



NATIONAL ASSOCIATION OF MUNICIPAL ADVISORS

**2018 ANNUAL CONFERENCE  
PROVIDENCE**

**Hot Topics  
Municipal Market**

Moderator

**Susan Gaffney, NAMA**

Speakers

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**Emily Brock, GFOA**

**Julie Egan, NFMA**



# **HOT TOPICS: DISCLOSURE AND MARKET ISSUES**

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## Regulatory Backdrop: SEC Rule 15c2-12

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- Rule 15c2-12 requires state or local government issuing bonds to enter into an agreement (contractual), to provide certain information to the Municipal Securities Rulemaking Board (MSRB) about the securities on an ongoing basis.
  - Annual Financial Information
    - Financial information and operating data provided by state or local government, or other obligated persons.
    - Audited financial statements for state or local government or other obligated persons, if available.
  - 14 Items Require Event Notices (see Appendix)

# MCDC Initiative: Orders and Cases Post MCDC

- Cease and Desist Orders
  - Underwriters: 72 Firms and >\$18m in Fines
    - Examples of “Materiality” Provided
    - Engage an Independent Consultant
  - Issuers: 71 Issuers Across 45 States
    - Enforcement Actions Against Obligated Parties of All Kinds from All Regions
    - “Materially false or misleading statements or omissions about their compliance with continuing disclosure obligations.”
  - See Appendix for findings
- Cases
  - *“Issuers and underwriters will continue to be held accountable when they fail to provide investors with an accurate picture of past compliance with continuing disclosure obligations.”*  
LeeAnn Ghazil Gaunt, Chief of the SEC Enforcement Division’s Public Finance Abuse Unit.
  - Issuer is Accountable for Meeting its Disclosure Obligations and the Representations in Offering Documents
    - Use of Dissemination Agent Does Not Absolve Obligated Party from Obligations
  - See Appendix for Overview

# What Should MAs Keep In Mind? The Underwriter's Perspective



- Approach to 15c2-12 Compliance – A New Reality Post MCDC
  - Review Obligations and Assess Corrective Actions for Issuers with Failures in Past Filings
  - Assessment of Issuer's Disclosure/Statements in POS/OS
  - Reach a Conclusion of an Issuer's Ability to Comply Prospectively
- What is “Reasonable Diligence?” No Single Standard
  - 5 Year Lookback – All Deals Outstanding at Any Time
  - Negotiated
    - Consistency in Depth for Audit and Fin/Op
    - Inconsistencies – Ratings (underlying and enhanced) and Calls; Issue and CUSIP level
  - Competitive
    - Timeliness of Audit and Fin/Op Overall
    - Our Clients – Issue and CUSIP
    - About 2/3rds of Our Clients Look at Detailed Fin/Op, Ratings and Calls Post-Win
- “Materiality” – Not Defined (Amendments Seemingly Help)
  - MCDC Examples (see Appendix) = “guardrails”
  - But .... “Facts and circumstances”
  - Whether the information would be important to the total mix of information made available to the reasonable investor, *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 440 (1976)

- Practices for Issuers/Obligors
  - Disclosure Management Policy and Practices: A Must Have
    - Understand Filing Obligations and Timing – Independent 3<sup>rd</sup> Party
      - Suggest Specific Annual Filing Date Deadlines
    - Analyze Disclosure History on EMMA – Independent 3<sup>rd</sup> Party
      - Careful diligence (15c2-12 Analysis) of *content* of secondary market Operating and Financial data filings
    - Update Past Delinquent Filings
    - Consider Ongoing 15c2-12 Analysis/Refresh/Alerts
      - Reminders for Current Filing Obligations
      - Independent Review to Confirm Filings Done Properly (vs. having the filing agent reviewing – “Fox watching the hen house”)
    - Let Underwriters Know of Issuer’s Policies and Procedures
    - Train Responsible Officials (Primary and Secondary)
  - Engagement of Borrower and Disclosure Counsel

# Amendments to Securities Exchange Act Rule 15c2-12

- Focus: Material financial obligations that could impact an issuer's liquidity, overall creditworthiness, or an existing security holder's rights.
  - Think: Direct Purchases/Placements and Direct Loans
- Purpose: To better inform investors and other market participants about the current financial condition of issuers of municipal securities and obligated persons.
- Amendments to 15c2-12: The issuer or obligated party must agree to provide the MSRB timely notice of the following events:
  - (15) 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
  - (16) 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*.
  - “Financial Obligation” means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii).
    - The term financial obligation does not include municipal securities where a final official statement has been provided to the Municipal Securities Rulemaking Board (consistent with the Rule, i.e., not voluntarily. See Adopting Release 83 FR 44700, 44715).

