INVESTMENT COMPANY INSTITUTE

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May 15, 2017

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

Re: Proposed Amendments to Exchange Act Rule 15c2-12

Dear Mr. Fields:

The Investment Company Institute[1] strongly supports the Securities and Exchange Commission's proposal to enhance the disclosure of information regarding municipal securities by amending Rule 15c2-12 under the Securities Exchange Act of 1934.[2] Timely and efficient access to comprehensive and accurate information about municipal securities is critical to investors. As of fourth-quarter 2016, US households held 23 percent of the $3.8 trillion in municipal securities through registered investment companies and another 43 percent directly.[3] Improving transparency and disclosure in the municipal securities market would not only provide investors with access to critical information that facilitates an accurate assessment of the creditworthiness of municipal securities, but also would strengthen investor confidence in the municipal securities market, benefiting investors and the marketplace as a whole.

I. Summary of Recommendations

- We support the proposal to add a new event to Rule 15c2-12's disclosure requirements that would require an obligated person to disclose the incurrence of a material financial obligation of the obligated person. We recommend the SEC broaden the proposal to

[1] The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$19.4 trillion in the United States, serving more than 95 million US shareholders, and US $1.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *See* Proposed Amendments to Exchange Act Rule 15c2-12, SEC Release No. 34-80130 (March 1, 2017), available at https://www.sec.gov/rules/proposed/2017/34-80130.pdf ("Release").

[3] Two other large investors in the municipal securities market include banks and insurance companies.

require mandatory disclosure of *any* terms in connection with a financial obligation that *affect security holders*. We also encourage the SEC to make the terms of all financial obligations, including the governing documents, part of the required disclosure under the new amendments.

- We support the proposal to add a new event under Rule 15c2-12 that would require an obligated person to disclose the occurrence of a default or similar events under the terms of an obligated person's financial obligation; however, we strongly encourage the SEC to broaden the concept of an "event" in this context to include all defaults, accelerations, terminations, modifications, and not solely those that "reflect financial difficulties," as proposed.
- We recommend the SEC add three additional event notices to the disclosure requirements of Rule 15c2-12. First, we recommend the SEC adopt a "catch-all" notice requirement for any event materially impacting the value of a bond. Second, we recommend that the SEC adopt an event notice to disclose modifications to escrow agreements or escrows, or to any other agreement governing security pledged to bondholders. Finally, we recommend that the SEC adopt an event notice that would require an issuer or obligated person to disclose covenant compliance reports and periodic financial information disclosed to other creditors.
- We recommend the SEC eliminate the current "materiality" threshold for determining whether submission of certain Rule 15c2-12 event notices is required, including (b)(5)(i)(C)(2) (non-payment related defaults), (7) (modifications to security holder rights), (8) (bond calls), (10) (security changes), (13) (corporate changes), and (14) (trustee changes).
- We recommend the SEC expand the scope of Rule 15c2-12 event notice (b)(5)(i)(C)(5) (substitution of credit or liquidity providers) and substantially revise event notice (6) (events affecting the tax status of the security).

II. Background

Beginning in 2009, municipal issuers and obligated persons have increasingly used certain financial obligations, such as bank loans and direct placements, as alternatives to public offerings of municipal securities. Market participants, including the Municipal Securities Rulemaking Board (MSRB), the primary regulator of the municipal market, have raised concerns about the lack of secondary market disclosure regarding these financial obligations.[4] Specifically, because financial obligations, such as bank loans and direct purchases, are not subject to the same level of disclosure as

[4] *See, e.g.,* Request for Comment on Concept Proposal to Improve Disclosure of Direct Purchases and Bank Loans, MSRB Notice 2016-11 (March 28, 2016) ("ICI 2016 Letter"); Letter from Dorothy Donohue, Deputy General Counsel—Securities Regulation, Investment Company Act, to Ronald W. Smith, Corporate Secretary, Municipal Securities Rulemaking Board (May 27, 2016); Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (September 8, 2009) ("ICI 2009 Letter").

public offerings of municipal securities, investors may not obtain complete information about the overall amount of indebtedness of an issuer in a timely fashion, and also may lack knowledge of key terms that apply to any undisclosed indebtedness. Indeed, our members point out that some direct purchases and bank loans may materially add to an issuer's level of debt, include provisions that make other creditors senior to bondholders, or create more restrictive events of default in favor of other creditors, potentially resulting in cross-defaults to public offerings without prior warning to bondholders.

