public offering of municipal securities. For example, there is typically no requirement to prepare an offering document or obtain a credit rating, liquidity facility, or bond insurance for a direct placement or other financial obligation.<sup>162</sup> However, benefits to issuers and obligated persons from raising capital through direct placements and other financial obligations may negatively affect investors who have previously invested in the issuer's or obligated person's outstanding

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<sup>160</sup> The dollar amount of commercial bank loans to state and local governments is computed using Call Report data, available at <https://cdr.ffiec.gov/public/>. The dollar amount is the sum of item RCON2107, "OBLIGATIONS (OTHER THAN SECURITIES AND LEASES) OF STATES AND POLITICAL SUBDIVISIONS IN THE U.S.," across all the depository institutions for the stated time period. See Federal Reserve Board, Micro Data Reference Manual (July 1, 2016) ("MDRM"), available at <http://www.federalreserve.gov/apps/mdrm/data-dictionary> (includes detailed variable definition).

<sup>161</sup> As of the end of 2010, the dollar amount of municipal securities outstanding was \$3.77 trillion. As of the end of 2015, the dollar amount of municipal securities outstanding was \$3.72 trillion. See Federal Reserve Board, Financial Accounts of the United States: Historical Data, Annual 2005 to 2015, at 114 Table L.212 ("Historical Flow of Funds"), available at <https://www.federalreserve.gov/releases/z1/current/annuals/a2005-2015.pdf>.

<sup>162</sup> See Daniel Bergstresser & Peter Orr, Direct Bank Investment in Municipal Debt, 35 Mun. Fin. J. 1, 3 (2014) ("Bergstresser & Orr"); California Debt and Investment Advisory Commission, New Frontiers in Public Finance: A Return to Direct Lending (Oct. 3, 2012), available at <http://www.treasurer.ca.gov/cdiac/webinars/2012/20121003/presentation.pdf>.

municipal securities. For instance, the incurrence of a financial obligation, such as a direct placement, if material, could substantially impact an issuer's or obligated person's overall indebtedness and creditworthiness and thereby the value of the municipal securities held by investors. In addition, an issuer or obligated person may agree to covenants of a financial obligation that alter the debt payment priority structure of the issuer's or obligated person's outstanding securities, and the new debt payment priority structure may negatively affect existing security holders. Events such as a 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 could also impact the value of municipal securities held by investors.<sup>163</sup>

However, under the current regulatory framework, investors and other market participants may not have any access or timely access to information related to the incurrence of financial obligations and other events proposed to be included, despite their potential impact on investors in municipal securities. More specifically, investors and other market participants may not have any access to disclosure of the proposed events if the issuer or obligated person does not provide annual financial information or audited financial statements to EMMA, or does not, subsequent to the occurrence of the proposed events, issue debt in a primary offering subject to Rule 15c2-12 that results in the provision of a final official statement to EMMA. Further, even if investors and other market participants have access to information about the proposed events, such access may not be timely if, for example, the issuer or obligated person has not submitted

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<sup>163</sup> Although historically, municipal securities have had significantly lower rates of default than corporate and foreign government bonds, as mentioned in Section II.D., defaults by issuers and obligated persons have occurred in the past. Since 2011, the municipal securities market has experienced four of the five largest municipal bankruptcy filings in U.S. history. See supra note 71.

annual financial information or audited financial statements in a timely manner or does not often issue debt that results in an official statement being submitted to EMMA. As discussed earlier, such annual financial information and audited financial statements may not be available until several months or up to a year after the end of the issuer's or obligated person's fiscal year, and a significant amount of time could pass before the issuer's or obligated person's next primary offering subject to Rule 15c2-12. As a result, investors could be making investment decisions on whether to buy, sell or hold municipal securities without the current information about an issuer's or obligated person's outstanding debt; and other market participants could also be undertaking credit analyses without such information. Moreover, even when investors and other market participants do have access to information about such events in the issuer's or obligated person's annual financial information or audited financial statements or in a subsequent official statement, the disclosure typically is limited.

Numerous market participants, including the MSRB, FINRA, academics and industry groups, have encouraged issuers and obligated persons to voluntarily disclose information about certain financial obligations.<sup>164</sup> In particular, the MSRB has noted its concern that the lack of disclosure of direct placements may hinder an investor's ability to understand the risks of an investment, and has published several regulatory notices encouraging voluntary disclosure of information about certain financial obligations, including bank loan financings.<sup>165</sup> However, despite these ongoing efforts, few issuers or obligated persons have made voluntary disclosures of financial obligations, including direct placements, to the MSRB.<sup>166</sup>

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<sup>164</sup> See supra notes 76, 77, and 82. See also Bergstresser & Orr, supra note 162.

<sup>165</sup> See supra note 76.

<sup>166</sup> See supra Section II.D.

The Commission is mindful of the costs imposed by and benefits obtained from its rules. The following economic analysis seeks to identify and consider the likely benefits and costs that would result from the proposed amendments, including their effects on efficiency, competition, and capital formation. Overall, the Commission preliminarily believes that the proposed amendments to Rule 15c2-12 would facilitate investors' and other market participants' access to more timely and informative disclosure in the secondary market about financial obligations of issuers and obligated persons, provide information that could be used to make more informed investment decisions or produce more informed analyses, and enhance investor protection. The discussion below elaborates on the likely costs and benefits of the proposed amendments and their potential impact on efficiency, competition, and capital formation.

Where possible, the Commission has attempted to quantify the costs, benefits, and effects on efficiency, competition, and capital formation that may result from the proposed rule amendments. However, the Commission is unable to quantify some of the economic effects. For example, because most municipal securities trade infrequently, recent trade prices are generally not available to estimate the value of these securities.<sup>167</sup> Even when recent trade information is available, prices may nevertheless deviate from the fundamental value of these securities given the existence of an information asymmetry between issuers or obligated persons and other market participants. In addition, the current municipal securities disclosures could be delayed or inadequately informative. Accordingly, information about the terms of a financial obligation, such as the interest rate paid by the issuer or obligated person, or how a financial obligation changes the priority structure of an issuer's or obligated person's outstanding municipal securities, is of limited availability. Therefore, we are limited in the extent to which

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<sup>167</sup> See 2012 Municipal Report *supra* note 58.

we can reasonably estimate the value of the municipal securities and the scope of the potential improvement in pricing of municipal securities under the proposed amendments. Further, information about some of the factors that could affect borrowing costs, such as the nature of the relationship between lenders and issuers or obligated persons, including the length of the relationship, and the number of lenders from which the issuers or obligated persons borrow is not readily available.<sup>168</sup> Therefore, we are unable to provide a reasonable estimate of the potential change in borrowing costs issuers or obligated persons may experience, or any costs that lenders may incur. We are requesting comment on all aspects of our analysis and estimates, and also request any information or data that would enable such quantification.