# Amendments to Securities Exchange Act Rule 15c2-12

- Key Terms and Phrases re: “15”
  - “Financial Obligation” - Defined in Amendment
    - Focuses on debt, debt-like and debt-related obligations of issuers/obligated persons
    - “Lease” – Removed from definition of Financial Obligation *but*
      - “... ‘debt obligation’ should be considered to include lease arrangements ... that operate as vehicles to borrow money.” 17 CFR Part 240.
    - Materiality of a financial obligation determined upon the incurrence of each distinct financial obligation
  - “Materiality”
    - “... the Commission continues to believe that materiality determinations should be based on whether the information would be important to the total mix of information made available to the reasonable investor.” 17 CFR Part 240, 23-24 (citing Exchange Act Release No. 34-33741 (March 9, 1994)).
    - “... an issuer or obligated person will need to consider whether a financial obligation or the terms of a financial obligation, if they affect security holders, would be important to a reasonable investor when making an investment decision.” *Id.* citing *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).
    - Facts and Circumstances: Some issuers and obligated persons may have differing opinions with respect to whether a piece of information would be considered important to a reasonable investor when making an investment decision. *Id.*
  - Material Terms of a Financial Obligation should be disclosed.

# Amendments to Securities Exchange Act Rule 15c2-12

- Key Terms and Phrases re: “16”
  - “Reflect Financial Difficulties” – “Market participants should be familiar with the concept as it relates to the operation of Rule 15c2-12.” Id. at 63. Existing disclosure events:
    - Unscheduled draws on debt service reserves *reflecting financial difficulties*
    - Unscheduled draws on credit enhancements *reflecting financial difficulties*
- Effective Date: February 27, 2019
  - The amendments will only affect those CDAs entered into on or after the compliance date. Issuers and obligated persons with a CDA entered into on or after the compliance date must disclose:
    - Material financial obligations incurred on or after the date on which such a CDA was entered into.
    - Default, Event of Acceleration, Termination Event, Modification of Terms or Similar Events under the terms of a financial obligation, any of which reflect financial difficulties that occurs on or after the compliance date must be disclosed regardless of whether such obligation was incurred before or after the compliance date. Id. at 65.
- How to Help
  - Helping the Issuer/Obligor Prepare – Maintain and Monitor All “Financial Obligations”
  - Adopting Release Suggests Issuers Amend Policies and Procedures to address the process for evaluating the materiality of financial obligations.
  - “Materiality” Determinations – Counsel
  - Periodic Check-In – Ask the Questions About Events that Require Disclosure

- SEC Rule 15c2-12 -- Event Notices (pre Amendments Effective February 2019)
  - Principal and interest payment delinquencies
  - Non-payment related defaults
  - Unscheduled draws on debt service reserves reflecting financial difficulties
  - Unscheduled draws on credit enhancements reflecting financial difficulties
  - Substitution of credit or liquidity providers, or their failure to perform
  - Adverse tax opinions or events affecting the tax-exempt status of the security
  - Modifications to rights of security holders
  - Bond calls and tender offers
  - Defeasances
  - Release, substitution or sale of property securing repayment of the securities
  - Rating changes
  - Bankruptcy, insolvency or receivership
  - Merger, acquisition or sale of all issuer assets
  - Appointment of successor trustee

## MCDC Cease & Desist Order Findings

- Competitive and Negotiated Deals
- “Materiality” Per MCDC
  - Missed/Late Audited Financial Filings & Operating Data
    - Overall Filing
    - Detailed Operating Data – Incomplete
    - “Certain financial information” as agreed under previous offerings
  - No Statement About Prior Compliance *Where Failures Existed*
  - Corrective Filings Prior to an Offering Does Not Cure
  - Failure to File Notice
  - EMMA Cross References
    - OS with an Annual Report filed with EMMA Lacking Cross-Reference to Issue and/or CUSIP
    - Failure to Provide, within EMMA, Cross-References to Previously Filed Audit and Operating Filings
  - Ratings & “Certain Notices of Defeasance”

