

CDIAC MUNICIPAL MARKET DISCLOSURE SEMINAR

Session Five: Private Placements and Direct Loans – Possible New Obligations under SEC Rule 15c2-12

February 7, 2018

Speaker Introductions

- Jeff Land, Vice President, Brandis Tallman LLC
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Topic Overview

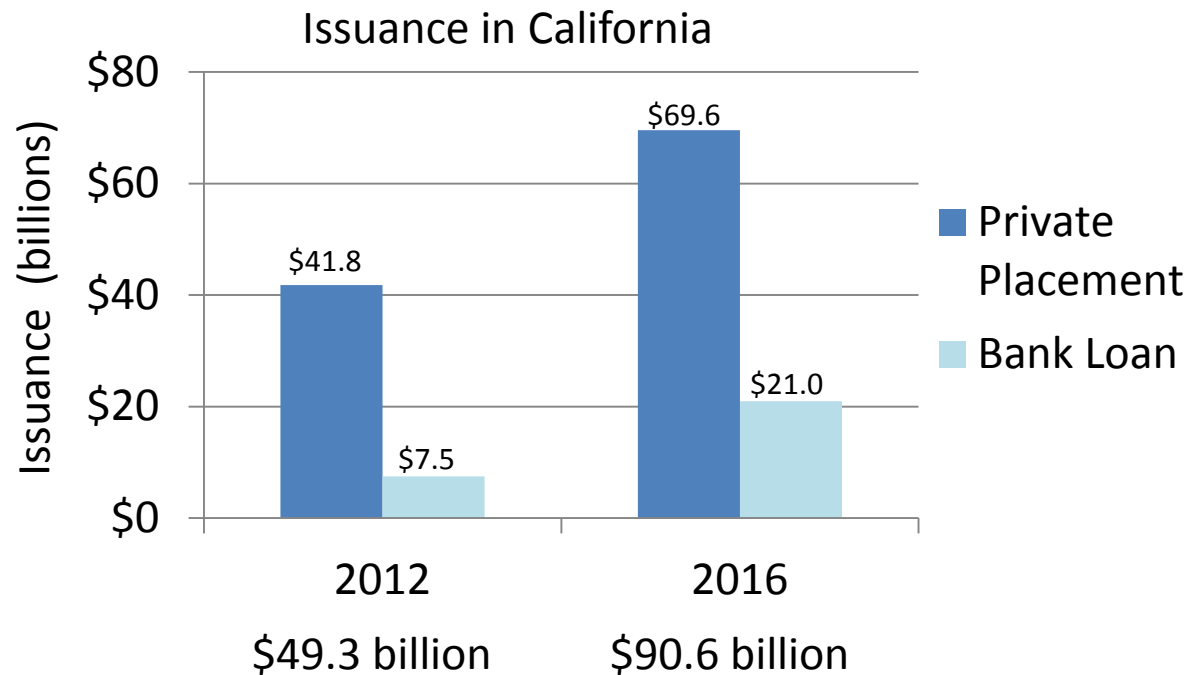
- This session will focus primarily on:
 - Private placements (and direct loans) vs. public offerings
 - Private placements and Rule 15c2-12
 - Current state of voluntary disclosure of private placements under Rule 15c2-12
 - SEC's proposed changes to Rule 15c2-12 making increased disclosures mandatory
 - MSRB Rule G-34

Key Terms Defined

- Private placement- a bank, or a limited number of accredited investors, purchase a bond directly from the issuer.
- Bank loans- a bank enters into a loan agreement or other type of financing agreement with the issuer.
- Public offering- the selling of securities to a wide range of investors which include institutional and retail.