B. Economic Baseline

To assess the economic impact of the proposed amendments to Rule 15c2-12, we are using as our baseline the existing regulatory framework for municipal securities disclosure, including current Rule 15c2-12, and current relevant MSRB rules.

1. The Current Municipal Securities Market

As discussed earlier, the need for more timely and informative disclosure of the municipal securities is highlighted by market developments beginning in 2009, which feature the increasing use of direct placements by issuers and obligated persons as financing alternatives to public offerings of municipal securities. As a starting point of our baseline analysis, we provide an overview of the current state of the municipal securities market and issuers' and obligated

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<sup>168</sup> Academic research shows that lending relationship could affect borrowing costs. See infra note 196.

persons' use of direct placements based on data from the Federal Reserve Board's Flow of Funds data,<sup>169</sup> and Call Report data from the FDIC.<sup>170</sup>

According to Flow of Funds data, the notional amount of the total municipal securities outstanding in the U.S. was \$3.83 trillion as of the end of the third quarter 2016.<sup>171</sup> Prior to (and during) the 2008 financial crisis, the amount of municipal securities outstanding was increasing

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<sup>169</sup> Municipal securities are defined in the table description for the Flow of Funds data as follows. "Municipal securities are obligations issued by state and local governments, nonprofit organizations, and nonfinancial corporate businesses. State and local governments are the primary issuers; detail on both long and short-term (original maturity of 13 months or less) debt is shown. This instrument excludes trade debt of, and U.S. government loans to, state and local governments. Debt issued by nonprofit organizations includes nonprofit hospital bonds and issuance to finance activities such as lending to students. Debt issued by the nonfinancial corporate business sector includes industrial revenue bonds. Most municipal debt is tax-exempt; that is, the interest earned on holdings is exempt from federal income tax. Since 1986, however, some of the debt issued has been taxable, including the Build America Bonds authorized under the American Recovery and Reinvestment Act of 2009." See Federal Reserve Board, Financial Accounts of the United States: All Table Descriptions, at 30-31 (Dec. 8, 2016) available at [http://www.federalreserve.gov/apps/fof/Guide/z1\\_tables\\_description.pdf](http://www.federalreserve.gov/apps/fof/Guide/z1_tables_description.pdf).

<sup>170</sup> Commercial banks report their individual lending to municipalities in call report. The data item used in the analysis is item 2107, OBLIGATIONS (OTHER THAN SECURITIES AND LEASES) OF STATES AND POLITICAL SUBDIVISIONS IN THE U.S. It includes all obligations of states and political subdivisions in the United States (including those secured by real estate), other than leases and other than those obligations reported as securities issued by such entities in "Securities Issued by States Political Subdivision in the U.S. (8496, 8497, 8498, and 8499)" or "Mortgage-backed securities (8500, 8501, 8502, and 8503). It excludes all such obligations held for trading. States and political subdivisions in the U.S. includes: (1) the fifty states of the United States and the District of Columbia and their counties, municipalities, school districts, irrigation districts, and drainage and sewer districts; and (2) the governments of Puerto Rico and of the U.S. territories and possessions and their political subdivisions. See MDRM, supra note 160.

<sup>171</sup> Flow of Funds, supra note 64, at 121 Table L. 212.

steadily, growing from \$2.82 trillion in 2004 to a post-crisis peak of \$3.77 trillion in 2010.<sup>172</sup> Since 2010, the overall size of the municipal securities market has remained flat.<sup>173</sup>

However, the involvement of commercial banks in the municipal capital markets has increased dramatically in terms of purchases of municipal securities and extensions of loans to state and local governments and their instrumentalities.<sup>174</sup> U.S. chartered depository institutions' holdings of outstanding municipal securities have grown rapidly, from 6.75% of the total outstanding (or \$254.6 billion) in 2010 to 13.43% of the total outstanding (or \$498.9 billion) in 2015, a near two-fold increase.<sup>175</sup> The fastest growth has been in direct lending to state and local governments and their instrumentalities. As discussed above, the dollar amount of bank loans to state and local governments has more than doubled since the 2008 financial crisis, increasing from \$66.5 billion as of the end of 2010 to \$153.3 billion by the end of 2015, or equivalently, an increase from 1.76% of total municipal securities outstanding to 4.13%.<sup>176</sup>

The use of direct placements and other financial obligations can result in an increase in the issuer's or obligated person's outstanding debt, and negatively impact the liquidity and creditworthiness of the issuer or obligated person and the prices of their outstanding municipal securities. However, currently, there is a lack of secondary market disclosure about these financial obligations which has been discussed by the MSRB, certain market participants and

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<sup>172</sup> Historical Flow of Funds, supra note 161, at 114 Table L. 212.

<sup>173</sup> Id.

<sup>174</sup> See Bergstresser & Orr, supra note 162, at 1-2.

<sup>175</sup> Historical Flow of Funds, supra note 161, at 121 Table L. 212.

<sup>176</sup> See MDRM, supra note 160.

academics.<sup>177</sup> As a result, investors and other market participants may not have timely access to information regarding financial obligations, and such information may not be incorporated in the prices of issuers' or obligated persons' outstanding municipal securities. Recognizing the credit implications of direct placements and other financial obligations, at least one rating agency, now requires issuers and obligated persons to notify them of the incurrence of certain financial obligations, including direct placements, and to provide all relevant documentation related to such indebtedness, and the Commission understands that other rating agencies strongly encourage this practice as well.<sup>178</sup> This rating agency also stated it may suspend or withdraw its ratings should issuers and obligated persons fail to provide such notification in a timely manner.<sup>179</sup> However, while such voluntary measures may help mitigate mispricing, they are unlikely to completely eliminate all potential mispricing in the municipal securities market that is related to a lack of information about direct placements or other financial obligations if the measures are costly or difficult to enforce.

## 2. Rule 15c2-12

As discussed above, the Commission first adopted Rule 15c2-12 in 1989 as a means reasonably designed to prevent fraud in the municipal securities market by enhancing the quality, timing, and dissemination of disclosure in the municipal securities primary market.<sup>180</sup> Currently, Rule 15c2-12, most recently amended in 2010, prohibits the Participating Underwriter from purchasing or selling municipal securities in connection with an Offering unless the Participating

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<sup>177</sup> See MSRB Letter to SEC CIO, supra note 18, NFMA letter to the Commission's Chair, supra note 19. See also Bergstresser & Orr, supra note 162, at 2-3.