Furthermore, the market and economic conditions stemming from the financial crisis have caused increasing events of default, not only on bank loans and direct placements, but also on contingent obligations, such as reimbursement agreements for letters of credit (LOCs) and standby bond purchase agreements (SBPAs) that many bank loans and direct placements have replaced. In addition, it is critical that investors are notified when these contingent obligations and other contingent obligations such as guarantees, collateral posting requirements under swaps, and lines of credit, convert to actual current obligations. Disclosure regarding the terms of and performance reports for these contingent obligations is just as important information to investors as information about bank loans and direct placements.

In response to these evolving market practices, the MSRB has encouraged issuers and obligated persons to voluntarily disclose information about certain financial obligations. Despite these efforts, the MSRB has stated that the number of actual disclosures is limited.

III. Need for Reform of Municipal Securities Disclosure Regime

The SEC recognized and underscored the importance of sufficient disclosure and transparency in municipal securities when it adopted Rule 15c2-12, establishing requirements for the initial disclosure, periodic disclosure, and secondary market reporting of municipal securities.[5] The SEC also designed the rule to assist underwriters in meeting their responsibilities under the antifraud provisions of the federal securities laws by requiring them to review issuer disclosure documents before commencing sales to investors. The disclosure and transparency provided in the rule, however, has not always kept pace with the extraordinary growth of the municipal securities industry or developments in the marketplace, in particular with the increasing frequency of events of default and the more restrictive terms commonly found in private financial obligations, as described above.

Since its adoption in 1989, the SEC has amended Rule 15c2-12 three times to enhance investor protections.[6] One of these key enhancements established a single centralized disclosure repository for

[5] *See* Securities and Exchange Commission Release No. 26985 (June 28, 1989), 54 FR 28799 (July 10, 1989); Securities and Exchange Commission Release No. 34961 (November 10, 1994), 59 FR 59590 (November 17, 1994) ("1994 Amendments").

[6] *See* 1994 Amendments; SEC Exchange Act Release No. 34-59062 (December 5, 2008), 73 FR 76104 (December 15, 2008) ("2008 Amendments"); SEC Exchange Act Release No. 34-62184A (May 26, 2010), 75 FR 33100 (June 10, 2010) ("2010 Amendments").

the electronic collection and availability of information about municipal securities.[7] This repository, which the MSRB operates as its Electronic Municipal Market Access System or EMMA, has greatly improved the availability of information about municipal securities to investors, market professionals, and the public generally. Indeed, the introduction of EMMA has made it substantially less burdensome and less costly for municipal issuers to comply with continuing disclosure requirements and communicate with investors.

In 2012, the SEC issued its Report on the Municipal Securities Market.[8] The 2012 SEC Report states, among other things, that the SEC could consider further amendments to Rule 15c2-12 to mandate more specific types of secondary market event disclosures, including disclosure relating to new indebtedness.[9] For example, the Report notes that market participants have expressed concerns that issuers and obligated persons may not properly disclose the existence or the terms of bank loans, particularly when the terms of those bank loans may affect the payment priority from revenues in a way that adversely affects bondholders.[10]

As the municipal market continues to develop and evolve, we believe it is again critical to amend the regulatory framework to provide investors with more accurate, current, and complete information to allow them to accurately evaluate the risks presented by each municipal security.

