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Market Transparency

## Request for Comment on a Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans

### Overview

The Municipal Securities Rulemaking Board (MSRB) is requesting comment on a concept proposal to require municipal advisors to disclose information regarding the direct purchases and bank loans of their municipal entity clients. Such disclosure could be made to the MSRB's Electronic Municipal Market Access (EMMA<sup>®</sup>) system for public dissemination.<sup>1</sup> This concept proposal is intended to elicit views and input from all interested parties on the benefits and burdens of this potential disclosure requirement and possible alternatives. The comments will assist the MSRB in determining whether to undertake a formal rulemaking to propose creating such a requirement for municipal advisors.

Comments should be submitted no later than May 27, 2016, and may be submitted in electronic or paper form. [Comments may be submitted electronically by clicking here.](#) Comments submitted in paper form should be sent to Ronald W. Smith, Corporate Secretary, MSRB, 1300 I Street NW, Washington, DC 20005. Generally, all comments will be made available for public inspection on the MSRB's website.<sup>2</sup>

Questions about this concept proposal should be directed to Margaret Blake, Associate General Counsel, or Carl Tugberk, Assistant General Counsel, at 202-838-1500.

<sup>1</sup> EMMA is a registered trademark of the MSRB.

<sup>2</sup> Comments generally are posted on the MSRB website without change. For example, personal identifying information such as name, address, telephone number, or email address will not be edited from submissions. Therefore, commenters should only submit information that they wish to make available publicly.



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## Background

For several years, the MSRB has expressed interest in the increasing use by municipal entities of direct-purchases<sup>3</sup> and bank loans, and the possibility that some “bank loans” are actually securities subject to MSRB rules.<sup>4</sup> The MSRB has encouraged state and local governmental entities to voluntarily disclose information about their bank loan financings to EMMA.<sup>5</sup> The MSRB has noted that, because bank loans are not subject to the same level of disclosure as public offerings of municipal securities, “holders of an issuer’s outstanding debt, as well as potential investors and other market participants, may not become aware of such bank loans or their impact on the issuer’s outstanding debt until the release of an issuer’s audited financial statements.”<sup>6</sup> As a result, investors may not be able to fully appreciate the overall amount of indebtedness of an issuer in a timely fashion, and they may also lack knowledge of key terms of any undisclosed indebtedness, which could be material to their investment decisions. For example, some direct purchases and bank loans may have provisions that make creditors senior to bondholders or that provide creditors with more favorable remedies than bondholders in the event of default.

The MSRB has specifically emphasized the importance of transparency in the market and alerted municipal market participants to the value of voluntarily disclosing bank loan financings, noting that:

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<sup>3</sup> For purposes of this concept proposal, a direct purchase is the private placement of municipal securities with a single purchaser (often times a bank, private fund or broker-dealer), as an alternative to a traditional public offering in the municipal securities market.

<sup>4</sup> See [MSRB Notice 2011-37 \(Aug. 3, 2011\)](#); [MSRB Notice 2011-52 \(Sept. 12, 2011\)](#); [MSRB Notice 2012-18 \(Apr. 3, 2012\)](#); [MSRB Notice 2015-03 \(Jan. 29, 2015\)](#). The MSRB recognizes that direct purchases and bank loans may be reasonable and appropriate options for municipal issuers under certain circumstances.

<sup>5</sup> See [MSRB Notice 2012-18 \(Apr. 3, 2012\)](#). Additionally, the MSRB reminded financial advisors and municipal advisors of their obligation to determine the status of an instrument as a security or a bank loan, and further noted that, in some instances, what market participants might refer to as a “bank loan” may, as a legal matter, actually be a security such that engaging in certain activities related to the placement of such security might result in a need for broker-dealer registration. See [MSRB Notice 2011-37 \(Aug. 3, 2011\)](#); [MSRB Notice 2011-52 \(Sept. 12, 2011\)](#). This request for comment does not address these two issues, which are within the jurisdiction of the Securities and Exchange Commission (SEC).

<sup>6</sup> [MSRB Notice 2012-18 \(Apr. 3, 2012\)](#). Bank loans that are not securities are not subject to the securities law requirements with respect to disclosure, and even “bank loans” that are, as a legal matter, securities are not always disclosed (*e.g.*, where the issuer negotiates and enters into the transaction directly with the bank).