<sup>178</sup> See supra note 81.

<sup>179</sup> Id.

<sup>180</sup> See supra Section II.B.

Underwriter reasonably determines that the issuer or obligated person has undertaken in a continuing disclosure agreement to provide the MSRB with: 1) certain annual financial and operating information and audited financial statements, if available; 2) notices of the occurrence of any 14 specific events; and 3) notices of the failure of an issuer or obligated person to make a timely annual filing, on or before the date specified in the continuing disclosure agreement. The current Rule does not impose on a Participating Underwriter any obligation to reasonably determine that an issuer or obligated person has undertaken in its continuing disclosure agreement to disclose the proposed events. As discussed in Section I., investors and other market participants may not have any access or timely access to disclosure about the proposed events. Investors and other market participants may not have access to such information because the issuer or obligated person may not provide annual financial information or audited financial statements to EMMA, or does not, subsequent to the occurrence of the proposed events, issue debt in a primary offering subject to Rule 15c2-12 that requires provision of a final official statement to EMMA. Even if investors and other market participants have access to disclosure about the proposed events, such access may not be timely if the issuer or obligated person has not submitted annual financial information or audited financial statements to EMMA in a timely manner or does not issue debt that requires an official statement be provided to EMMA for an extended period of time. Typically, investors and other market participants do not have access to an issuer's or obligated person's annual financial information or audited financial statements until several months or up to a year after the end of the issuer's or obligated person's applicable fiscal year, and a significant amount of time could pass before an issuer's or obligated person's next primary offering subject to Rule 15c2-12.<sup>181</sup>

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<sup>181</sup> See supra note 14.

Furthermore, even if it is accessible to investors and other market participants, the disclosure of the information about the proposed events in an issuer's or obligated person's official statement, annual financial information, or audited financial statements may not include certain details about the financial obligations. Specifically, disclosure of a financial obligation in an issuer's or obligated person's financial statements may be a line item about the amount of the financial obligation, and may not provide investors and other market participants with information relating to an issuer's or obligated person's agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation, any of which affect security holders, if material.

### 3. MSRB Rules

MSRB rules do not address the disclosure of the events listed in Rule 15c2-12. However, as described above, the MSRB has highlighted the increased use of direct placements as a financing alternative.<sup>182</sup> The MSRB has encouraged issuers to voluntarily disclose direct placements on EMMA,<sup>183</sup> including providing instructions to issuers on how they may provide such disclosures using EMMA. Despite the MSRB's efforts to encourage voluntary disclosure, the number of disclosures made using EMMA has been limited.

In March 2016, the MSRB published a regulatory notice requesting comment on a concept proposal to require municipal advisors to disclose information regarding the direct placements of their municipal entity clients to EMMA.<sup>184</sup> On August 1, 2016, the MSRB announced that it had decided not to pursue the ideas set forth in the MSRB Request for

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<sup>182</sup> See supra note 76.

<sup>183</sup> See MSRB Notice 2012-18, supra note 20.

<sup>184</sup> See MSRB Request for Comment, supra note 76.

Comment. Many who commented on the MSRB's Request for Comment noted that the best way to ensure disclosure of direct placements is to amend Rule 15c2-12.<sup>185</sup>

#### 4. Existing State of Efficiency, Competition, and Capital Formation

Under current rules, certain inefficiencies may arise in the municipal securities market as a result of the lack of timely disclosure of information on important credit events. In particular, because the proposed events need not be included in the issuer's and obligated person's continuing disclosure agreements, the impact of such events may not be learned by market participants in a timely manner. The lack of timely disclosure may cause the prices of certain municipal securities to not reflect fundamental value.

As discussed above, there exists an information asymmetry between lenders and municipal securities investors under the current Rule 15c2-12. The terms of a financial obligation incurred by an issuer or obligated person may include covenants that give the lender or counterparty priority rights over existing security holders. Existing security holders may be unaware of the change in priority structure of the issuer's or obligated person's municipal securities for an extended period of time, and future investors may buy the securities at inflated prices which do not reflect the change in priority structure. Existing investors may also be unaware of the occurrence of certain events under the terms of a financial obligation, such as a default, where the lender might have renegotiated the terms of lending agreement and which may reflect the worsened financial condition of the issuer or obligated person. The information asymmetry between lenders and municipal securities investors could place investors in a

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<sup>185</sup> See Comment Letters in Response to MSRB Request for Comment, supra note 76.

disadvantageous position relative to lenders when making municipal securities investment decisions.<sup>186</sup>

The price inefficiencies in the municipal securities market and the disparity in available information for different types of investors could result in obstacles for the efficient allocation of capital. For example, while some investors may overinvest in municipal securities due to incomplete information about the amount and priority structure of an issuer's or obligated person's debt obligations, other municipal securities investors who are aware of the possible information asymmetry may underinvest because of a perceived information disadvantage relative to issuers or obligated persons or risks associated with making investment decisions.

C. Benefits, Costs and Effects on Efficiency, Competition, and Capital Formation

The Commission has considered the potential costs and benefits associated with the proposed amendments.<sup>187</sup> The Commission believes that the primary economic benefits of the proposed amendments stem from the potential improvement in the timeliness and informativeness of municipal securities disclosure. In particular, the Commission believes that the proposed Rule 15c2-12 amendments would provide investors with more timely access to information that could be used to make more informed investment decisions, and enhance investor protection. In addition, improved disclosure would assist other market participants including rating agencies and municipal securities analysts in providing more accurate credit

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<sup>186</sup> For discussion of the implications of asymmetric information for market efficiency see infra note 203.

<sup>187</sup> The Commission understands that it is possible that the issuer or obligated person may not comply with its previous continuing disclosure undertakings and may not provide the MSRB with notice of the proposed events pursuant to proposed Rule 15c2-12 amendments, in which case, the actual costs and benefits of the proposed amendments would depend on the issuer or obligated person's commitment to disclosure.

ratings and credit analysis as they would have more timely access to information regarding an issuer's or obligated person's outstanding debt.<sup>188</sup> The disclosure produced by the issuer or obligated person would become more informative under the proposed amendments, because it would include not only the existence of the financial obligation that the issuer or obligated person has incurred, but also specified material terms of the financial obligations that can affect security holders, including affecting their priority rights. Disclosure that is both more timely and informative can positively affect efficiency, competition, and capital formation. The Commission also notes that the proposed amendments would introduce costs to other parties, including issuers, obligated persons, underwriters and lenders, as the alternative financing option (e.g., direct placements) becomes more expensive. We discuss the economic costs and benefits of the proposed amendments in more detail below as well as the effects of proposed amendments on efficiency, competition, and capital formation.

