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Recent SEC Interpretation of Exchange Act Rule 15c2-11 May Pressure Private Issuers of Fixed Income Securities to Publicly Disclose Financial Information

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Following a recent interpretation of a long-standing rule, Rule 15c2-11 (the "Rule") under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), by the Staff of the Securities and Exchange Commission (the "Commission"), issuers of fixed income (*e.g.*, debt) securities, including such securities initially offered and sold to investors in reliance on available exemptions from registration under the Securities Act of 1933, as amended (the "Securities Act") (most notably Rule 144A under the Securities Act ("Rule 144A")), will be required to publicly disclose specified current financial and other information in order to allow US-regulated broker-dealers ("US broker-dealers") to publish quotations on such securities. For example, this rule will impact private companies that issue high yield or other bonds under Rule 144A and who wish to ensure that there is sufficient liquidity for their investors. Securities of issuers that do not choose to publicly disclose the information required under the Rule could suffer significant limitations in liquidity, as discussed below.

Background

The Rule, first adopted in 1971, while not directly applicable to issuers, requires US broker-dealers to collect and review certain issuer information before publishing quotes on the issuer's securities in the Over the Counter ("OTC") markets.[1] In 2020, the Commission adopted amendments to that Rule, substantially limiting the exceptions to such requirements and requiring that specified issuer information be current and publicly available in order for US broker-dealers to publish quotes on that issuer's securities. As these amendments were set to come into effect in September of 2021, the Division of Trading and Markets, in a no-action letter, confirmed a new and surprising interpretation of the Rule, stating that the rule applies to all securities, including fixed income securities, despite never having been applied or enforced in fixed income securities markets.[2] Following that initial letter, the Division of Trading and Markets issued an additional no-action letter a few months later, providing for a phased-in approach to its enforcement of the amended Rule with respect to fixed income securities markets (the "No-Action Letter").[3]

Impact on Markets for Unregistered Securities

The implications of the new interpretation of the Rule are likely to be most keenly felt in the Rule 144A market in relation to fixed income securities issued by companies ("Private Companies") which are not registrants under the Exchange Act[4] nor otherwise required to publicly provide current financial and other information in the manner contemplated in that Rule.[5] In addition, Private Companies which issue fixed income securities in reliance on certain other exemptions, such as Section 3(a)(9) (exempting exchanges of one

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security previously issued by an issuer for another security of the same issuer, for no further consideration), Section 3(a)(10) (exempting exchanges of securities for existing securities or other claims pursuant to a governmental hearing) or Section 1145 of the U.S. Bankruptcy Code (exempting issuances of securities by a debtor in exchange for claims against it or an affiliate pursuant to a plan of bankruptcy under Chapter 11 of the U.S. Bankruptcy Code), will also be similarly affected.

Securities offered and resold pursuant to Rule 144A are, by their nature, restricted to qualified institutional buyers ("QIBs") and are generally subject to highly negotiated and detailed financial reporting covenants. In addition, for Private Company issuers, Rule 144A has, since its adoption in 1990, required that QIB investors be entitled upon request to receive certain specified information (the "Rule 144A(d)(4) Information")[6] from the issuer. Typically, such information has been provided by Private Companies only to QIBs through a secure online portal, or direct delivery to the QIB, which allows the information to be disseminated efficiently, without public disclosure. As a result of the new interpretation of the Rule, Private Companies that issue Rule 144A fixed income securities and wish to ensure that US broker-dealers may publish quotations for such securities will no longer be able to rely solely on such private dissemination methods of Rule 144A(d)(4) Information.[7]

Requirements of the Rule

Below we summarize the key requirements for Private Company issuers of fixed income securities under the Rule (as recently amended) which, for Rule 144A fixed income securities, will take effect on January 4, 2023, absent any further action by the Commission.