IV. Proposal

A. Disclosure of Financial Obligations

The SEC is proposing to add two new events to Rule 15c2-12's disclosure requirements. The first proposed event would require an obligated person to disclose the incurrence of a "financial obligation"[11] 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. The actual incurrence of the financial obligation, or agreement to

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[7] *See* 2008 Amendments.

[8] Securities and Exchange Commission, Report on the Municipal Securities Market (July 31, 2012) ("2012 SEC Report"). The 2012 Report provides an overview of the municipal securities market and addresses two key areas of concern—disclosure and market structure. Specifically, the Report includes a series of recommendations for potential further consideration, including legislative changes, Commission rulemaking, MSRB rulemaking, and enhancement of industry best practices. The SEC notes that these recommendations were designed to address concerns raised by market participants and others and provide avenues to improve the municipal securities market, including transparency for municipal securities investors.

[9] *Id*. at 139-40.

[10] *Id*. at 66; *see also* ICI 2016 Letter.

[11] Under the SEC's proposed definition, financial obligation means a debt obligation, lease, guarantee, derivative instrument, or monetary obligation resulting from a judicial, administrative, or arbitration proceeding.

covenants, events of default, remedies, priority rights, or similar terms would trigger the obligation to provide the event notice in a timely manner (not in excess of 10 business days). The SEC explains that timely access to disclosure about the incurrence of an issuer's or obligated person's material financial obligation would provide potentially important information about the current financial condition of the issuer or obligated person, including potential impacts to the issuer's or obligated person's liquidity and overall creditworthiness.

We strongly support the proposed new event notice. Such information is critical in assisting investors to make informed investment decisions. Indeed, in response to the SEC's 2009 proposed amendments to Rule 15c2-12 (which were adopted in 2010), we recommended that the SEC implement a similar disclosure requirement to reflect the creation of any material financial obligation (including contingent obligations) whether in the form of long- or short-term direct debt, hedge, swap or other derivative instrument, capital lease, operating lease or otherwise, because of the implications these obligations may have on the credit risk and fundamental value of the associated bonds.[12] Without timely disclosure of this information, investors and other market participants may not be aware that an issuer or obligated person has incurred a material financial obligation or agreed to certain terms that affect security holders. Specifically, such information may significantly impact the fundamental value that investors place on a municipal bond and is therefore necessary to accurately assess, monitor, and compare credit quality of securities and issuers.

As noted above, the proposal adds a "materiality" determination to both the incurrence of a financial obligation and each of the listed terms typically agreed to in connection with its incurrence (*i.e*., covenants, events of default, remedies, priority rights, or similar terms). To balance the burden that such disclosure might impose and in recognition that in a number of instances such events may not be critical to investors, we generally support the SEC's preliminary assessment that disclosure of such an incurrence include a materiality determination. On the other hand, we believe the SEC should require mandatory disclosure for *any* terms in connection with a financial obligation *that affect security holders*. Indeed, terms that reflect on the obligated person's creditworthiness or overall liquidity *and* affect security holders' rights to assets or revenues are by their very nature essential pieces of information that should always be publicly disclosed. We therefore recommend that the SEC eliminate the proposed second "materiality" qualifier.

The Release correctly points out that specific loan terms like acceleration rights and priority claims can affect bondholders. The text of the actual proposed rule, however, requires notification only of the "incurrence" of a financial obligation. This suggests that issuers can satisfy their disclosure obligations without describing the terms of the financial obligation, or the issuer's performance under these terms. Without knowing the actual terms of the financial obligation or the issuer's performance under these terms, investors have no way to assess the impact of the financial obligation on their rights or security. As such, we strongly encourage the SEC to make the terms of all financial obligations part

[12] *See* ICI 2009 Letter.

of the required disclosure under the new amendments. Ideally, obligated persons would disclose all of the governing borrowing documents (*e.g.*, term sheet, indenture or loan agreement) for each financial obligation. The benefits of providing these governing documents are two-fold: first, governing documents include essential information such as par amount, coupon and/or borrowing spread, issue price, term to maturity, and other material provisions (such as call, put, and sinking fund schedules, debt and lien priority, event-driven changes in financing cost, financial covenants, events of termination and default (including cross defaults), and remedies, such as acceleration), counterparties, and current or contingent collateral security provisions; and second, issuers that provide governing documents on EMMA would not incur additional cost to recreate separate essential terms for bondholders. Competitively sensitive information or personal information, including the names and addresses of the creditor, could be redacted to this limited extent if necessary. We note that the practice of filing the governing contracts has been firmly established in the municipal market with respect to LOCs and SPBAs for variable rate demand obligations.