1. Anticipated Benefits of the Proposed Rule 15c2-12 Amendments

i. Benefits to Investors

The Commission preliminarily believes that the proposed Rule 15c2-12 amendments would potentially yield several benefits to municipal securities investors. First, the proposed amendments would provide investors with access to more timely and informative disclosure about an issuer's or obligated person's financial condition, both of which can assist them in making more informed investment decisions when trading in the secondary market.

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<sup>188</sup> As discussed above, at least one credit rating agency currently is requiring disclosure of information about bank loans. The benefit to rating agencies of the proposed increased disclosure exists only to the extent that the proposed amendments provide new information that the rating agencies are not already collecting as part of rating a bond issue.

As discussed in Section III.A., the information regarding the proposed events is relevant for investors' investment decision making. The incurrence of a financial obligation can result in an increase in the issuer's or obligated person's outstanding debt; agreement to a covenant, event of default or remedy under the terms of a financial obligation of the issuer or obligated person may create contingent liquidity and credit risk that could also potentially impact the issuer's or obligated person's liquidity and overall creditworthiness. The occurrence of a default, event of acceleration, termination event, modification of terms, or other similar event under terms of a financial obligation of the issuer or obligated person, any of which reflect financial difficulties, could provide relevant information regarding whether the financial condition of the issuer or the obligated person has changed or worsened, and if the issuer or obligated person has agreed to new terms that would provide the counterparty with superior rights to assets or revenues that were previously pledged to existing security holders. All these pieces of information contain relevant information about the cash flows investors may expect to receive, and can therefore impact the prices of municipal securities. Without this information, prices of municipal securities could be distorted from fundamental value in both the primary and secondary markets.

However, currently, notice of these events may not be available to the public at all, because the issuer or obligated person may not provide annual financial information or audited financial statements to EMMA, and a Participating Underwriter in an Offering is not currently required under Rule 15c2-12 to reasonably determine that an issuer or obligated person has undertaken to provide notices of these events. If an issuer or obligated person provides such information in their annual financial information or audited financial statements, this information may not become available until several months or up to a year after the end of the issuer's or obligated person's applicable fiscal year, and a significant amount of time could pass before the

issuer or obligated person's next primary offering subject to Rule 15c2-12. Moreover, the disclosure information may not include all the proposed events. For example, the disclosure may include only the existence of the financial obligation that the issuer or obligated person has incurred, but not specified material terms of the financial obligations that can affect security holders, including those terms that, for example, affect security holders' priority rights. Therefore, investors could be making investment decisions without knowing that their contractual rights have been adversely impacted. As such, the current level of disclosure regarding the proposed events is neither timely nor adequately informative about the issuer's or obligated person's creditworthiness.

To the extent that investors in the municipal securities market rely on credit ratings as a meaningful indicator of credit risk, the recent efforts of certain credit rating agencies to collect information from issuers and obligated persons about the incurrence of direct placements may help improve the accuracy of credit ratings and mitigate potential mispricing in the municipal securities market.<sup>189</sup> However, because not all credit rating agencies require information on direct placements to provide a rating, and there are other undisclosed financial obligations and significant events (such as defaults) that may affect the issuers' and obligated persons' creditworthiness besides the incurrence of financial obligations, such efforts alone are unlikely to remove all potential mispricing related to direct placements.

Under the proposed amendments to Rule 15c2-12, Participating Underwriters would be required to reasonably determine that an issuer or obligated person had agreed in its continuing

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<sup>189</sup> See supra note 81 for examples of credit rating agency initiatives. For academic evidence on pricing effect of credit rating agencies' actions, see John R.M. Hand, Robert W. Holthausen, & Richard Leftwich, The Effect of Bond Rating Agency Announcements on Bond and Stock Prices, 47 J. Fin. 733, 733-752 (1992).

disclosure agreement to provide notices for the proposed events within 10 business days. Consequently, pursuant to the proposed amendments, municipal securities investors and other market participants would potentially have access to the disclosure within 10 business days as opposed to waiting for the issuer's or obligated person's next primary offering subject to Rule 15c2-12, or until the release of annual financial information or audited financial statements, or not receive any information at all. Therefore, the proposed amendments would provide investors access to information regarding the issuer's or obligated person's financial obligations in a more timely manner. In addition, the proposed notices would include agreement to covenants, events of default, remedies, priority rights or other similar terms of a direct or contingent financial obligation of the issuer or obligated person that affect security holders, so the disclosures provided to MSRB would be informative about not just the existence of the incurred financial obligation, but also how they may impact security holders. Overall, the proposed amendments would provide information investors could use to better assess the risks involved with an investment in a municipal security, and therefore make more informed investment decisions.

Second, improvement in municipal disclosure may reduce information asymmetries between investors and other more informed parties such as issuers, obligated persons, counterparties and lenders, and therefore enhance investor protection. As discussed above, for example, the terms of a financial obligation may include covenants that give lenders or counterparties priority rights over existing security holders. Specifically, for example, a bank loan agreement could give the lender a lien on assets or revenues that also secure the repayment of an issuer's or obligated person's outstanding municipal securities which could adversely affect the rights of existing security holders. If disclosure is not available to security holders about such events, they will be unable to take any actions they would have taken had they been

informed, such as exiting their position. In this situation, the direct lenders enjoy an information advantage over investors. More timely and informative disclosure of the proposed events could reduce investors' disadvantage by providing them with a means to obtain information in a timely manner if their contractual rights have been negatively impacted and take appropriate actions.

ii. Benefits to The Issuers Or Obligated Persons

Issuers and obligated persons may also experience a decrease in borrowing costs that are related to public offerings of municipal securities under the proposed amendments because of the increased level of disclosure. For example, in the context of corporate issuers, economic theories suggest that information asymmetry can lead to an adverse selection problem and therefore reduced the level of liquidity for firms' equity.<sup>190</sup> In an asymmetric information environment, investors recognize that issuers may take advantage of their position by issuing securities at a price that is higher than justified by the issuer's fundamental value. As a result, investors demand a discount to compensate themselves for the risk of adverse selection. This discount translates into a higher cost of capital. By committing to increased levels of disclosure, the firm can reduce the risk of adverse selection faced by investors, reducing the discount they demand and ultimately decreasing the firm's cost of capital. The theory of adverse selection applies broadly to financial markets, or any market that involves asymmetric information between the participants. Therefore, the Commission preliminarily believes that a similar analysis can be applied to municipal securities. As the proposed rule amendments would result in municipal securities disclosures that provide more information that is relevant to investors, the costs of raising capital may decrease for issuers and obligated persons.