- Miami Key Takeaways
  - Willingness To Go to Trial/Significant Penalties
  - Miami and its former budget director guilty of securities fraud for faulty disclosures.
  - *“We will ... hold municipalities and their officers accountable ... if they engage in financial fraud or other conduct that violates federal securities laws.”* Andrew Ceresney, former SEC Enforcement Director
- Beaumont Key Takeaways
  - ...Beaumont, California and its then-executive director settled charges that they made false statements about prior compliance with continuing disclosure obligations in five bond offerings.
  - The Order noted that “negligence is sufficient to establish violations of Sections 17(a)(2) and (a)(3).”
  - A misrepresentation or omission is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision.

### **Gregg Bienstock, CEO and Co-Founder of Lumesis**

Gregg is the CEO and a Co-Founder of Lumesis. He is a frequent speaker on municipal market compliance and has authored several articles on current regulatory issues impacting the municipal market. Prior to Lumesis, Gregg spent more than thirteen years with Ambac Financial Group where, most recently, he was responsible for Strategic Initiatives and previously served as Chief Administrative Officer and Employment Counsel. Gregg is a 1991 graduate of Brooklyn Law School. He received his B.S. in Business and Economics from the University of Maryland. He serves as a member of the Board of Directors of The Children’s Village, leads a fund-raising initiative (“Tri-ing for CV”) for the Children’s Village and is an amateur triathlete.

**Lumesis, Inc. is** a municipal market leader in providing regulatory, business and data solutions to firms of all sizes. Lumesis was founded in 2010 and is dedicated to delivering technological solutions to today’s municipal market issues. Today, the company’s DIVER platform helps hundreds of firms with over 45,000 users efficiently meet their regulatory and business needs.

We are muni debt experts, thought leaders and technology innovators. Our core competency is muni market data and a deep understanding of web-based technology that allows municipal market participants to work better, faster and smarter. As importantly, we are a relationship company and committed to serving each and every one of our clients. Our clients range from the largest firms in the industry to individual issuers across the country.

# GFOA: DC Update

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- **Aftermath of 2017 Tax Reform**
  - Life without advance refundings
  - Could have been worse
- **Keeping an Eye Out: 2018 and Beyond**
  - Tax Reform 2.0
    - No specific muni provisions
  - Advocating for return of advance refundings
    - H.R. 5003
  - Defense
    - Preserving tax exemption
    - Opposing limits on muni exemption
    - Opposing placing limits on types of bonds that qualify as tax-exempt
    - Not tying tax-exemption to other issues, such as pension funding

# GFOA: DC Update

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- **Keeping an Eye Out: 2018 and Beyond, Continued**
  - Offense
    - Increasing and making permanent BQ Limit at \$30m and indexed to inflation
    - Bringing back advance refundings
    - Relaxing limits on tax-exempt bonds, private activity bonds, P3s
    - Reworking arbitrage rules
    - Permanent disaster recovery financing options (per NABL paper)
- **HQLA**
  - A win!
- **Money Market Mutual Funds**
  - Stable vs floating NAV
- **SALT**

# GFOA: DC Update

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- **SEC 15c2-12 Amendments**

- Education for our members will be a key GFOA initiatives
- Understanding the baselines set forth in the amendments
- Helping issuers apply the rule to their facts and circumstances
- Use of outside counsel for assistance
- Request guidance from SEC

- **General Disclosure**

- SEC Working group recommendations/2012 Municipal Securities Paper
- Additional issuer requirements (timing and content of disclosures)
- 15c2-12 Interpretive Guidance

- **Issue Price Regulations**

- Seeking further clarification especially related to the exemption for competitive sales
- SEC Working group recommendations/2012 Municipal Securities Paper

# GFOA: DC UPDATE

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- **GFOA Debt Best Practices**
  - Roles of Counsels
  - Investment of Bond Proceeds
  
- Other GFOA Debt Committee Projects
  - Refundings
  - Investor Relations Programs and
    - Update Disclosure Best Practices and Advisories
  - LIBOR
  - Climate/Cybersecurity

# NFMA Update

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- NFMA's Views on Rule 15c2-12 Changes
- NFMA Disclosure Best Practices
- Buyer Experiences in the Market