BEFORE THE
OFFICE OF THE SECRETARY
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

In the Matter of: Proposed Amendments to Exchange Act Rule 15c2-12	File No. S7-01-17

REPLY COMMENTS OF TYLER BROWN, J.D. CANDIDATE
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This comment is submitted in response to the Security and Exchange Commission's (SEC) proposed amendments to the Municipal Securities Disclosure provision of the Exchange Act of 1934 (Exchange Act), Rule 15c2-12. While I agree with the need to expand the list of triggering events that must be disclosed by municipal issuers and underwriters, this comment argues that further guidance regarding the definition of materiality in the context of municipal securities would be a more effective approach to ensuring important information is being provided to investors. Additional clarity on this definition would enable issuers and underwriters to more readily determine when an event or incurrence of a financial obligation is material for the purposes of Rule 15c2-12. This would work to decrease the instances of over-reporting by underwriters and brokers, and also allow these institutional actors to better fulfill their duties under the Municipalities Continuing Disclosure Cooperating Initiative (MCDC Initiative), by narrowing the scope of information and documentation they must reasonably receive and analyze from the issuer. This comment hopes to show that the SEC should adopt a definition of "material" that includes an objective standard for analysis, rather than merely subjective interpretation of its regulatory language by issuers and underwriters.

INTRODUCTION

The Proposed Amendments are a reaction to the shift in the municipal securities market, which has seen a recent rise in the number of defaults, thereby increasing the risk attached to this typically "safe" investment vehicle. The addition of the proposed events to those which must be disclosed pursuant to Rule 15c2-12 seems to be consistent with the Commission's policy goals of providing investors and other market participants access to important information in a timely manner; that is, helping to enhance transparency in the municipal securities market and improving investor protection. In addition to the fourteen events already listed under the Rule, the Proposed Amendments would include:

> (15) Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders, if material.
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> (16) Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties.

To the extent that the SEC wishes to significantly broaden the scope of events that might affect existing or potential investor interests, the proposed term of "financial obligation" seems to cast the widest net possible. However, this appears to be the limit of the amendments' effect; it merely increases the amount of information that must be disclosed, yet does not go far enough in describing the threshold that would trigger the reporting of an event.

Materiality plays a key role in the SEC's regulations concerning which events an issuer must disclose and an underwriter must report in its Official Statement prior to an offering. Currently, seven of the fourteen triggering events listed under Rule 15c2-12 must be disclosed "if material." This construction places the responsibility of determining what is material directly on the issuers and underwriters. In the text of the Proposed Rule, the SEC states that "including a materiality determination would strike a balance." However, it is unclear what balance is to be struck. The implication seems to be that the materiality determination functions to filter out non-essential information that an investor would not consider significant. If so, the ambiguity of the term "material" in the context of 15c2-12 undermines this narrowing function.

Currently, underwriters are subject to sanctions if they do not complete due diligence requirements in determining whether issuers complied with their continuing disclosure obligations. This system of liability incentivizes underwriters to over-report violations, even if the violations would not be considered material. Without further guidance on materiality—especially with the significant broadening of disclosable events—the fear of liability will continue to cause underwriters and brokers to over-report events that may not otherwise be useful to investors, the effect being that important information will get buried in mountains of trivial information, and that truly material disclosures will be missed.

The Commission has not explicitly defined materiality in the context of Rule 15c2-12, but hints at what the standard should be. In the Proposed Rule (III.A.1), the Commission states that information about the incurrence of a material financial obligation of the issuer would allow investors and other market participants to learn important information about the current financial condition of the issuer, including potential impacts to the issuer's liquidity and overall creditworthiness. Given the uniqueness of municipal securities, as opposed to corporate equity and debt markets, a definition of materiality should address the specific interests and information sought by investors within this particular market—e.g., issuer creditworthiness, capital preservation, tax advantages, and meeting specific cash needs. As such, the SEC would better achieve its goals of protecting municipal securities investors by providing a clear standard for when an event is considered "material" for the purposes of the Rule.