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<sup>190</sup> See Douglas W. Diamond & Robert E. Verrecchia, Disclosure, Liquidity, and the Cost of Capital, 46 J. Fin. 1325, 1325-1359 (1991).

Currently, the Commission is unable to provide reasonable estimates of the potential change in borrowing costs. Such costs may vary significantly depending on a number of factors, including the characteristics of the issuer or obligated person (e.g., size, credit ratings, etc.), and possible changes in their borrowing behavior.

iii. Benefits to Rating Agencies and Municipal Analysts

The proposed Rule 15c2-12 amendments would help rating agencies and municipal analysts gain access to more updated information about the issuer's and obligated person's credit and financial position at a lower cost. As rating agencies and municipal analysts have stated on a number of occasions, direct placements can have credit implications for ratings on an issuer's or obligated person's outstanding municipal securities.<sup>191</sup> Rating agencies must expend resources to collect information about financial obligations including direct placements to provide more accurate ratings. A certain rating agency stated that it would suspend or withdraw ratings if issuers or obligated persons do not provide such notification in a timely manner. The process for suspending or withdrawing ratings could also be costly for a rating agency.<sup>192</sup> The proposed amendments may reduce the need for rating agencies or analysts to separately implement a process to gain more timely access to the information regarding proposed events. Therefore, under the proposed amendments, rating agencies and municipal analysts may have access to information they need to produce more accurate credit ratings and analyses at a cost lower than the baseline scenario. A portion of any cost savings may be passed through to investors and represent a benefit to them depending on how much they rely on rating agencies for information.

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<sup>191</sup> See Moody's, Special Comment: Direct Bank Loans Carry Credit Risks Similar to Variable Rate Demand Bonds for Public Finance Issuers (Sept. 15, 2011); see also supra note 81.

<sup>192</sup> See supra note 81.

## 2. Anticipated Costs of the Proposed Rule 15c2-12 Amendments

### i. Costs to Issuers and Obligated Persons

The Commission expects that, under the proposed amendments, issuers and obligated persons would experience an increase in administrative costs from undertaking in their continuing disclosure agreements to produce the proposed notices. As discussed above,<sup>193</sup> an advantage of a direct placement versus a public offering of municipal securities is the lower costs due to, among other things, no requirement to prepare a public offering document for the borrowing transaction. Under the proposed amendments, Participating Underwriters would be required to reasonably determine that issuers or obligated persons have undertaken in a continuing disclosure agreement to submit event notices to the MSRB within 10 days of the events. Issuers and obligated persons providing notice consistent with the proposed amendments would incur a cost to do so. As discussed earlier, the Commission assesses that the increase in the number of event notices would result in an increase of 4,400 hours in the annual paperwork burden for all issuers to submit event notices. As discussed above in Section IV.E.2., the Commission has estimated that these hours spent preparing event notices would be done internally, for an estimated cost of \$1,513,600.<sup>194</sup> The Commission also believes issuers would

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<sup>193</sup> See supra Section V.A.

<sup>194</sup> This estimate reflects an assumption that issuers perform this internal work through internal counsel. 4400 hours (estimated increase in hours for issuers to prepare event notices under the proposed amendments to the Rule) x \$344 (average rate for an internal compliance attorney) = \$1,513,600. The \$344 per hour estimate for an internal compliance attorney is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, and adjusted for inflation.

incur an additional estimated cost of \$585,000 in fees for designated agents to assist in the submission of event notices.<sup>195</sup>

Borrowing costs also could potentially increase for issuers and obligated persons compared to the baseline scenario as lenders might be less willing to continue engaging in direct placements or other types of alternative financings in their current form under the proposed amendments because lenders may be less able to profit from their information advantage over other investors. Currently, an issuer or obligated person may agree to provide superior rights to the counterparty in assets or revenues that were previously pledged to existing security holders when they enter into a financial obligation without disclosing the information to the public. Lenders might be willing to offer lower rates to issuers and obligated persons in return for the superior rights. A public disclosure of such arrangements under the proposed amendments, therefore, could potentially reduce opportunities for lenders to move ahead in the priority queue either because issuers and obligated persons are discouraged from providing lenders with priority at the current level, or because investors demand covenants which prevent issuers and obligated persons from doing so and reduce the benefits lenders currently enjoy. Currently, while investors may also claim their rights under the covenants, they may not be aware that their rights have been affected without the disclosures, and therefore may fail to make such claims.

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<sup>195</sup> See supra Section IV.E.2. See also supra notes 148, 150, 151. As discussed above, the Commission has estimated that 65% of issuers may use designated agents to submit some or all of their continuing disclosure documents to the MSRB, and that the average total annual cost that would be incurred by issuers that use the services of a designated agent would be \$9,750,000. The Commission has estimated that the two proposed amendments would cause issuers that use the services of a designated agent to incur additional costs of six percent, or \$585,000 ( $\$9,750,000 \times 6\% = \$585,000$ ). See supra note 150.

Therefore, borrowing costs that are related to financial obligations may rise for the issuers or obligated persons.<sup>196</sup>

Currently, the Commission is unable to provide reasonable estimates of the potential change in borrowing costs related to direct placements, as well as other financial obligations. Similarly, as discussed earlier, such costs may vary significantly depending on a number of factors, including both the characteristics of the issuer or obligated person (e.g., size, credit ratings, etc.) and the level of the disclosure issuers or obligated persons committed themselves to provide under their continuing disclosure agreements. In addition, as discussed earlier, since borrowing costs related to municipal securities might also decrease as disclosure increases, the opposite effects might neutralize the proposed amendments' ultimate impact on borrowing costs when viewed in totality.

ii. Costs to Dealers

Pursuant to Rule 15c2-12, a dealer acting as a Participating Underwriter in an Offering has an existing obligation to contract to receive the final official statement.<sup>197</sup> The final official statement includes, among other things, a description of any instances in the previous five years

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<sup>196</sup> There is also likelihood that lenders' private information about the borrowers developed over the course of their lending relationship with the borrowers could be eroded as a result of a detailed disclosure by the issuers and obligated persons, which could impact lenders incentives to continue lending, developing proprietary information and maintain long-term relationships with borrowers, and borrowing costs thereby. However, such an impact would depend upon the level of the disclosure provided by the issuers and obligated persons in their notices. Lenders generally develop proprietary information about the borrower during a lending relationship because they actively engage in information gathering and monitoring. Lenders and borrowers tend to form stable relationships. Such stability provides economies of scale for the lenders to offset the costly information production and monitoring, and it benefits the borrowers by increasing the availability of financing and lowering overall borrowing costs. See Mitchell A. Petersen & Raghuram G. Rajan, The Benefits of Lending Relationships: Evidence from Small Business Data, 49 J. Fin. 3, 3-37 (1994).