[t]he 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. . . . 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.<sup>7</sup>

Despite the MSRB’s continued encouragement that issuers voluntarily disclose bank loan financings on EMMA, the number of actual disclosures made remains limited.<sup>8</sup> The MSRB is concerned that the lack of disclosure hinders an investor’s ability to truly understand the risks of an investment, thus frustrating the transparency, integrity, fairness and efficiency of the municipal securities market.

## Concept Proposal

Currently, investors do not have timely access to important details of the levels and terms of many issuers’ outstanding indebtedness. Although the MSRB facilitates the voluntary disclosure of this information by issuers and their agents to EMMA, and has provided detailed instructions on the process for doing so,<sup>9</sup> as previously noted, voluntary submissions on such financings have been limited. Indeed, information about such financings generally is only available in an issuer’s financial statements,<sup>10</sup> which do not necessarily

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<sup>7</sup> [MSRB Notice 2015-03 \(Jan. 29, 2015\)](#).

<sup>8</sup> For example, as of March 28, 2016, a search of EMMA for the term “bank loan” produced 143 results. Of these results, 79 included the words “bank loan” in the issue description and were filed under the subcategory suggested by the MSRB. See [MSRB Notice 2012-18 \(Apr. 3, 2012\)](#) (providing a recommended procedure for disclosing information about bank loan financings to EMMA®). Another 23 submissions included the words “bank loan” in the issue description, but the document reported under a subcategory other than that suggested by the MSRB may not be related to a bank loan. The remaining 41 results, while including the words “bank loan” in the document, did not include any document under the subcategory suggested by the MSRB.

<sup>9</sup> *Id.*

<sup>10</sup> This information may become available sooner if, for example, the issuer makes a public offering of municipal securities before filing its financial statements and the information is included in the official statement for that offering.

include key terms of the financings or all of the information bondholders might need to evaluate effectively the credit quality of outstanding bonds, such as provisions of the debt that would affect the seniority of bondholders in the event of an issuer's default.<sup>11</sup>

The MSRB is considering ways by which material information related to a municipal entity's direct purchases and bank loan financings could be made more available to the investing public. One possible method of obtaining this information would be to require disclosure to the MSRB by municipal advisors that advise municipal entities on such financings, with public dissemination then undertaken by the MSRB. The MSRB is seeking comment on ways in which more information or more timely information about such financings could be made available to investors, including whether and how to require municipal advisors to disclose information about a municipal entity client's outstanding indebtedness.

The MSRB has considered disclosure-related matters previously when adopting MSRB Rule G-32, on disclosures in connection with primary offerings, and Rule G-34, on CUSIP numbers, new issue, and market information requirements. While Exchange Act Section 15B(d)(1) prohibits the SEC and the MSRB directly, or indirectly through a broker, dealer or municipal securities dealer (collectively, a "dealer"), from requiring an issuer to file the equivalent of a registration statement or similar documents before the sale of municipal securities,<sup>12</sup> existing Rules G-32 and G-34 appropriately require dealers to make certain disclosures with respect to such sales. For

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<sup>11</sup> Rule 15c2-12 under the Securities Exchange Act of 1934 ("Exchange Act") requires dealers, when underwriting certain types of municipal securities, to ensure that the state or local government issuing the bonds enters into an agreement to provide certain information to the MSRB about the securities on an ongoing basis, including, but not limited to, annual financial information. However, the requirements of Rule 15c2-12 do not apply unless the financial instrument is a municipal security, and disclosure documents are typically not prepared for direct purchases or bank loans. Additionally, while issuers are required to make continuing disclosures for certain events set out in Rule 15c2-12(b)(5)(i)(C), the incurrence of additional indebtedness, as in a direct purchase or bank loan, is not one of the events enumerated.

<sup>12</sup> Section 15B(d)(1) states:

Neither the Commission nor the Board is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.

example, Rule G-32(b)(i)(B)(1) requires dealers, when underwriting an offering, to submit to EMMA the official statement for the offering within one business day “after receipt” of the official statement from the issuer.<sup>13</sup> Additionally, Rule G-32(c) requires a dealer, acting as a financial advisor, that prepares an official statement for an issuer regarding a primary offering to make the official statement available in an electronic format “promptly” after the distribution is approved by the issuer.<sup>14</sup> Likewise, Rule G-34 requires remarketing agents for variable rate demand obligations to “use best efforts to obtain” and submit to the Short-term Obligation Rate Transparency (SHORT) System any letter of credit agreement or similar document prepared in connection with the financing.<sup>15</sup> In all of these instances, however, no disclosure document is considered to be directly or indirectly required of the issuer.

