A Reminder that the SEC Requires Disclosure of Rating Changes and Financial Obligation

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- Administrative & Regulatory
- All Federal

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When it comes to continuing disclosure, two of the more common “material events” to occur are rating changes and the incurrence of a “financial obligation.” As a general matter, these are reportable events that should be posted to Electronic Municipal Market Access (EMMA). However, as a practical matter, these material events are frequently overlooked.

Whether a rating change involves an upgrade or a downgrade, it is necessary to post such changes to EMMA pursuant to Rule 15c2-12, even though municipal ratings are usually considered public knowledge. Typically, a change in “outlook” (such as stable, positive, or negative) is not considered a rating change for the purpose of Rule 15c2-12, although there is no prohibition in voluntarily posting a notice of such a change on EMMA.

On Feb. 27, 2019, the Securities and Exchange Commission (SEC) implemented two new material events, bringing the total number of material events to sixteen. With the rise of private placements and direct purchases in recent years, the SEC sought to enhance transparency with respect to these obligations, which were not previously subject to Rule 15c2-12. One of the two newly added material events includes the incurrence of a “financial obligation,” if material. A financial obligation is defined as a (i) debt obligation; (ii) derivative instrument entered into in
connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) a guarantee of (i) or (ii). However, the definition of financial obligations does not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board (MSRB) consistent with Rule 15c2-12, nor does such definition include ordinary financial and operating liabilities incurred in the normal course of business of an issuer or obligated person. The term “material” is also undefined in the context of a financial obligation. To the extent that an issuer or an obligated person has entered into a continuing disclosure undertaking since Feb. 27, 2019 pursuant to Rule 15c2-12, this newly implemented material event is likely to have application.

In the absence of an exception, SEC Rule 15c2-12 mandates underwriters of municipal securities ensure issuers or other obligated persons undertake to provide to the public continuing disclosure information presumed to be important to investors by filing that information with EMMA. Among other things, Rule 15c2-12(i)(C) requires issuers or obligated persons who have agreed to a continuing disclosure undertaking must provide the MSRB notice of: (a) payment delinquencies and defaults; (b) unscheduled draws on debt service reserves or credit enhancements; (c) substitution of credit or liquidity providers; (d) adverse opinions or notices from the Internal Revenue Service (IRS); (e) bond calls or tender offers; (f) defeasances; (g) bankruptcy; (h) ratings changes; and (i) a default, event of acceleration, termination event, modification of terms or similar event. Although there are other material events, those material events are qualified by a “materiality” standard. Any issuer or obligated person who has agreed to a continuing disclosure undertaking must notify the MSRB of the forgoing events within 10 business days.

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