<sup>197</sup> 17 CFR 240.15c2-12(a) and (b)(3).

in which the issuer or obligated person failed to comply, in all material respects, with any previous undertakings in a written contract or agreement to provide certain continuing disclosures.<sup>198</sup> Dealers acting as Participating Underwriters in an Offering also have an existing obligation under Rule 15c2-12 to reasonably determine that an issuer or obligated person has undertaken in its continuing disclosure agreement for the benefit of holders of the municipal securities to provide notice to the MSRB of specified events. In addition, dealers are prohibited under Rule 15c2-12 from recommending the purchase or sale of municipal securities unless they have procedures in place that provide reasonable assurance that they will receive promptly event notices and failure to file notices with respect to the recommended security. Dealers typically use EMMA or other third party vendors to satisfy this existing obligation.

As a practical matter, dealers' obligations under the proposed Rule 15c2-12 amendments would include verifying that the continuing disclosure agreement contains an undertaking by the issuer or obligated person to provide the proposed new event notices to the MSRB, verifying whether the issuer or obligated person has complied with their prior undertakings, and verifying whether the final official statement includes, among other things, an accurate description of the issuer's or obligated person's prior compliance with continuing disclosure obligations. Because the proposed Rule 15c2-12 amendments would not significantly alter existing dealer obligations, dealers should not be subject to significant costs. As discussed earlier, the Commission has estimated that 250 dealers would each incur a one-time, first-year burden of 30 minutes to prepare and issue a notice to its employees regarding the dealer's new obligations under the proposed amendments, and that the proposed amendments would result in an average expenditure of an additional 10 hours per year per dealer for each dealer to determine whether

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<sup>198</sup> 17 CFR 240.15c2-12(f)(3).

issuers or obligated person have failed to comply with any previous undertakings in a written contract or agreement. Therefore, under the proposed amendments, the total burden on dealers would increase 125 hours for the first year and 2500 hours on an annual basis.<sup>199</sup> However, as discussed in Section IV.E.1., the Commission does not believe dealers will incur any additional external costs associated with the proposed amendments to the Rule because the proposed amendments do not change the obligation of dealers under the Rule to reasonably determine that the issuer or obligated person has undertaken, in a written agreement or contract, for the benefit of holders of such municipal securities, to provide continuing disclosure documents to the MSRB. Specifically, the Commission believes that the task of preparing and issuing a notice advising the dealer's employees about the proposed amendments is consistent with the type of compliance work that a dealer typically handles internally. Thus, dealers would incur an annual internal compliance cost of \$903,000 for the first year, and \$860,000 in subsequent years.<sup>200</sup>

### iii. Costs to Lenders

Under the proposed amendments, lenders may incur a cost from the disclosure about financial obligations and the terms of the agreements creating such obligations. The increased level of disclosure may reduce lenders' information advantage over other investors. As discussed above, lenders may enjoy certain priority rights in these financial arrangements, which may not be publicly disclosed, or reflected in the price of the issuer's or obligated person's outstanding municipal securities. To the extent that such benefits may be reduced by the

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<sup>199</sup> See Section IV.D.1.

<sup>200</sup> First year costs: 125 hours (first year burden on dealers) x \$344 (average hourly cost of internal compliance attorney) + 2500 hours (annual hourly burden on dealers) x \$344 (average hourly cost of internal compliance attorney) = \$903,000. Subsequent annual costs: 2500 hours (annual hourly burden on dealers) hours x \$344 average hourly cost of internal compliance attorney = \$860,000.

disclosure, lenders would incur a cost. In addition, lenders might have reduced incentives to provide financing to issuers or obligated persons, or may only be willing to lend at an increased interest rate, one that better reflects the risks underlying an issuer's or obligated person's entire portfolio of issuances and borrowings, both of which could potentially lead to a loss of investment opportunities and hence a cost to lenders.<sup>201</sup> However, as noted above, under the baseline scenario, benefits of direct placements and other financial obligations accrue to lenders, as well as issuers and obligated persons, at the expense of investors in municipal securities. The Commission preliminarily believes that any loss of investment opportunities or other costs to lenders as described in this section translate into benefits to investors such as those described above.

The Commission is unable to quantify the potential cost to lenders at this time. Whether the existing lending relationship between lenders and issuers or obligated persons would be affected and how large the impact might be would depend on the level of the disclosure and the nature of the lending relationship, such as the length of the relationship and the number of banks/lenders from who the issuers or obligated persons borrow. However, how much issuers or obligated persons would change in terms of their disclosure behavior, and how much lenders would change in their lending behavior in response to the proposed amendment is not predictable. Without such data, the Commission is unable to provide reasonable estimates of the potential cost to lenders.

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<sup>201</sup> Lenders' information advantage could also be impacted if their private information about the borrowers developed over the course of their lending relationship with the borrowers were eroded as a result of a detailed disclosure by the issuers and obligated persons. However, such an impact would depend upon the disclosure provided by the issuers and obligated persons in their notices.

iv. Costs to Municipal Securities Rulemaking Board

The proposed Rule 15c2-12 amendments would increase the type of event notices submitted to the MSRB which may result in the MSRB incurring costs associated with such additional notices. As discussed earlier, the Commission estimates, based on preliminary consultations with MSRB staff, that it would require approximately 1,162 hours to implement the necessary modifications to EMMA to reflect the additional disclosures under Rule 15c2-12 in the proposed amendments. Accordingly, the total estimated one-time cost to the MSRB of updating EMMA would be \$373,002.<sup>202</sup>

3. Effects on Efficiency, Competition, and Capital Formation

The proposed Rule 15c2-12 amendments have the potential to affect efficiency, competition, and capital formation by improving the timeliness and informativeness of disclosure to investors, reducing information asymmetry among market participants, and enhancing transparency about issuers' and obligated persons' debt structures. As described above, lack of disclosure can lead to information asymmetries among different types of investors (i.e., investors in publicly offered municipal securities and direct lenders), and between investors and issuers and obligated persons, which can result in securities prices that do not reflect market value.<sup>203</sup>

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<sup>202</sup> See supra Section IV.D.3. Estimates are calculated as follows: 1,162 hours x \$321 (hourly rate for Senior Database Administrator). \$321 per hour figure for a Senior Database Administrator is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, and adjusted for inflation.

