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June 13, 2018

Brent J. Fields  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

RE: Proposed Amendments to Exchange Act Rule 15c2-12 (Release  
No. 34-80130; File No. S7-01-17)

Dear Mr. Fields:

The National Association of Bond Lawyers (NABL) respectfully submits the enclosed supplemental comments to the U.S. Securities and Exchange Commission regarding the proposed amendments to Exchange Act Rule 15c2-12, Release No. 34-80130, File No. S7-01-17, which were published in the Federal Register on March 15, 2017. The enclosed comments were prepared by the Securities Law Working Group, comprising the individuals listed in Exhibit 1 and approved by the NABL Board of Directors.

NABL exists to promote the integrity of the municipal securities market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

If NABL can provide further assistance, please do not hesitate to contact Jessica Giroux in our Washington, D.C. office at [REDACTED].

Thank you in advance for your consideration of these comments.

Sincerely,

Alexandra M. MacLennan

Enclosure

SECOND SUPPLEMENT TO NABL COMMENTS  
TO PROPOSED RULE 15c2-12 AMENDMENTS

*Purpose.* The National Association of Bond Lawyers (“NABL”) submits these supplemental comments to the proposed amendments to Exchange Act Rule 15c2-12 (the “*Proposed Amendments*”) because two significant subsequent events should be taken into account by the Commission in considering whether to adopt the Proposed Amendments.

*Executive Summary.* Since the time Commission staff performed a Paperwork Reduction Act and cost-benefit analysis of the Proposed Amendments and the Commission voted to propose them, two significant events have significantly changed the benefits and costs that can be expected from the proposed amendments. The Commission should consider the impact of these events before deciding whether the Proposed Amendments outweigh the costs of compliance and are consistent with the Paperwork Reduction Act.

- Tax Cut and Jobs Act: P.L. 115-97, commonly known as the Tax Cut and Jobs Act (the “*Tax Cut Act*”), was enacted by Congress in late 2017. Effective January 1, 2018, it reduced the highest corporate federal income tax rate from 35% to 21% and, as a result, has increased the cost of tax-exempt bank loans and direct placements as compared to publicly offered debt.<sup>1</sup> Consequently, the recent growth of bank loans and direct placements of tax-exempt municipal securities is likely to be reversed;<sup>2</sup> undisclosed tax-exempt bank loans and direct placements will likely be substantially less frequent than expected when the Proposed Amendments were proposed; and the Proposed Amendments are correspondingly likely to have substantially reduced benefit.
- GASB Statement 88: The Governmental Accounting Standards Board published Statement No. 88 (the “GASB Direct Debt Statement”) on April 2, 2018. The GASB Direct Debt Statement require that additional information related to debt (including direct placements and bank loans) be disclosed in notes to financial statements prepared in accordance with generally accepted accounting principles. To enable underwriters to comply with Rule 15c2-12, substantially all issuers undertake to provide financial statements to the MSRB at least annually. Consequently, existing undertakings will require adequate disclosure of bank loans and direct placements at least annually, so the incremental disclosure benefits from the Proposed Amendments will be substantially reduced.

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<sup>1</sup> See “*Tax Reform Threatens the Future of Direct Purchase Transactions*,” National Law Review (February 14, 2018), <https://www.natlawreview.com/article/tax-reform-threatens-future-direct-purchase-transactions>; see also K. Glazier, “*Why Muni Issuers Are Eschewing Bank Loans*,” The Bond Buyer (May 21, 2018) (“The passage late last year of a new federal tax law that slashed the corporate income tax rate to 21% from 35%, as well as rising short-term interest rates have and may continue to cause issuers to eschew the bank loan market in favor of more traditional borrowing options, Moody’s Investors Service said in a new report.”), <https://www.bondbuyer.com/news/why-muni-issuers-are-eschewing-bank-loans>.

<sup>2</sup> K. Glazier, supra n. 1 (“The migration away from bank loans represents a near-complete reversal from the trend over the past several years, when the variable-rate securities market dropped sharply and issuers increasingly began to favor bank loans and private placements.”)

