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ARE YOU PREPARED FOR THE SEC’S NEW DISCLOSURE RULES?

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BEGINNING IN 2019, ISSUERS WILL FACE NEW DISCLOSURE REQUIREMENTS RELATED TO MATERIAL FINANCIAL OBLIGATIONS OUTSIDE OF MUNICIPAL BONDS.

The federally mandated disclosure rules for issuers of municipal debt have grown steadily more complex through the years. Until recently, those rules have been primarily limited to bond offerings, but in early 2019, that will no longer be the case. Now is the time to prepare for the new regulatory landscape.

As a result of amendments to the Security and Exchange Commission's (SEC) Rule 15c2-12 ("the Rule"), beginning on Feb. 27, 2019, issuers will face new disclosure requirements related to material financial obligations outside of municipal bonds. The amendments bring bank loans, private placements and similar debt instruments and guarantees under the regulatory purview of the SEC and create two new events that issuers must report going forward:

1. 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 ("Event 15"); and
2. Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties ("Event 16").

The Growing Popularity of Bank Loans

In recent years, municipal issuers have increasingly turned to bank loans as a financing option due to the historically low interest rate environment. These loans have not carried the same disclosure requirements as bond issues, and as they've grown more popular, many issuers and market participants have anticipated that additional regulatory oversight was just a matter of time.

That time has arrived. The SEC announced the new rules in August 2018 and provided issuers with a 180-day window to meet the new compliance requirements. Any municipal security offerings as of Feb. 27, 2019, must have a continuing disclosure agreement that includes these two new events.

Although bank loans have lost some of their appeal as interest rates begin to rise, and in spite of the six-month lead-up to implementation, these new disclosure rules will significantly impact issuers. The full scope of the impact remains to be seen, but one thing is certain: issuers must take steps now to prepare for the pending February 2019 deadline. Because existing and future material bank loans and other financial obligations will need to be disclosed, it will be important to have clear and consistent policies and records to remain compliant going forward.

What Issuers Need to Disclose

The uncertainty surrounding these new rules includes defining exactly which debt obligations issuers must disclose. The SEC does not provide detailed guidance around what is considered "material." Instead, it applies the common understanding that an obligation or event is considered material if its disclosure would be important in order to allow a reasonable investor to make an informed investment decision.

It will be up to issuers to establish and implement policies for determining the materiality of their current and future financial obligations covered by the new requirements. This important step toward compliance should be undertaken well in advance of the new rules' effective date.

In addition, issuers should begin identifying, cataloguing and tracking these financial obligations and have a monitoring system in place for triggering events. It will be important for issuers to educate the internal employees responsible for compliance to ensure that they maintain an effective database going forward. Establishing consistent guidelines and procedures early will go a long way toward ensuring a smooth transition when the new rules take effect.

Disclosure Timelines

In regards to default, acceleration, termination or other triggering events related to existing material financial obligations, issuers have 10 business days to report. Unlike other material events, such as rating changes or refundings, there is no central repository of information regarding bank loans and other financial obligations. This places a heavier burden on issuers to monitor for triggering events and report them when necessary.

For new financial obligations, there are questions around whether issuers should disclose at the time the debt is incurred or upon their next municipal bond issuance. Reporting early is the safer choice and reinforces the importance of establishing clear guidelines around these new events, sooner rather than later.

Navigating the Ever-Changing Regulatory Landscape

HilltopSecurities has long encouraged our clients to disclose private placements and bank loans in anticipation of these new requirements. Establishing robust policies around these disclosures not only enhances transparency, but has better prepared issuers for the current situation now that the requirements have been codified into SEC rule 15c2-12.

As a reflection of our commitment to building strong relationships with issuers, HilltopSecurities is one of the only municipal advisory firms in the United States with a dedicated continuing disclosure practice. Our goal is to reduce the challenges associated with compliance and serve as trusted advocates for state and local governments. We work closely with our clients to establish policies and procedures and provide ongoing education surrounding the new rules, as well as other existing regulatory issues.

With the ever-evolving nature of continuing disclosure and oversight of the municipal bond market, it's important for issuers to have experienced professional advisors help them navigate the regulatory landscape.

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About Hilltop Securities Inc.

Hilltop Securities Inc., a member of NYSE, FINRA and SIPC, delivers the forthright advice and tailored solutions necessary for municipal issuers, institutions, broker-dealers and individuals to thrive. The financial services firm and registered investment adviser is headquartered in Dallas, Texas, with offices across the United States. HilltopSecurities consistently ranks among the nation's top municipal advisors, and has served municipal issuers for more than 70 years.

About Lou Ann Heath

Lou Ann Heath has more than 30 years of experience in public finance and joined Dallas-based HilltopSecurities as director, continuing disclosure, in 2016. She served for 17 years as senior director, relationship management in the Dallas office of Standard & Poor's and has also served as finance director for the City of Southlake, Texas. She earned a BBA in accounting from the University of Texas, Arlington, and is a Certified Public Accountant. Lou Ann is a member and past president of Texas Government Finance Officers Association, and is a member of Texas Women in Public Finance.

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