<sup>203</sup> Specifically, when there is asymmetric information about material risks, investors may not be able to distinguish low-risk securities from high-risk securities. In such cases, market participants will only value securities as if they bear an average level of risk, undervaluing low-risk securities and overvaluing high-risk securities. Such mispricing can harm market efficiency and distort capital allocation. See, e.g., Paul M. Healy & Krishna G. Palepu, Information Asymmetry, Corporate Disclosure, and the Capital

The proposed amendments would require a Participating Underwriter to reasonably determine that an issuer or obligated person has undertaken in a continuing disclosure agreement to provide notice to the MSRB of the proposed events. Such disclosures could provide an investor engaged in investment decision-making, and ratings agencies and municipal analysts undertaking a ratings review or credit analysis, with more timely access to information about the issuer's or obligated person's credit profile and financial condition, reduce mispricing of municipal securities, and therefore enhance the efficiency of the municipal securities market.

As discussed above, at least one credit rating agency currently requires issuers and obligated persons to provide notification and documentation of the incurrence of certain financial obligations including direct placements in order to maintain their credit ratings, a process that may involve duplicative costs, because each rating agency would have to implement similar process to collect the same information, and issuers and obligated persons would have to provide identical responses multiple times.<sup>204</sup> The proposed amendments may improve efficiency in the disclosure process by eliminating such potential duplicative costs. By potentially reducing information asymmetries between municipal securities investors and other more-informed market participants, including issuers, obligated persons and lenders, the proposed Rule 15c2-12 amendments could promote competition among municipal capital market participants. As discussed earlier, by allowing lenders to enjoy an information advantage about the proposed events, existing rules may provide certain lenders with a competitive advantage over the municipal securities investors because lenders could be in better position to compete with municipal securities investors for investment opportunities. Currently, for example, the terms of

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Markets: A Review of the Empirical Disclosure Literature, 31 J. Acct. & Econ. 405, 405-40 (2001).

<sup>204</sup> See supra note 81.

a financial obligation incurred by an issuer or obligated person may include covenants that give the lender or counterparty priority rights over existing security holders. As a result, for example, the lender or counterparty may have a senior lien on assets or revenues that were previously pledged to secure repayment of an issuer's or obligated person's outstanding municipal securities. Unless an issuer or obligated person voluntarily discloses this information, existing investors may be unaware that an issuer's or obligated person's outstanding debt amount and priority structure has changed. Under the current Rule, existing investors may also be unaware of the occurrence of an event such as a default, where the lender might have renegotiated the terms of lending agreement reflecting financial difficulties of the issuer or obligated person. In both these scenarios, municipal security investors are disadvantaged, existing security holders may continue to hold the municipal securities without learning that the credit quality of the municipal securities has deteriorated, and future investors may buy the securities at inflated prices. Therefore, more timely and informative disclosure of the proposed events by issuers' and obligated persons' could help reduce the information gap between the lenders and municipal securities investors, leveling the playing field for market participants looking for investment opportunities in the municipal capital market.

The proposed amendments to Rule 15c2-12 may also promote competition among issuers and obligated persons looking for funding. Under the current rule, issuers or obligated persons who are not engaged in alternative financings such as direct placements might be competing for capital in a relatively disadvantaged position – all else equal, they should be at least as creditworthy as their counterparts who have incurred undisclosed material financial obligations. However, the market could be pricing these issues identically, placing more creditworthy issuers and obligated persons at a competitive disadvantage. Since the proposed amendments could

improve pricing efficiency and increase the likelihood that prices reflect credit risk, the proposed amendments may also promote competition for capital among issuers and obligated persons.

The proposed Rule 15c2-12 amendments may also positively affect efficiency by providing issuers and obligated persons with incentives to make management decisions that promote an efficient market for municipal securities. For example, when issuers or obligated persons are considering a direct placement versus a public municipal securities offering, they may weigh, among other things, the benefits of lower borrowing costs against future liquidity risk considerations. That is, issuers and obligated persons might choose financial obligations over a public offering of municipal securities if, among other things, the value of lower borrowing costs exceeds the costs of future liquidity concerns associated with the financial obligations. However, to the extent that borrowing costs may be priced incorrectly under the baseline scenario due to information asymmetries, issuers and obligated persons might be making decisions that, while optimal for themselves based on available pricing information, do not necessarily take into account the costs that financial obligations may impose on other creditors. Moreover, they may have incentives to exploit the mispricing should it yield lower borrowing costs, which may sustain or even amplify the market inefficiency. If issuers and obligated persons were to increase financial obligations and such information was not incorporated in the market in a timely fashion as is the case under the baseline, mispricing of municipal securities would also likely increase. Such concerns might be reduced under the proposed amendments, which aim to reduce information asymmetries that may lead issuers and obligated persons to favor direct placements and other financial obligations over public offerings. To the extent that this reduces the incentive to exploit mispricing, price inefficiencies in the municipal securities market may diminish.

The proposed Rule 15c2-12 amendments may also help facilitate capital formation. As discussed earlier, under the baseline scenario, there may be price inefficiencies in the market for municipal securities that result from asymmetric information between different sets of municipal securities investors and lenders. By increasing the timeliness and informativeness of disclosure, the proposed rules could reduce the potential for price inefficiencies, resulting in improved allocation of capital. For example, municipal securities investors may underinvest because of a perceived disadvantage or make investment decisions based on untimely and incomplete information. Under the proposed rule amendments, as the municipal securities market becomes more efficient and investors make more informed decisions, capital would be better deployed at an aggregate level, resulting in more efficient capital allocation.

A more transparent and competitive market could also improve market liquidity and facilitate capital formation. According to academic research, disclosure policy influences market liquidity because uninformed investors concerned about asymmetric information, price protect themselves in their securities transactions by offering to sell at a premium or buy at a discount. This price protection could be manifested in higher bid-ask spreads and reduced market liquidity.<sup>205</sup> Therefore, by reducing information asymmetry in the municipal capital market, the proposed amendments can potentially improve liquidity in the municipal market. As the municipal securities market becomes more transparent, and investors sense stronger protections, they may be more likely to participate in the municipal securities market as a result. Therefore, to the extent that increased participation in the municipal securities market reflects new

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<sup>205</sup> See Michael Welker, Disclosure Policy, Information Asymmetry, and Liquidity in Equity Markets, 11 Contemp. Acct. Res. 801, 801-827 (1995). Welker provides evidence that disclosure policy reduces information asymmetry and increases liquidity in equity markets. See also Christian Leuz & Robert E. Verrecchia, The Economic Consequences of Increased Disclosure, 38 J. Acct. Res. 91, 91-124 (2000).

investment, as opposed to substitution away from other securities markets, enhanced disclosure could also positively affect capital formation.