In view of these two significant developments, NABL recommends that the Commission further defer consideration of the Proposed Amendments until it has performed a sound, updated cost-benefit and Paperwork Reduction Act analysis that takes into account the expected effects of both the Tax Cut Act tax law change and the new GASB Statement.

Background. On May 15, 2017, NABL provided comments (the “*NABL May 15 Comments*”)<sup>3</sup> to the U.S. Securities and Exchange Commission (the “*Commission*”), addressing amendments (the “*Proposed Amendments*”) to Exchange Act Rule 15c2-12<sup>4</sup> (the “*Rule*”) of the Commission proposed by Securities Exchange Act Release No. 34-80130, File No. S7-01-17, adopted March 1, 2017, and published in the Federal Register on March 15, 2017 (the “*Proposing Release*”).

The NABL May 15 Comments included a recommendation that the Commission postpone or provisionally withdraw the Proposed Amendments for a two-year period to allow for (A) voluntary disclosure of bank loans and direct placements (and negotiated disclosure requirements) to continue to develop, especially in light of growing voluntary disclosure since the Municipal Securities Rulemaking Board (the “*MSRB*”) enhanced its Electronic Municipal Market Access (EMMA) system to facilitate such disclosure, (B) continued growth of information service companies and other internet or technology tools that provide investors with public information regarding issuers and events that could affect the value of municipal securities, and (C) an opportunity for quantitative analysis of the benefits to investors. Since the time NABL May 15 Comments were submitted, voluntary disclosure of bank loans and direct placements has continued to develop<sup>5</sup>. Furthermore, the Governmental Accounting Standards Board (“*GASB*”) has taken action that will result in additional disclosure of bank loans and direct placements in audited annual financial statements.

NABL submitted supplemental comments on August 29, 2017 (the “*NABL August 29 Supplement*”) to note that GASB had published a Proposed Statement regarding Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements, an amendment of GASB Statements No. 34 and No. 38 (the “*Direct Debt Exposure Draft*”).<sup>6</sup> The NABL August 29 Supplement noted that the release of the Direct Debt Exposure Draft provided an additional reason for the Commission to postpone or provisionally withdraw the Proposed Amendments: the Direct Debt Exposure Draft addressed many of the same concerns as the Proposed Amendments

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<sup>3</sup> In addition to filing the NABL May 15 Comments, on April 11, 2017, NABL also submitted its *Comments Regarding Collection of Information Burden of Proposed Amendments to SEC Rule 15c2-12* to the Commission and the U.S Office of Management and Budget.

<sup>4</sup> 17 C.F.R. 240.15c2-12.

<sup>5</sup> Based on the Continuing Disclosure Statistics reported by EMMA (available at <https://emma.msrb.org/MarketActivity/ViewStatistics.aspx>), the number of filings under the category “Bank Loan Disclosures” for the period June-December 2017 (273) was significantly higher than the number of filings in that category for the period June-December 2016 (180). January 2018 showed a record number of filings (78) under the Bank Loan Disclosure category for a single month since the filing category was created, likely reflecting the high year-end 2017 issuance corresponding with the passage of the Tax Cut Act. Thereafter, monthly volumes have been lower than in corresponding periods in 2017, perhaps reflecting reduced bank lending post-tax reform.

<sup>6</sup> GASB Exposure Draft, Proposed Statement of the Governmental Accounting Standards Board, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements (June 29, 2017).

and could obviate much of the need for the Proposed Amendments because of the role that accounting standards play in providing consistent, comparable, and audited information for investors.

NABL submits this second supplement to the NABL May 15 Comments to call to the Commission's attention both (a) further action by GASB to enhance disclosure of bank loans and direct placements and (b) the likely impact of the Tax Cut Act to reduce the incidence of bank loans and direct placements.