The second proposed event would require an obligated person to disclose the occurrence of a 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. The SEC explains that the occurrence of defaults and other events under the terms of a financial obligation can significantly and adversely impact the value of an issuer's or obligated person's outstanding municipal securities.

We also strongly support the SEC's second proposed event and agree with the SEC's belief that timely disclosure about defaults or other events including the termination of any material financial obligation would help to enhance transparency in the municipal securities market and enhance investor protection. Indeed, we believe it is essential that issuers disclose the non-scheduled, voluntary or involuntary termination of any material financial obligation, including termination of contingent obligations such as lines of credit, LOCs, and guarantees. Without this information, investors could be making investment decisions without important information regarding the current financial condition of the issuer or obligated person. To this end, we strongly encourage the SEC to broaden the concept of an "event" in this context to include all defaults, accelerations, terminations, modifications, and *not* solely those that "reflect financial difficulties." This would remove the subjectivity that the obligated person may view this event differently than an investor. Finally, removing the "reflect financial difficulties" qualifier appropriately broadens this event to include information that may both adversely and positively affect the creditworthiness of a borrower.

B. Additional Event Notices

In response to the SEC's 2009 proposed amendments, we recommended that the SEC add additional event notices to the disclosure requirements of Rule 15c2-12 to capture events that reasonable investors would want to know about a borrower. As noted above, one of our recommendations is the subject of the current proposal. Although the SEC did not adopt all of our recommendations in 2010, the SEC left open the possibility that it will consider commenters' views as it continues its efforts to bring greater transparency and other improvements to the municipal securities markets.[13] At this time, we reiterate two of our previous recommendations, and add a new recommendation relating to covenant compliance information and periodic financial information disclosed to other creditors.

First, we recommend that the SEC include a "catch-all" event notice in Rule 15c2-12, subject to a materiality determination as determined by the particular facts and circumstances of such an event. We believe that any event materially impacting the value of a bond should be disclosed to investors, in part as recognition that the market is lending these issuers money. A catch-all provision would account for developments in the municipal securities markets that have a major effect on the creditworthiness of municipal debt securities but outpace regulatory response. A catch–all provision would capture, for example, a cyber security incident of sufficient scope and scale that causes great costs for a municipality.

Second, we recommend that the SEC adopt an event notice to disclose modifications to escrow agreements or escrows, or to any other agreement governing security pledged to bondholders, such as mortgaged property. Similar to credit or liquidity agreements, a change to, or substitution of, the security in an escrow agreement or the amount of or type of securities held or eligible to be held in an escrow or the sale or substitution of properties subject to a mortgage, could significantly alter an investor's assessment of the credit quality of a particular bond and, therefore, the investor's decision to buy or sell the bond. We believe the recommended disclosure should be mandatory to reflect the value of escrow and other amendments to collateral securing investors' bonds.

Finally, we recommend that the SEC adopt an event notice that would require an issuer or obligated person to disclose covenant compliance reports and periodic financial information disclosed to other creditors. This information is critical to investors to assess distance to distress or to covenant violations. Members report that they often own bonds that get downgraded without warning, or are subject to a cross-default due to undisclosed covenant violations or near-covenant violations. Receiving parity disclosure would enable bondholders to have access to information that would better inform trading in the secondary market. Increased financial transparency is especially critical during periods of high market volatility when disruptions can exacerbate the ability to accurately assess an issuer's current creditworthiness. Indeed, we are aware through select issuers' voluntary disclosure of loan agreements on EMMA that banks typically request equivalent disclosure as bondholders. Additionally, certain issuers already voluntarily disclose on EMMA all financial reports under bank agreements, greatly benefiting investors who may be evaluating those issuers' bonds in the secondary market. A level playing field promotes efficient markets.