Background Statistics*

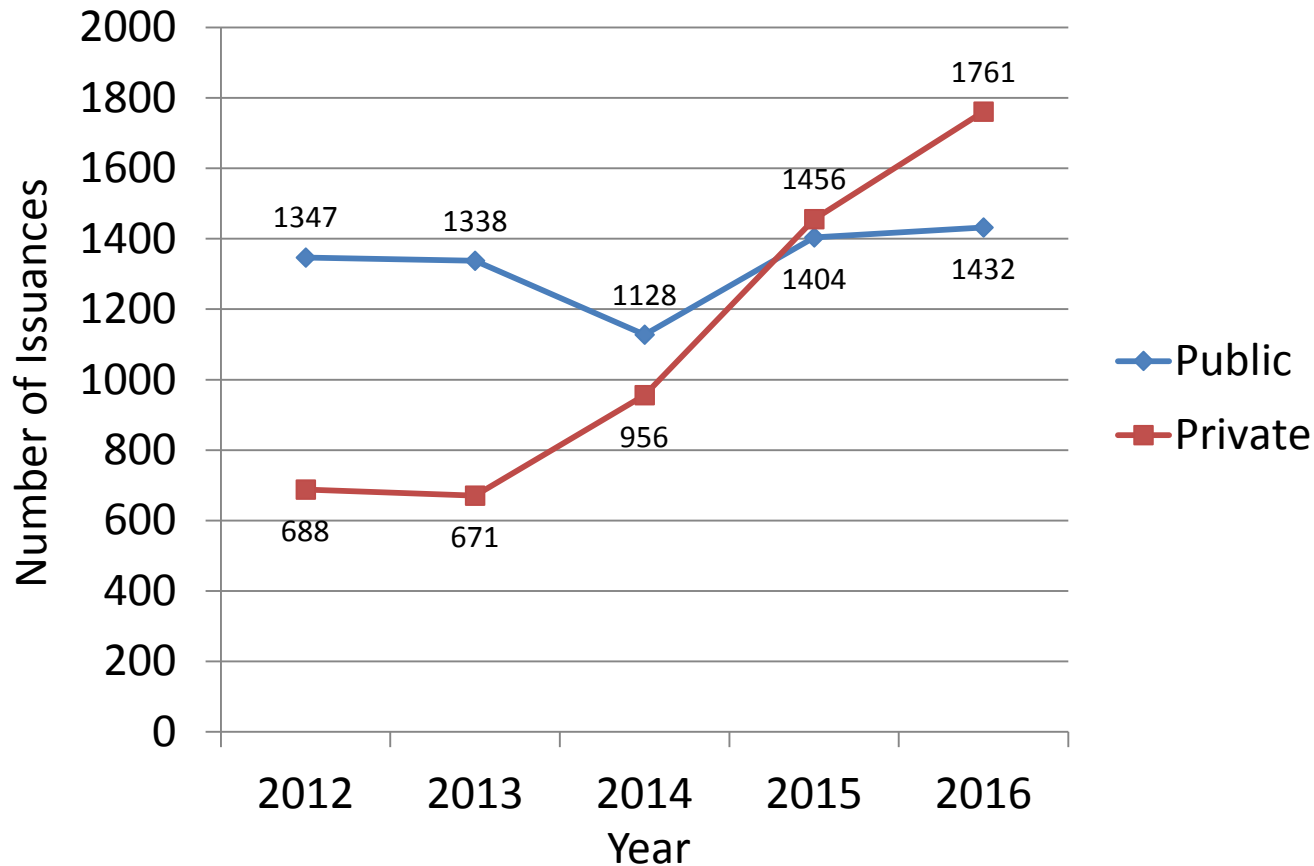
- Private Placement & Bank Loan Increase Over 4 Years = 83.77%



* Statistics provided by the Stanford Institute for Economic Policy Research as of August 2017

Background Statistics (Cont.)*

California Public Offerings vs. Private Placement 2012-2016



* Statistics provided by the Stanford Institute for Economic Policy Research as of August 2017

Background Statistics (Cont.)*

Interest Rate and Issuance Cost Average Comparisons, Public Offerings vs. Private Placement

Year	Private Placements, Total Issuance Costs	Public Offerings, Total Issuance Costs	Private Placements, Interest Rate	Public Offerings, Interest Rate
2012	\$116,020	\$369,598	3.50%	2.52%
2013	\$122,250	\$334,973	3.26%	2.97%
2014	\$94,062	\$430,740	3.76%	2.85%
2015	\$85,347	\$392,495	3.48%	3.09%
2016	\$100,178	\$412,871	3.36%	2.74%

* Statistics provided by the Stanford Institute for Economic Policy Research as of August 2017

Review of SEC Rule 15c2-12

- Rule 15c2-12 requires underwriter (among other things) to ensure issuer agrees to provide:
 - Annual reports: (i) audited financial statements and (ii) financial information or operating data of the type included in the OS
 - Listed event notices: 14 events currently listed in the rule (e.g., rating changes)
- Continuing disclosure provides secondary market with material information on a timely basis

Private Placements and Rule 15c2-12

- Rule 15c2-12 does not require disclosure of private placements (only applies to “publicly offered” bonds)
- However, may be material to existing bond holders, if:
 - Payable from revenues or taxes or assets that are pledged to existing bonds
 - Have different covenants and events of default
 - Structured with a balloon payment (e.g., a put prior to final maturity at the end of the bank’s stated holding period) or acceleration risk

Voluntary Disclosure

- Voluntary disclosure of private placements and their material terms has been promoted as a best practice and encouraged
 - MSRB Notice 2012-18 (Apr. 2012)
 - Direct Purchases and Bank Loans as Alternatives to Public Financing in the Municipal Securities Market, FINRA Regulatory Notice 16-10 (Apr. 2016)
 - GFOA Alert: Bank Loan Disclosure (May 12, 2016)
- To date, very few issuers have been providing voluntary disclosure

Voluntary Disclosure (Cont.)