D. Alternative Approaches

Instead of the proposed Rule 15c2-12 amendments, the Commission could encourage issuers and obligated persons to voluntarily disclose on an ongoing basis information about 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 a financial obligation of the issuer or obligated person, any of which reflect financial difficulties. However, it is unclear whether issuers or obligated persons would have sufficient incentives to do so. As discussed above, despite previous efforts of municipal securities market participants, the MSRB and numerous industry groups<sup>206</sup> to encourage timely voluntary disclosure regarding financial obligations, issuers and obligated persons have not consistently disclosed such information. Voluntary disclosure likely would be less costly for issuers and obligated persons since they may choose to disclose less frequently or not at all, but it would fail to yield the same benefits as the disclosures proposed in the amendments that require a Participating Underwriter to reasonably determine that an issuer or obligated person has undertaken in a continuing disclosure agreement to provide to the MSRB notice of the proposed events. If issuers and obligated persons were to voluntarily disclose at the level set forth in the proposed amendments, the costs of the disclosure also would be comparable.

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<sup>206</sup> See Section II.D; see also supra note 76.

E. Request for Comment

To assist the Commission in evaluating the costs and benefits that could result from the proposed amendments to the Rule, the Commission requests comments on the potential costs and benefits identified in this proposal, as well as any other costs or benefits that could result from the proposed amendments to the Rule. In addition, the Commission also seeks comment on alternative approaches to the proposed amendments and the associated costs and benefits of these approaches. Specifically, the Commission seeks comment with respect to the following questions: Are there any costs and benefits to any entity that are not identified or misidentified in the above analysis? Are there any effects on efficiency, competition, and capital formation that are not identified or misidentified in the above analysis? Please be specific and provide analysis and data in support of your views. Should the Commission consider any of the alternative approaches outlined above instead of the proposed amendments? Which approach and why? Are there any other alternative processes to improve municipal disclosure related to financial obligations that the Commission should consider? If so, what are they and what would be the associated costs or benefits of these alternative approaches?

**VI. Small Business Regulatory Enforcement Fairness Act**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”),<sup>207</sup> the Commission requests comment on the potential effect of the proposed amendments on the United States economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation.

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<sup>207</sup> Pub. L. 104-121, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Under SBREFA, a rule is considered “major” where, if adopted, it results in or is likely to result in:

- An annual effect on the economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries;  
and
- Any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

## **VII. Regulatory Flexibility Certification**

The Regulatory Flexibility Act (“RFA”) requires the Commission, in promulgating rules, to consider the impact of those rules on small entities.<sup>208</sup> Section 3(a)<sup>209</sup> of RFA generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules to determine the impact of such rulemaking on small entities unless the Commission certifies that the rule amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.<sup>210</sup> For purposes of Commission rulemaking in connection with the

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<sup>208</sup> 5 U.S.C. 601 et seq.

<sup>209</sup> 5 U.S.C. 603.

<sup>210</sup> 5 U.S.C. 605(b).

RFA,<sup>211</sup> a small entity includes: (1) a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,<sup>212</sup> or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization;<sup>213</sup> and (2) a municipal securities dealer that is a bank (including a separately identifiable department or division of a bank) if it has total assets of less than \$10 million at all times during the preceding fiscal year; had an average monthly volume of municipal securities transactions in the preceding fiscal year of less than \$100,000; and is not affiliated with any entity that is not a “small business.”<sup>214</sup>

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<sup>211</sup> Although Section 601 of the RFA defines the term “small entity,” the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term “small entity” for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

<sup>212</sup> 17 CFR 240.17a-5(d).

<sup>213</sup> See 17 CFR 240.0-10(c). See also 17 CFR 240.0-10(i) (providing that a broker or dealer is affiliated with another person if: such broker or dealer controls, is controlled by, or is under common control with such other person; a person shall be deemed to control another person if that person has the right to vote 25 percent or more of the voting securities of such other person or is entitled to receive 25 percent or more of the net profits of such other person or is otherwise able to direct or cause the direction of the management or policies of such other person; or such broker or dealer introduces transactions in securities, other than registered investment company securities or interests or participations in insurance company separate accounts, to such other person, or introduces accounts of customers or other brokers or dealers, other than accounts that hold only registered investment company securities or interests or participations in insurance company separate accounts, to such other person that carries such accounts on a fully disclosed basis).

<sup>214</sup> 17 CFR 240.0-10(f).

As discussed above in Section IV, the Commission estimates that approximately 250 dealers would be Participating Underwriters within the meaning of Rule 15c2-12. The Commission does not believe that any Participating Underwriters would be small broker-dealers or municipal securities dealers. Accordingly, the Commission certifies that the proposed rule amendments would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. The Commission solicits comment as to whether the proposed rule amendments could have an effect on small entities that has not been considered. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

### **VIII. Statutory Authority and Text of Proposed Rule Amendments**

Pursuant to the Exchange Act, and particularly Sections 2, 3(b), 10, 15(c), 15B, 17 and 23(a)(1) thereof, 15 U.S.C. 78b, 78c(b), 78j, 78o(c), 78o-4, 78q and 78w(a)(1), the Commission is proposing amendments to § 240.15c2-12 of Title 17 of the Code of Federal Regulations in the manner set forth below.

#### **Text of Proposed Rule Amendments**

##### **List of Subjects in 17 CFR Part 240**

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II, of the Code of Federal Regulations is proposed to be amended as follows.

#### **PART 240 — GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

\* \* \* \* \*

2. Section 240.15c2-12 is amended by the following:

- A. In paragraph (b)(5)(i)(C)(14) remove “and”;
- B. Add new paragraphs (b)(5)(i)(C)(15) and (16);
- C. Add new paragraph (f)(11);

The additions and revisions read as follows.

**§ 240.15c2-12 Municipal securities disclosure.**

\* \* \* \* \*

- (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; 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.

\* \* \* \* \*

(f) \* \* \*

(11) The term financial obligation means a (i) debt obligation, (ii) lease, (iii) guarantee, (iv) derivative instrument, or (v) monetary obligation resulting from a judicial, administrative, or arbitration proceeding. 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.

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By the Commission.

Brent J. Fields  
Secretary

Dated: March 1, 2017