[13] 2010 Amendments at 85. The SEC echoed this sentiment in the 2012 SEC Report.

C. Recommended Changes to Current Event Notices

In addition to the additional event notices suggested above, we recommend the SEC eliminate the current "materiality" threshold for determining whether submission of certain Rule 15c2-12 event notices is required , including (b)(5)(i)(C)(2) (non-payment related defaults),[14] (7) (modifications to security holder rights), (8) (bond calls), (10) (security changes), (13) (corporate changes) and (14) (trustee changes). Investors generally believe that these events are "per se" material because they reflect on the creditworthiness of the issuer or the terms of the bond being offered and therefore their disclosure should not be discretionary.

We also recommend the SEC expand the scope of event notice (C)(5) (substitution of credit or liquidity providers) and substantially revise event notice (6) (events affecting the tax status of the security).

Specifically, the SEC should modify event notice (C)(5) regarding substitution of credit or liquidity providers, or their failure to perform, to include any material modification of any credit or liquidity facility or other agreement supporting or otherwise material to a municipal security. Material changes to or violations of any of the credit or liquidity agreements structured into a municipal security can have significant implications for an investor by modifying the overall security, causing a mandatory tender event, and/or impacting the prospects for remarketing.[15]

The SEC also should revise event notice (C)(6) regarding the tax status of a security because the current wording of (6) does not sufficiently capture all events affecting the tax-exempt status of a security. Indeed, we believe all notices, determinations, or events that may affect the tax status of a security are material to investors. This would include preliminary audit notices, proposed IRS determinations of taxability, and voluntary settlement discussions. We therefore recommend the SEC consider revising (C)(6) as follows:

"(6) Adverse tax opinions, the issuance by the Internal Revenue Service (IRS) of any notices related to the selection of bonds for IRS examination or notices related to IRS ~~of~~ proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other ~~material~~ notices or determinations with respect to the tax status of the security, or other ~~material~~ events affecting

[14] For example, in the non-profit health care and university sectors, where bank lending, LOCs, and SBPAs are prevalent, rating agencies often ignore the violation of a rate covenant or a liquidity covenant in assigning their ratings. Or, they may downgrade a security multiple notches for violations of such covenants, leaving bondholders unaware of these matters until after a rating agency acts.

[15] We included a similar recommendation in the ICI 2009 Letter. We recognize that this information should already be disclosed in the current requirement for notice of modifications to the rights of security holders. We continue to believe that it is more appropriate and useful to investors, however, to include this information in the event notice for substitutions and violations of credit or liquidity agreements.

the tax status of the security (including, without limitation, the commencement and/or the conclusion of voluntary closing agreement discussions with the IRS)."

V. Compliance Date and Transition

The proposal would apply only to continuing disclosure agreements that are entered into in connection with primary offerings occurring on or after the effective date of the amendments, if adopted. The SEC is considering a compliance date that would be no earlier than three months after any final adoption of the proposal.

We support the suggested three month period as an appropriate timeframe to prepare for compliance with the proposed amendments. The sooner the amendments are effective, the sooner investors will benefit from the enhanced disclosure regime.

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We look forward to working with the SEC as it continues to examine these critical issues. In the meantime, if you have any questions, please feel free to contact me directly at [redacted] or Jane Heinrichs, Associate General Counsel, at [redacted].

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue
Deputy General Counsel—Securities Regulation

cc: The Honorable Jay Clayton
The Honorable Michael S. Piwowar
The Honorable Kara M. Stein

Jessica Kane, Director
Office of Municipal Securities

US Securities and Exchange Commission