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Market Transparency

Bank Loan Disclosure Market Advisory

Introduction*

The Municipal Securities Rulemaking Board (MSRB) is committed to promoting a fair and efficient municipal securities market and protecting investors, state and local governments and other municipal entities that issue municipal securities (issuers), and the public interest. Pursuant to Section 15B of the Securities Exchange Act of 1934, the MSRB regulates brokers, dealers and municipal securities dealers engaged in municipal securities activities and municipal advisors engaged in municipal advisory services. As part of its charge to promote a fair and efficient market, the MSRB is aware of the increasing use of bank loans¹ and direct-purchase debt as financing alternatives² to public offerings in the municipal securities market for funding capital improvement projects or refunding outstanding bonds. Specifically, the MSRB is concerned that a bank loan could impair the rights of existing bondholders, including its impact on the seniority status of existing bondholders, or its impact on the credit or liquidity profile of an issuer. As such, the MSRB is publishing this market advisory to alert municipal market participants of the importance of voluntary disclosure of

* While this market advisory focuses specifically on bank loan disclosures, many of the principles described herein would be equally applicable to other types of indebtedness, including direct loans from hedge fund investors and others. Market participants are encouraged to consider whether the disclosure of other indebtedness is also warranted.

¹ For the purposes of this market advisory, “bank loan” is defined as: 1) a direct purchase – by purchasing a bond directly from the issuer; or 2) a direct loan – by entering into a loan agreement or other type of financing agreement with the municipal issuer. The term “bank loan” does not include purchases of bonds by banks in a primary public offering or in the secondary market.

² Bank loans as an alternative to a public offering could provide potential advantages for issuers, 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.



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bank loans. Given the current regulatory ambiguities regarding bank loans,³ inconsistent market practices and lack of commonly accepted provisions within bank loan agreements, the MSRB believes that informing the market of the incurrence of a bank loan and its terms is beneficial to the continued fairness and efficiency of the municipal securities market.

Two previous notices [MSRB Notice 2011-37 (August 3, 2011) and MSRB Notice 2011-52 (September 12, 2011)] review certain MSRB rules applicable to a bank loan, subject to a determination whether the transaction involves a loan or security.⁴ As the MSRB previously observed, if a bank loan, in fact, is not a municipal security, existing securities law requirements with respect to disclosure for that municipal security transaction do not apply. In addition, even if a bank loan is, in fact, a municipal security, no disclosure document typically will be prepared if the issuer negotiates and enters into the loan directly with the bank as an investor thereby making disclosure obligations under SEC Rule 15c2-12 not applicable to the transaction.⁵ However, an issuer's existing bondholders, as well as potential investors and other market participants, may not become aware of such bank loans, including their impact on the seniority status of existing bondholders, or their impact on the issuer's outstanding debt, until the issuer's next public offering or the release of an issuer's audited financial statements.⁶ This may cause a significant delay in the release of this disclosure, particularly in the case of small or infrequent issuers.⁷

³ See [MSRB Notice 2011-52 \(September 12, 2011\)](#). The Securities and Exchange Commission (SEC) and the courts, not the MSRB, ultimately have the authority to interpret the meaning of the term "security" for purposes of the federal securities laws. See also the National Association of Municipal Advisors, Letter to SEC Chair Mary Jo White, December 15, 2014 (NAMA letter). The NAMA letter requests regulatory clarification and an exemption from broker-dealer registration for municipal advisors engaged in municipal advisory activities related to providing advice or negotiating on behalf of municipal entities or obligated persons in direct-purchase transactions.

⁴ See generally *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

⁵ See [MSRB Notice 2012-18 \(April 3, 2012\)](#).

⁶ Governmental Accounting Standards Board Statements 34 and 38, and Governmental Accounting Standards Board Codification 2300-120, 1500.102 and 1500.121 require bank loan activity to be disclosed as appropriate in long-term liabilities, governmental fund financial statements, proprietary fund financial statements, notes disclosure about debt service requirements and significant violations of legal covenant provisions and long-term liabilities.

⁷ *Supra* note 5.