VARYING INTERESTS: MUNICIPAL SECURITIES VS. CORPORATE EQUITY AND DEBT MARKETS

A definition of materiality for the purposes of Rule 15c2-12 would necessarily consider the differences between corporate equity and debt markets and the municipal bond market. A material event for a publicly held corporation could be a trivial event for a municipal entity. For example, short-term stock prices may be affected by investor confidence in a corporation and its management, whereas information concerning the municipal issuer's creditworthiness and liquidity can affect a bond's price. A municipal bond issuer's financial deterioration can also take longer to appear in the municipal bond market, which lacks sensitivity to day-to-day fluctuations. Additionally, investors in municipal securities and corporate equity have different goals. Individual households, or retail investors, directly hold about 50% of outstanding municipal bonds and indirectly hold an additional 25% of bonds through other investment funds; these investors are more concerned with long-term prices, and typically hold the bonds until maturity.

Furthermore, the lack of regulation in the municipal securities market must also be considered for the purposes of establishing a different materiality standard. The SEC, through its decades-long series of amendments to the Rule, has consistently tried to compensate for its inability to directly regulate issuers—due to potential constitutional dual-sovereignty issues at the federal, state, and local levels—by placing a hefty burden on underwriters and brokers to ensure that issuers fulfill their obligations under the continuing disclosure agreements. As such, disclosure of "material" events remain largely a voluntary affair from the issuer side, leaving the underwriters and brokers to expend large amounts of resources to complete their reasonable due diligence requirements under the Rule and MCDC Initiative.

DEFINING A STANDARD OF MATERIALITY UNDER 15c2-12

The SEC has declined to provide guidance on what it considers “material” for the purposes of 15c2-12. At its most subjective, a determination of materiality currently requires the issuer or broker to ask: “If I were buying these bonds, what would I like to know?” In the municipal securities context, that information would concern whether the issuer will fulfill its obligations; ultimately, if the investor will be repaid on time.

In *TSC Industries, Inc. v. Norway, Inc.*, the Supreme Court adopted an objective materiality standard in the context of Rule 14a-9, an antifraud provision of the Exchange Act. The Court stated that “there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” The Court adopts this standard again when it applies it to Rule 10b-5, another antifraud provision, in *Basic, Inc. v. Levinson*. However, this reasonableness standard raises some issues when being applied in the municipal securities context. As stated above, holders of municipal bonds have a specific set of concerns when assessing risk of these particular instruments. A “reasonable investor” in the municipal securities market would be less focused on short-term market fluctuations or voting, and more so on the overall creditworthiness of the issuer, which reflects long-term financial stability.

Within the municipal securities context, the concept of materiality has been consistently linked with an issuer’s creditworthiness and ability to make debt service payments. In the posted SEC Memorandum from March 10, 2017, re: Meeting with Representatives of the Government Finance Officers Association (GFOA), GFOA Best Practices documents state that Official

Statement disclosure is about the credit quality of the bonds being offered; governmental entities should also analyze the materiality of a transaction to determine if it might affect a bond or other credit-related rating of such entity. Charlotte Rhodes, in her Wash. & Lee Law Review note, suggests that the SEC should adopt a "creditworthiness" standard for materiality under Rule 15c2-12.[1] She states that an event would be material for the purposes of 15c2-12 if it substantially affects the issuer's creditworthiness or ability to make its debt service payments. Because she identifies creditworthiness as the primary concern for investors in municipal securities, she believes that the *TSC Industries* reasonable investor test is implicitly satisfied by the creditworthiness of the issuer. Although I would mostly agree with her analysis, I think the SEC should retain some form of the reasonableness standard to account for information that may pertain to an individual issuer's specific situation.

Therefore, I would like to suggest that the SEC adopt a synthesis of the *TSC Industries* and creditworthiness standards. A definition that satisfies these materiality standards will address events that affect both the financial condition of the issuer, as well as important concerns for investors within the municipal securities market. Finally, I would like to offer two formulations of a materiality definition for consideration by the Commission, which I believe will narrow the scope of materiality within the context of Rule 15c2-12, while remaining consistent with the Commission's articulated policy concerns pertaining to the municipal securities market:

1. An event is material for the purposes of 15c2-12 if it affects the creditworthiness or other credit-related rating of the issuer, or would otherwise be of substantial interest to investors.
2. An event is material for the purposes of 15c2-12 if the information would be of substantial interest to municipal investors, or is such that it affects the issuer's ability to make debt service payments, or places pressures on the basic functions of the municipal entity that would affect the creditworthiness of the securities.

Respectfully submitted,

__/s/________________

28 April 2017

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1. Charlotte W. Rhodes, Living in A Material World: Defining "Materiality" in the Municipal Bond Market and Rule 15c2-12, 72 Wash. & Lee L. Rev. 1989, 1990 (2015)