Current Information Required by the Rule

For US broker-dealers to be permitted to provide quotations for fixed income securities of Private Companies, the Rule requires the following issuer information, as of a date within 12 months of the date of the quotation (unless otherwise indicated), be publicly available[8]:

1. identifying information about the issuer and the relevant security (including the name, address, title, class, etc.) and the total amount of the securities outstanding as of the end of the issuer's most recent fiscal year;
2. information about the issuer's business (*e*., a description of the business, the products and services offered, names and titles of all insiders, etc.); and
3. the issuer's most recent balance sheet (as of a date less than 16 months) and profit and loss and retained earnings statements for the 12 months preceding the date of the most recent balance sheet, and similar financial information for such part of the two preceding fiscal years as the issuer or its predecessors have been in existence.

The information described above is substantially similar to the Rule 144A(d)(4) Information requirement of Rule 144A for a company that is neither subject to the reporting requirements of the Exchange Act nor a foreign private issuer exempt from such reporting requirements pursuant to Rule 12g3-2(b) thereunder. However, unlike those requirements under Rule 144A, the Rule will require that the Private Company issuer make such information publicly available if they wish to permit US broker-dealers to publish quotations on the issuer's OTC securities.

Meaning of "Publicly Available"

Under Rule 15c2-1, as amended, the relevant current information will only be deemed "publicly available" if it is "available on EDGAR; on the website of a state or federal

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agency, a qualified interdealer quotation system, a registered national securities association, a registered broker or dealer or an issuer; or through an electronic information delivery system that is generally available to the public in the primary trading market of a foreign private issuer…".[9] Notably, the definition in the Rule explicitly excludes information to which access is restricted by user name, password, fees, or other restraints, which issuers of Rule 144A securities have historically used to protect information disclosed to QIBs in accordance with highly-negotiated financial reporting covenants.

Phased Implementation

The Rule is now in effect for fixed income securities. However, in response to requests from industry representatives seeking additional time to implement the operational and systems changes necessary to comply with the Rule in respect of fixed income securities, the Division of Trading and Markets issued the No-Action Letter, providing a phased-in approach to application of the amended Rule to fixed income securities markets in limited circumstances.[10] Pursuant to the No-Action Letter, the Commission confirmed that, during the period from January 3, 2022 until January 3, 2023 ("Phase 1"), it would not recommend enforcement against a US broker-dealer that provides a quotation for a fixed income security where that security or its issuer meets one of a limited number of criteria[11], including, most notably for Private Company issuers, that such securities are being offered pursuant to Rule 144A (provided the US broker-dealer reasonably believes the issuer will provide the Rule 144A(d)(4) Information to investors upon request). Under the No-Action Letter, from January 4, 2023, "Phase 2" described in the No-Action Letter will begin and run from such date, there will no longer be an exemption available for quotations relating to fixed income securities sold pursuant to Rule 144A.

Accordingly, from and after January 4, 2023, US broker-dealers will no longer be permitted to provide quotations for securities sold pursuant to Rule 144A unless there is current and publicly available financial information about the issuer meeting the requirements of the Rule.

Next Steps and Considerations

Industry groups such as the Securities Industry and Financial Markets Association (SIFMA) and the Investment Company Institute (ICI) continue to engage with the Commission regarding the application of the Rule to fixed income securities.[12] These groups are also advocating publicly against the application of the Rule to fixed income securities generally[13] and, especially, Rule 144A securities.[14] Nonetheless, a change in policy by the Commission in advance of the expiration of the current phase of the No-Action Letter regulatory regime on January 4, 2023 remains uncertain.