GASB Statement 88. On April 2, 2018, GASB published the GASB Direct Debt Statement, after receiving responses on the Direct Debt Exposure Draft from organizations and individuals and feedback from the Governmental Accounting Standards Advisory Council (GASAC).<sup>7</sup>

The GASB Direct Debt Statement requires governments to include additional debt-related information in their note disclosures for financial statements prepared in accordance with generally accepted accounting standards (GAAP). The great majority of municipal issuers present their financial statements in accordance with GAAP, and many who do not are believed to look to GAAP for note disclosure guidance. Under the GASB Direct Debt Statement, information regarding direct borrowing and direct placements is required to be presented, and furthermore is required to be presented separately from other debt. In addition, the GASB Direct Debt Statement requires that governments include information regarding unused lines of credit, assets pledged as collateral to debt, and certain documents terms (specifically, terms specified in debt agreements related to significant (1) events of default with finance-related consequences, (2) termination events with finance-related consequences, and (3) subjective acceleration clauses). The GASB Direct Debt Statement is effective for reporting periods beginning after June 15, 2018, and GASB encourages earlier implementation.

In response to the GASB Direct Debt Statement, governments will soon include information regarding bank loans and direct placements in annual audited financial statements, including information of particular interest to investors such as significant events of default, termination events and subjective acceleration clauses. The GASB Direct Debt Statement therefore addresses, in substantial part, the subject matter of the Proposed Amendments.<sup>8</sup>

The GASB Direct Debt Statement also addresses bank loans, lines of credit and direct placements in a more tailored manner than the Proposed Amendments. The GASB Direct Debt Statement focuses on debt, defined as “a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount

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<sup>7</sup> The Financial Accounting Standards Board (“FASB”) also is engaging actively in considering the adequacy of debt disclosures in financial statements, including disclosure about events of default. See, e.g., proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent), available at [https://www.fasb.org/jsp/FASB/FASBContent\\_C/ProjectUpdatePage&cid=1176164405275](https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=1176164405275).

<sup>8</sup> See S&P Global Market Intelligence, *Bank Loan Structures Risks Remain, But GASB 88 Is A Positive Step Toward Transparency In Financial Reporting* (May 02, 2018).

that is fixed.”<sup>9</sup> In addition, the definition excludes contractual obligations from executory contracts “in which further action would need to occur before a liability exists and is recognized.”<sup>10</sup> Other GASB Statements already require financial statement disclosure of derivatives and guarantees.<sup>11</sup> Hence, the GASB Direct Debt Statement indicates a judgment by GASB that additional reporting of guarantees and derivative instruments, two of the proposed categories of items included in to the Proposed Amendments, is not necessary.

The GASB Direct Debt Statement also reflects a judgment that additional reporting is not necessary for lease obligations that are already subject to financial statement disclosure. For example, GASB notes that Statement No. 87, Leases, “already provides the essential information about lease liabilities. Accordingly, except [for contracts under which the lessee finances the purchase of the underlying asset] the Board excluded leases from the disclosure requirements...”

The information required by the GASB Direct Debt Statement will be particularly helpful to investors. By including this information in annual financial statements, reviewed by independent auditors, governmental issuers will make information regarding bank loans and direct placements available to investors in a consistent, comparable and reliable manner. This annual information will continue to be supplemented by voluntary filings, including quarterly filings and notices filed in connection with new bank loans and direct placements.<sup>12</sup>

Although compliance with the GASB Direct Debt Statement admittedly will not require immediate disclosure of new bank loans and direct placements, the Commission should consider whether the benefit of immediate, rather than annual, disclosure is sufficient to justify the substantial additional compliance costs that an immediate disclosure regime would impose. (As noted in the May 15 NABL Comments, governmental issuers generally have stable credit, backed either by taxing authority or by the revenue of a utility or other enterprise that provides essential services to a community without the risk of competition, sources that are less susceptible to economic volatility. In addition, issuers of any sort are unlikely to obtain a bank loan or successfully place significant debt in a direct placement, if the lending institution believed there to be any appreciable risk of the loan or debt being accelerated before the issuer’s next audited financial statements become available. Consequently, bank loans and direct placements would only infrequently affect credit, so investors in most cases would not be prejudiced if they have to wait for an annual audit to learn of a bank loan or direct placement or its terms.) Given the GASB Direct Debt Statement and its assurance that investors will receive disclosure about bank loans and direct placements at least annually, the Commission should make a statistically sound determination of how often investors would be prejudiced if they have to wait for an audit report

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<sup>9</sup> Defined as “a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed.” GASB Direct Debt Statement, Appendix D, at 21.

