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Securities Law

How The SEC Could Help With Issuer Bank Loan Disclosure

By Jack Casey
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TORONTO – Market participants need to continue working toward broad disclosure of bank loans, possibly by amending the Securities and Exchange Commission's disclosure rule to classify the loans as material events for issuers.

Panelists relayed that message to issuers during a session at the Government Finance Officers Association annual meeting here on Monday.

Nat Singer, who chairs the board of the Municipal Securities Rulemaking Board, said it is hard to get exact figures on the size of the bank loan market, but added the best estimates put the number between $60 billion to $80 billion a year.

"You're talking about something that could be 20% of the [municipal] market right now," he said. "It's enormous and continuously growing."

Bank loans have become a popular alternative to securities for issuers because they are cheaper and less regulated. However, they can mean issuers are dealing with a larger amount of debt, which many investors may find material information.

Issuers are not required to disclose the loans although numerous market groups and self-regulators, along with the MSRB, have issued alerts and best practices urging issuers to voluntarily disclose.

Kristina Eng, a director with Wells Fargo Bank in Seattle, said that her firm requests that the issuers they work with on bank loan transactions send the loan documents to the rating agencies before closing.

"We think it is a best practice," she said. Eng added that they ask the issuers to work through the details of any loan deal to make sure it is structured in a way that works for their specific needs and then requests that the issuer voluntarily disclose the loan on the MSRB's EMMA system.

However, the problem, according to the MSRB and others, is that issuers' voluntary disclosures of their loans and the terms of those loans haven't been very robust.

Singer said the MSRB can only go so far in trying to fix that problem because the self-regulator does not have authority over issuers.

"All we can do to issuers is to encourage them to submit this information because we think it is useful for the market," he said.

For that reason, he said he has "sort of been begging" the SEC to give the market more guidance on bank loans and to possibly amend SEC Rule 15c2-12 on disclosure to classify bank loans as a required material event that would need to be posted on EMMA.

In the absence of that SEC guidance, the MSRB floated a concept release on March 28 that asked for market participants' opinions about whether the MSRB should propose a rule requiring municipal advisors to disclose information about the bank loans or privately placed munis of their issuer clients. The market has until May 27 to file comment letters on the concept release.

Market participants have mostly spoken out against that concept, pointing out that municipal advisors have a fiduciary duty to their issuer clients and that requiring MAs to report bank loans would conflict with that duty.

Issuers at the GFOA debt committee meeting over the weekend also said that the process for posting bank loan disclosures on EMMA is too confusing and may be artificially deflating the number of filings, and thus inflating the disclosure problems, the MSRB is saying exist.

Daniel Hartman, a managing director with PFM, said his firm does not think the MSRB concept release is the right course of action and instead said he would endorse the amendments to 15c2-12 that Singer mentioned.

"The municipal advisor cannot have a fiduciary duty to the issuers and also be working in the best interests of the investors," he said.

Eng said that Wells Fargo would also be supportive of having underwriters be responsible for bank loan disclosures, as would happen if 15c2-12 were amended.

Hartman also said regulators should address the often discussed question of whether MAs sometimes act as placement agents when helping their issuer clients with bank loans. He said it is important to have the municipal advisor at the table when loan negotiations are underway and suggested that the SEC approve a safe harbor for municipal advisors when advising issuers on bank loans. The safe harbor would allow MAs to assist their issuer clients without the concern they may penalized for acting as a placement agent that is not registered as a broker-dealer, Hartman said.

Geoffrey Buswick, a managing director with S&P Global Ratings in Boston, said the rating agency has "been screaming into the wind" about bank loans and disclosure since May 2011.

"We've sat with the MSRB, we've been to the [office of municipal securities] of the SEC, we've sat with … some of the largest underwriters in the country about where we see risk," Buswick said. He added that S&P regularly communicates with the various portions of the market like financial advisors, issuers, and the investor community.

"As much as we talk with all these groups and hear everyone say, 'This is a great idea, disclosure should be there,' it's not yet happening," Buswick said.

When S&P sees bank loan documents, it particularly looks for, and sometimes finds, potentially troubling portions that may allow the banks to accelerate payments. Banks can take such action it believes the issuer is in a materially adverse position or if the bank finds its own finances are insecure. Buswick said those circumstances are tricky because the bank decides what is materially adverse for the issuer and what makes its own finances insecure. However, he made clear that he was not speaking out against bank loans themselves, saying most issuers are "doing a good thing" and understanding their documents.

"Where we worry is the perception of the broader market," Buswick said. "If one deal fails … it starts to sour the public opinion on public debt, making everything more difficult. We really think one [failure] could drive a mindset change on public debt."