Similar to Exchange Act Section 15B(d)(1), Exchange Act Section 15B(d)(2) (commonly known as the Tower Amendment), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”),<sup>16</sup> prohibits the MSRB from requiring any issuer of municipal securities

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<sup>13</sup> MSRB Rule G-32(b)(i)(B)(1) states:

Except as otherwise provided . . . the underwriter of a primary offering of municipal securities shall submit the official statement for such offering to EMMA® within one business day after receipt of the official statement from the issuer or its designee, but by no later than the closing date.

<sup>14</sup> MSRB Rule G-32(c) states:

A [dealer] that, acting as financial advisor, prepares an official statement on behalf of an issuer with respect to a primary offering of municipal securities shall make the official statement available to the managing underwriter or sole underwriter in a designated electronic format promptly after the issuer approves its distribution.

<sup>15</sup> MSRB Rule G-34(c)(ii)(B)(1) states:

Each Remarketing Agent shall use best efforts to obtain and shall submit to the SHORT System the current versions of the following documents detailing provisions of liquidity facilities associated with the Variable Rate Demand Obligations for which it acts as a Remarketing Agent . . . and shall submit to the SHORT System any future, subsequently amended or new versions of such documents no later than five business days after they are made available to the Remarketing Agent:

- (a) Stand-By Bond Purchase Agreement;
- (b) Letter of Credit; and
- (c) Any other document that establishes an obligation to provide liquidity.

<sup>16</sup> Pub. Law No. 111-203, 124 Stat. 1376 (2010).

directly or indirectly through a dealer, municipal advisor or otherwise, to furnish certain information respecting the issuer to the MSRB or to purchasers or prospective purchasers of municipal securities.<sup>17</sup> However, the MSRB believes that, much like the disclosures required under Rules G-32 and G-34, it may be possible to require disclosures by municipal advisors of information about direct purchases and bank loans of their municipal entity clients within the limitations of the Tower Amendment. The MSRB has broad rulemaking authority under the Exchange Act, as amended by the Dodd-Frank Act, over municipal advisors and municipal advisory activities<sup>18</sup> (*i.e.*, “provid[ing] advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar matters concerning such financial products or issues; or undertak[ing] a solicitation of a municipal entity or obligated person”).<sup>19</sup>

The MSRB believes that the availability of timely disclosure of information about an issuer’s direct purchases and bank loans is beneficial to fostering transparency and ensuring a fair and efficient municipal market.<sup>20</sup> Industry participants also have voiced concern over the need for disclosure of this

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<sup>17</sup> Exchange Act Section 15B(d)(2) provides:

The Board is not authorized under this chapter to require any issuer of municipal securities, directly or indirectly through a municipal securities broker, municipal securities dealer, municipal advisor or otherwise . . . to furnish to the Board . . . any . . . document, or information with respect to such issuer: *Provided, however*, [that] the Board may require municipal securities brokers and municipal securities dealers or municipal advisors . . . to furnish the Board . . . documents, and information with respect to the issuer thereof which is generally available from a source other than such issuer.

<sup>18</sup> See Section 15B(b)(2) of the Exchange Act (15 U.S.C. 78o-4(b)(2)) (“The [MSRB] shall propose and adopt rules to effect the purposes of this chapter with respect to . . . advice provided to or on behalf of municipal entities or obligated persons by . . . municipal advisors with respect to municipal financial products, the issuance of municipal securities, and solicitations of municipal entities or obligated persons undertaken by . . . municipal advisors.”)

<sup>19</sup> 17 CFR 240.15Ba1-1(e). More generally, the MSRB has the authority to design rules to, among other things, remove impediments to and perfect the mechanism of a free and open market in municipal securities and municipal financial products, and to protect investors, municipal entities, obligated persons, and the public interest. See 15 U.S.C. 78o-4(b)(2)(C).

<sup>20</sup> See [MSRB Notice 2015-03 \(Jan. 29, 2015\)](#).

information and have offered guidance on best practices for disclosing other indebtedness.<sup>21</sup> Despite all of these efforts, few issuers have made information about their direct purchases or bank loans available.