<sup>10</sup> GASB Direct Debt Statement, Appendix B, at 8.

<sup>11</sup> See GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – An Amendment of GASB Statement No. 53* (June 2011); GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (November 2006); GASB Statement No. 70, *Accounting and Financial Reporting For Nonexchange Financial Guarantees* (April 2013).

<sup>12</sup> See *supra*, n. 4.

to learn of a direct placement, and it should weigh its conclusion against the burden that the Proposed Amendments would impose on all issuers.

The Commission also should reevaluate the cost to issuers of complying with the Proposed Amendments in light of the requirements imposed by the GASB Direct Debt Statement. This cost will be greater the more that the scope or timing of notices required by the Proposed Amendments diverges from the scope or timing of financial statement disclosure required by the GASB Direct Debt Statement. (As noted in NABL’s *Comments Regarding Collection of Information Burden of Proposed Amendments to SEC Rule 15c2-12* (April 11, 2017) (the “NABL PRA Comments”), the Commission very significantly underestimated compliance costs when it proposed the Proposed Amendments, and it should make a new, good faith, reasonable estimate of those burdens before acting on the Proposed Amendments.)

The Commission should give considerable weight to GASB’s conclusions regarding what should be disclosed, and what is not necessary to be disclosed, to investors regarding bank loans, direct debt, leases, and similar financial instruments.<sup>13</sup> GASB is the independent, private-sector organization that establishes accounting and financial reporting standards for U.S. state and local governments that follow GAAP. Its mission includes “to establish and improve financial accounting and reporting standards to provide useful information to investors and other users of financial reports.” Moreover, in adopting the GASB Direct Debt Statement, GASB followed a thorough, transparent, and inclusive process. It surveyed users of financial statements, including investors, “regarding the perceived value of required disclosures related to debt and additional information related to debt they consider essential for disclosure.”<sup>14</sup> It then developed and invited comments on the Direct Debt Exposure Draft, receiving many comments, which GASB took into account in adopting the GASB Direct Debt Statement. Finally, GASB applied a cost-benefit analysis, which it summarized in the GASB Direct Debt Statement:

The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board’s setting of standards for financial reporting is the assessment of the expected benefits and perceived costs. The Board strives to determine that its standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.<sup>15</sup>

The GASB Direct Debt Statement recognizes the public cost of any new requirement to disclose terms of bank loans, direct placements, and other debt instruments:

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<sup>13</sup> Likewise, the Commission should give considerable weight to FASB’s conclusions regarding what should—and does not need to—be disclosed for borrowers subject to FASB guidance.

<sup>14</sup> GASB Direct Debt Statement, Appendix A, at A.2.

<sup>15</sup> GASB Direct Debt Statement Appendix B at 24.

The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze new information to meaningfully inform their assessments and decisions.<sup>16</sup>

The same is true of any new requirements that would be imposed if the Proposed Amendments are adopted.

Given the thorough process employed by GASB in adopting the GASB Direct Debt Statement, the Commission should give considerable weight to GASB's conclusions in making its own cost-benefit conclusions. The Commission should avoid imposing requirements in the Proposed Amendments that are more onerous than the disclosures required by the GASB Direct Debt Statement unless the benefits of the additional requirements clearly outweigh their costs.