The MSRB believes that the availability of timely disclosure of additional debt in any form and debt-like obligations is beneficial to foster market transparency and to ensure a fair and efficient municipal market. MSRB Notice 2012-18 (April 3, 2012) encouraged issuers to voluntarily post information about their bank loan financings to the Electronic Municipal Market Access (EMMA[®]) website.⁸ Generally, municipal market participants have acknowledged the importance of bank loan disclosure, and have put forth best practices and guidance for voluntarily disclosing information about bank loans in the municipal market.⁹ In addition, we are aware that many frequent issuers as well as bank lenders now encourage borrowers to voluntarily post information about their bank loan financings to EMMA.¹⁰ However, despite municipal market participants' efforts to provide bank loan best practices and guidance to encourage timely voluntary bank loan disclosure, bank loan executions have far exceeded bank loan disclosures in comparison.¹¹ Since the publication of MSRB Notice 2012-18 (between April 3, 2012 and January 23, 2015) approximately 88 bank loan disclosure documents have been submitted to EMMA.¹²

⁸ EMMA is a registered trademark of the MSRB. EMMA presently permits issuers and their agents to voluntarily submit bank loan information under the EMMA continuing disclosure service. Using the current mechanism to submit documents related to securities that are ineligible for CUSIP numbers, issuers are encouraged to use the current voluntary continuing disclosure category of "Financial/Operating Data - Investment/Debt/Financial Policy" for submission and indicate in the "Consisting of" free-text field that the documentation consists of "Bank Loan" disclosures.

⁹ National Federation of Municipal Analysts White Paper, *Best Municipal Bond Issuance and Disclosure Practices*, January 2014; Government Finance Officers Association, *Best Practice: Understanding Bank Loans*, September 2013; Bank Loan Disclosure Task Force White Paper, *"Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans,"* May 2013; see also, Moody's Investors Service, *Growth in Bank Loans and Private Placements Increases Risk and Reduces Transparency in the Municipal Market*, October 2014; Standard & Poor's Credit FAQ: *Bank Loans and Bond Ratings: What to Disclose?* June 2013; National Association of Bond Lawyers, *Practice Pointers for Bank Loans and Other Private Placements*, February 2012.

¹⁰ While disclosure of bank loans is not required under Rule 15c2-12, any voluntary disclosure may be held to the same standards of materiality and timeliness as information disclosed under Rule 15c2-12.

¹¹ See Moody's Investors Service, *Growth in Bank Loans and Private Placements Increases Risk and Reduces Transparency in the Municipal Market*, October 2014; see also Standard & Poor's, *Alternative Financing: Disclosure Critical to Credit Analysis in Public Finance*, February 2014.

¹² These filings are located on EMMA in the voluntary continuing disclosure category of "Financial/Operating Data - Investment/Debt/Financial Policy" and used free text to indicate

Municipal Market Transparency Implications

Voluntary bank loan disclosure information serves important investor protection and market efficiency functions by ensuring that information is properly recorded and disseminated to the marketplace. The implications of delayed or undisclosed debt-like obligations could impair the rights of the issuer's existing bondholders, including their impact on the seniority status of existing bondholders, or impact on the credit or liquidity profile of an issuer. In some instances, particularly for small and less frequent issuers, a bank loan and its loan agreement documents may substantially increase an issuer's outstanding debt, contain covenants and events of default provisions that differ from those within existing bond indentures, pledge assets previously available to secure bonds or structure the loan maturity as a balloon or with the potential for accelerated payments,¹³ which could present liquidity risks. The inability to timely assess the 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. In addition, the current lack of bank loan disclosure undermines market transparency.

Suggested Bank Loan Disclosure Practices¹⁴

The MSRB encourages municipal market participants¹⁵ to promote transparency and further market efficiency by following voluntary bank loan disclosure best practices when executing a bank loan.

that the submission was for bank loan information. Bank loan information submitted without explicit indication as such may not be captured.

¹³ Some bank loan payment acceleration provisions require a put prior to the final maturity at the end of the bank's stated holding period. Acceleration provisions may be triggered by events of default specified, among others, as payment default on any parity obligation for the loan, ratings changes below a particular threshold, failure to provide a timely financial report to the lender, or maintenance of certain liquidity levels.

¹⁴ References to best practices are not intended to create legal standards.