## Request for Comment

The MSRB seeks public comment on the following questions, as well as any other comments on this topic, to assist it in determining whether to propose a requirement for municipal advisors to disclose information about the direct purchases and bank loans of their municipal entity clients. If the MSRB determines to proceed with developing such a requirement after reviewing the comments received, it will publish a second request for comment, seeking further industry and public input on a specific proposal intended to achieve the goals noted herein.

1. Would implementation of a disclosure requirement as described above help protect investors and promote informed investment decisions? If so, how? If not, why not?
2. What information regarding outstanding indebtedness, such as direct purchases and bank loans, do issuers typically disclose in financial statements? What are considered industry best practices for such disclosures?
3. What information does a bondholder need with respect to an issuer's outstanding indebtedness to make informed decisions about an investment (*e.g.*, whether to buy, hold or sell a bond)?
4. Do any market participants currently have more or more timely information about issuers' direct purchases or bank loans than other market participants?

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<sup>21</sup> See, *e.g.*, Standard & Poor's Ratings Services, *S&P Evaluated \$5.1 Bil. Of U.S. Public Finance Bank Loans In 2015: Issuers' Liquidity Positions Helped To Support Ratings*, March 2016; Moody's Investors Service, *Growth in Bank Loans and Private Placements Increases Risk and Reduces Transparency in the Municipal Market*, October 2014; National Federation of Municipal Analysts White Paper, *Best Municipal Bond Issuance and Disclosure Practices*, January 2014; Standard & Poor's Ratings Services, *Alternative Financing: Disclosure Is Critical to Credit Analysis in Public Finance*, February 2014; Government Finance Officers Association, *Best Practice: Understanding Bank Loans*, September 2013; Standard & Poor's Credit FAQ: *Bank Loans and Bond Ratings: What to Disclose?*, June 2013; Bank Loan Disclosure Task Force White Paper, *Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans*, May 2013; National Association of Bond Lawyers, *Practice Pointers for Bank Loans and Other Private Placements*, February 2012.

5. Would the information available to a municipal advisor when advising on or negotiating aspects of a direct purchase or bank loan be useful to the investing public? If so, how?
6. What activity should trigger the disclosure requirement discussed in this concept proposal (*e.g.*, advising on a specific type of financing transaction that occurs; advising on any financing transaction that occurs)?
7. How expansive should any proposed disclosure be (*e.g.*, only if material to the financing on which advice is being given; all alternative financings outstanding, regardless of materiality to current transaction)?
8. What specific information regarding the direct purchases and bank loans should be required to be disclosed (*e.g.*, documents from the financing or only certain terms thereof)? What information is important to investors? Is there a particular document typically used in these types of transactions that contains any or all of this information, and, if so, please describe the document and the information it provides?
9. Are there alternative methods the MSRB should consider for obtaining and publicly disseminating material information related to an issuer's direct purchases and bank loans?
10. Should such a disclosure obligation also apply to dealers broadly or in certain circumstances?
11. What would be the additional costs and/or burdens on municipal advisors resulting from such a disclosure requirement? Would these costs and/or burdens be outweighed by the benefit of making the information available?
12. How might such a disclosure requirement economically impact issuers of municipal securities and current investors?
13. Is the requirement under MSRB Rule G-34 for submitting information to the SHORT System analogous to the concept being proposed? Is the information sought in MSRB Rule G-34(c)(ii)(B)(1) comparable to that which would be disclosed under the type of requirement contemplated?



14. Is there additional information an investor may need in order to have a complete picture of an issuer's overall financial condition?
15. In addition to direct purchases and bank loans, what other types of debt financings do municipal entities use as alternatives to the issuance of municipal securities for which disclosure would be useful to investors?
16. The MSRB has provided detailed guidance on how an issuer or its agent can voluntarily submit disclosures regarding bank loans to EMMA, but there has been a limited number of submissions. What additional steps might the MSRB take to facilitate these voluntary disclosures?
17. Please provide current or historical data, studies, or other information relevant to evaluating the number, value and terms of outstanding municipal entity direct purchases and bank loans. Additionally, please provide the number and value of municipal entity direct purchases and bank loans originated annually.

March 28, 2016