*Impact of Tax Cut Act.* In weighing expected benefits from the Proposed Amendments, the Commission should recognize the effect of the enactment of the Tax Cut Act on the incidence of tax-exempt bank loans and direct placements.<sup>17</sup>

Bank loans and direct placements grew in frequency after the financial crisis of 10 years ago both reduced the creditworthiness of banks and imposed new reserve costs on letters of credit and liquidity facilities that had previously been used to support issuers' publicly offered variable rate demand obligations. By buying and holding debt directly, rather than supporting debt issued to the public, banks obtain assets and avoid liquidity risks that impose reserve requirements. Banks could compete with the public markets for short- and intermediate-term debt, even when tax-exempt, because the banks' marginal federal income tax rate (35%) was almost as high as that of individuals. If banks received at least 65% (100% less 35% lost to taxes) of a taxable interest rate for a comparable credit, their after-tax return from tax-exempt obligations would be competitive with their after-tax return on taxable loans.

The Tax Cut Act reduced the highest federal income tax rate for banks and other corporations from 35% to 21%, effective for tax years beginning on or after January 1, 2018. As a result, banks must now receive approximately 79% (100% less the reduced 21% lost to taxes) of a comparable taxable interest rate to maintain an equivalent after-tax return. Consequently, banks are expected to be significantly less competitive buyers of tax-exempt debt, and to remain competitive only when making taxable loans and buying taxable direct placements.<sup>18</sup> The great majority of municipal securities and loans are tax-exempt obligations because they afford a lower

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<sup>16</sup> GASB Direct Debt Statement Appendix B at 25.

<sup>17</sup> K. Glazier, "Banks show largest drop in muni holdings in 30 years," The Bond Buyer (June 7, 2018) ("Bank holdings of municipal securities fell to \$555.7 billion in the first quarter of 2018 from \$571.5 billion in the final quarter of 2017, a 2.8% decline that is the first in nearly a decade and the largest in more than 30 years. The drop is directly attributable to tax reform, according to experts.")

<sup>18</sup> K. Glazier, supra n. 1 ("Banks are attracted to municipal issuers' low default rates and tax-free interest income," said Moody's. "The new federal tax law's reduction in the corporate income tax rate to 21% from 35%, however, has eroded some of the attractiveness of municipal loans and bonds to bank lenders. Municipal issuers typically paid lower interest rates than their corporate counterparts, in part because the tax-free interest earnings on municipal bonds were on par with the after-tax yield on corporate loans. With a lower tax rate payable by banks, the relative benefit for the municipal tax exemption has diminished." As a result, bank loans will be more costly for issuers.")

rate of interest than taxable obligations and most municipal issuers can finance their projects with tax-exempt obligations. Consequently, the incidence of new bank loans and direct placements is likely to be significantly less frequent in the future than was expected when the Commission performed its cost-benefit and Paperwork Reduction analyses and proposed the Proposed Amendments.

In addition, it is expected that many existing bank loans and direct placements will be refinanced with publicly offered debt. Many existing tax-exempt bank loans and direct placements include interest rate modification provisions to preserve the banks' after-tax rates of return.<sup>19</sup> Although these provisions take many forms, in general they have the effect of increasing the rate of interest to a rate at which the bank would make a tax-exempt loan in the reduced federal income tax environment, thus substantially increasing tax-exempt borrowing rates. Consequently, many municipal issuers are expected to refinance and therefore terminate existing tax-exempt bank loans and direct placements, as well as avoiding them in the future.

*Recommendation.* In light of the GASB Direct Debt Statement and the Tax Cut Act, as well as the continuing growth of voluntary disclosure, information service companies and other internet or technology tools that provide investors with public information regarding issuers, the benefit from the Proposed Amendments is likely to be substantially less than expected when the Proposed Amendments were proposed. The cost to issuers should also be reevaluated in light of the new requirements imposed on them by the GASB Direct Debt Statement, unless the notice requirements of the Proposed Amendments are conformed to the scope and timing of disclosure required by the GASB Direct Debt Statement. For these reasons and for the additional reasons outlined in the NABL PRA Comments, the Commission should redo its Paperwork Reduction Act and cost-benefit analyses before acting on the Proposed Amendments. Unless a robust, updated cost-benefit analysis indicates that the benefit from the Proposed Amendments is expected to outweigh their public costs, the Commission should further defer action on or withdraw the Proposed Amendments.

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<sup>19</sup> Id.

**EXHIBIT 1**

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