¹⁵ As noted in MSRB Notice 2011-37, financial advisors should consult with their legal counsel on whether any placements in which they are engaged are placements of loans or placements of securities. Certain financial instruments, although characterized as loans (*e.g.*, "bank loans"), may in fact be municipal securities. All financial advisors, including those that are already registered as broker-dealers, should also consult with their legal counsel on whether engaging in such activities could trigger the application of SEC and MSRB rules that apply to placement agents. All financial advisors may also find helpful the SEC publication "[Guide to Broker-Dealer Registration.](#)"

Generally, municipal market participants have espoused the following practices to foster greater municipal bank loan transparency:

- Develop voluntary disclosure policies and procedures related to the execution of bank loans;
- Understand the characterizations of bank loans for legal¹⁶ and accounting purposes;
- Determine the priority of payments for the bank loan relative to existing bonds;
- Highlight any debt acceleration provisions within the bank loan;
- Highlight any events that could cause the interest rate on the bank loan to change;
- Understand the treatment of bank loans in financial statements;
- Review the implications of structures, terms and pricing of bank loans; and
- Disclose bank loan information to EMMA using the voluntary disclosure mechanism.

MSRB Notice 2012-18 encourages voluntary filing of bank loan information by either submitting a summary of the key terms of the bank loan to EMMA, with consideration given to adding any provisions that have an impact on the security of existing bondholders, or by submitting the bank loan financing documents. The MSRB believes that timely access to this information can provide current or prospective bondholders and other market participants with key information that can be useful in assessing their current holdings of municipal securities or in making investment decisions regarding transactions in municipal securities.¹⁷ The MSRB believes that disclosure of the following information related to bank loans,¹⁸ although not exhaustive, supports market transparency and enhances market efficiency:

- Details of the purpose of the additional debt obligation and use of proceeds;
- Amount of additional debt and its impact on the debt position;

¹⁶ In addition to securities law implications, state and local laws should be reviewed to ensure the bank loan is within the legal limits and characterized as required by such laws. See Government Finance Officers Association, *Best Practice: Understanding Bank Loans*, September 2013.

¹⁷ *Supra* note 5.

¹⁸ *Supra* note 9.

- Source of repayment;
- Payment dates;
- Interest rate, if fixed, or method of computation, if variable;
- Maturity and amortization of bank loan;
- Covenants and other ancillary business provisions;
- Terms of the additional debt including liquidity requirements and optional, mandatory, and extraordinary prepayment terms, if any;
- Evidence of compliance with additional debt test, if applicable;
- Events of default and remedies;
- Acceleration events such as a ratings downgrade;
- Disclosure of “most-favored nation” or similar clause;
- Ratings, if assigned;
- Governing law;
- Tax status of interest;
- CUSIP number, if applicable;
- Redistribution rights, if applicable; and
- Financial reporting requirements.

In addition, submission of bank loan financing documents may warrant consideration of MSRB Rule G-34(c), which may be considered analogous to the submission of bank letter of credit documents that support variable rate demand obligations.¹⁹ Moreover, the bank loan disclosure information provided should be consistent with the requirements of SEC Rule 10b-5²⁰ such that information is not false or misleading in the context in which it is provided.

Market participants are also encouraged to be mindful of their legal responsibilities in the development of primary offering documents to fully inform investors of other debt-related obligations.²¹ The Governmental Accounting Standards Board requires disclosure of bank loan debt obligation in an issuer’s financial statements.²² Underwriters participating in municipal bond offerings that are subject to Rule 15c2-12 are required to receive, review and distribute official statements of issuers of primary municipal

¹⁹ See [MSRB Notice 2011-17 \(February 23, 2011\)](#) and [MSRB Notice 2012-20 \(April 11, 2012\)](#).

²⁰ See 17 CFR 240.10b-5.

²¹ See National Federation of Municipal Analysts White Paper, *Best Municipal Bond Issuance and Disclosure Practices*, January 2014.

²² *Supra* note 6.

securities offerings. Inclusion of bank loan information, if material, within publicly offered municipal securities documents, supports the underwriter's due diligence obligations to have a complete understanding of an issuer's debt profile and potential implications for existing and potential bondholders. The inclusion of bank loan information within publicly offered municipal securities documents further supports the timeliness of investor awareness of possible credit implications and risks associated with a bank loan (*i.e.*, liquidity, rollover and repayment risks) that could impact the issuer's ability to meet existing and future bond debt service obligations. This awareness can inform a bondholder's credit assessment and determine the appropriate pricing and valuation of the issuer's outstanding bonds.

Questions about this advisory should be directed to Ritta McLaughlin, Chief Education Officer, at 703-797-6600 or rmclaughlin@msrb.org.

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