- In general, only large sophisticated issuers have engaged in voluntary disclosure of private placements
 - Issuer staff may not be aware of best practice and disclosure considerations
 - Banks sometimes have concerns with disclosure of material terms, resulting in negotiations
 - Issuers have not have sufficient staff to prepare voluntary disclosure filings and/or redactions, particularly on a timely basis (10 business days)
 - Until recently, uncertainty about how to file voluntary disclosures on EMMA

Voluntary Disclosure (Cont.)

- Audited financial statements and/or an official statement for other publicly offered securities may contain information
- However, audited financials may not be available until many months after the private placement transaction closes, and infrequent issuers may not prepare an official statement (OS)

Voluntary Disclosure (Cont.)

- Additionally, disclosure in audited financials or in an OS may be limited to the amount of the financial obligation and may not provide certain details about the contractual obligations incurred
- Financial disclosure of an obligation would not likely be updated to reflect any financial troubles of the issuer

Implications of Disclosure to Issuers

- Rule 10b-5 makes it unlawful for any person engaged with the purchase or sale of a security to:
 - “Make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”
 - This is an anti-fraud rule, governing both issuers and others in the marketplace

Implications of Disclosure to Issuers

- Rating agencies are also interested in private placements
- In May 2014, S&P sent letters to all issuers whose bonds it rates stating it needs information on all private placement debt; otherwise potential downgrade in rating

Definition of Materiality

- “Materiality” is not statutorily defined, but defined by a series of court cases
 - A fact is material if there is a substantial likelihood that, under all the circumstances, the fact would have actual significance in the deliberations of the reasonable investor when deciding whether to buy or sell the securities
 - This is a facts-and-circumstances test – not a bright-line rule

Proposed Amendments

- Release No. 34-80130
 - Proposal and request for comments issued by the SEC on March 1, 2017
 - Comments were due May 15, 2017
 - Numerous comments received from individuals, organizations and municipal bond issuers
- The amendments should be seen as natural reaction to changes in marketplace
 - Rule 15c2-12 dates to 1989, and was previously amended in 1994, 2008, and 2010

Proposed Amendments (Cont.)

- Proposal would add 2 new events:
 - 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
 - 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

Proposed Amendments (Cont.)

- “Financial obligation” would be a new term, defined as:
 - A debt obligation, lease, guarantee, derivative instrument, or monetary obligation resulting from a judicial, administrative, or arbitration proceeding
 - This category would include lease financing arrangements, guarantees, and swap transactions

Proposed Amendments (Cont.)

- “If material” was clarified in the Release as applying to the entrance into a financial obligation or any of the enumerated terms, such as covenants, events of default, remedies, priority of rights, or other similar terms

Proposed Amendments (Cont.)

- If a filing of a material financial obligation is required, a description of the material terms should be included, for example:
 - Date of incurrence
 - Principal amount and interest rate
 - Maturity dates and amortization schedule
 - Default rates

Proposed Amendments (Cont.)

- With respect to the second proposed change, the event must reflect financial difficulties
 - The Release clarifies that 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, issuer could be in default for not providing notice of change of address as required; this would not need to be reported

Proposed Amendments (Cont.)

- Occurrence of events of default and termination events are quite rare in municipal securities
- At the same time, they are of very high significance to bond holders
- The proposed amendments would have a phase-in period and only apply to new undertakings – existing undertakings need not be amended

Proposed Amendments (Cont.)

- Unanswered is whether “financial difficulties” relates only to the pledged source of repayment or any repayment source or the issuer’s general creditworthiness

Implications for Issuer

- 10 days is quick turnaround time to make “materiality” determination and file, if needed
 - Issuers need processes in place to make these determinations – ideally, a disclosure coordinator as well
 - Will full documents be posted (perhaps with redactions) or summaries of key terms
 - If summaries or redactions, need to ensure all material information is being disclosed

Implications for Underwriters

- Underwriters need to perform due diligence on whether issuers have complied with their undertakings and will do so in the future
- Investors will have more information to absorb and discuss with underwriters
- Additional disclosure could have either positive or negative impact on pricing

Implications for Dissemination Agents

- Dissemination agents are not proactive and will not have access to the types of contracts and other obligations at issue
- Disclosure consultants are more proactive, but again challenge is keeping them in the loop
- Internal or outside counsel may be able to assist and issue-spot potentially disclosable obligations

MSRB Amended Rule G-34

- Effective June 14, 2018
- Reflects MSRB's long-standing interpretation that direct purchase transactions must obtain a CUSIP number
- Final rule exceptions:
 - Dealer reasonably believes the investor has present intention to hold loan/security until final maturity
 - Investor must be bank, control affiliate of bank or consortium of these entities, or SRF or bond bank

Questions/Contact

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