In the absence of any further relief from the Commission, Private Company issuers and all other market participants in these fixed income securities should now be considering the effects of the Rule (including the obligation of Private Company issuers to make certain information publicly available and the consequences of not doing so within the time-frame required by the SEC). For US broker-dealers this will mean screening for fixed income issuers that do not publicly provide current financial and other information required by Rule 15c2-11 and refraining from quoting securities from such issuers until such financial information is publicly available. Investors, similarly, will need to consider the liquidity of potential investments in the fixed income securities (including Rule 144A securities) of Private Company issuers that do not publicly provide current financial and other information required by Rule 15c2-11. Private Company issuers of fixed income securities (including Rule 144A securities) that are not otherwise required to publicly disclose current financial information must determine whether they will begin providing such information publicly in order to allow US broker-dealers to quote their securities. Failure to do so could impact the liquidity (and trading value) of such securities. For those issuers who decide to make such information publicly available in accordance with the Rule, they should be implementing proper infrastructure and controls to be ready for publication before January 4th. In addition, future Private Company issuers may also consider whether they

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would prefer to rely on other sources of capital raising, such as bank debt or debt securities offerings into other markets (especially for foreign private issuers), if available to them.

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[1] The Rule does not (and the prohibition on US broker-dealers discussed herein does not), however, apply to publications or submissions by a US broker-dealer, solely on behalf of a customer, of certain quotations for an OTC security that represent customers' unsolicited indications of interest. *See* Rule 15c2-11(f)(2).

[2] Letter from Josephine Tao, Assistant Director, Office of Trading Practices, Division of Trading and Markets to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA (Sept. 24, 2021) (Temporary Staff No-action Letter Regarding Rule 15c2-11 and Fixed Income Securities), available here.

[3] Letter from Josephine Tao, Assistant Director, Office of Trading Practices, Division of Trading and Markets to Racquel Russell, Senior Vice President and Director of Capital Markets Policy, Office of the General Counsel, FINRA (Dec. 16, 2021) (Temporary Staff No-action Letter 2 Regarding Rule 15c2-11 and Fixed Income Securities), available here.

[4] Issuers that offer fixed income or other securities in public offerings registered under the Securities Act, and/or which otherwise register a class of securities under Section 12 of the Exchange Act, are require to file annual and interim reports with the Commission pursuant to Sections 15(d) and/or 13 of the Exchange Act until such time, if any, that the issuer validly suspends or terminates such reporting requirements. The issuer's annual and interim reports timely filed with the Commission in accordance with Sections 15(d) or 13 of the Exchange Act will also satisfy the publicly available current information requirement of Rule 15c2-11. However, notwithstanding any valid suspension and/or termination of its Exchange Act reporting requirements, for so long as any of the issuer's OTC securities (including fixed income securities) remain outstanding thereafter, Rule 15c2-11 will require that issuer publicly disclose the required current information in accordance with the Rule if it wishes for US broker-dealers to be able to provide quotations for such securities.

[5] See below under "Meaning of Publicly Available."

[6] 17 CFR § 230.144A(d)(4).

[7] In contrast to Rule 144A issuers, issuers of fixed income securities under certain other exemptions from registration under the Securities Act, such as Sections 3(a)(9) and 3(a)(10) under the Securities Act and Section 1145 of the Bankruptcy Code, are not required, by the terms of those exemptions, to provide or otherwise make public any information on an ongoing basis after issuance. Following this new interpretation of the Rule, however, such Private Company issuers that wish to ensure that US broker-dealers may provide quotations in such securities will similarly be required to publicly provide the financial and other information required by the Rule.

[8] For companies that are not Private Companies, such current information requirement alternatively may, if sufficiently current for purposes of the Rule, be met, for example, by any of the following (i) a prospectus or offering circular filed by the issuer as part of a registered public offering or offering under Regulation A under the Securities Act, (ii) an annual report or statement filed pursuant to Sections 15(d) and/or 13 of the Exchange Act, or pursuant to Regulation A or Regulation Crowd Funding under the Securities Act, or (iii) a copy of the information that, since the first day or its most fiscal year that a foreign private issuer has published in order to establish or maintain its exemption from registration under Section 12(g) of the Exchange Act provided by Rule 12g3-2(b) thereunder.

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[9] Additionally, note that the Rule does not provide any limitation on liability or safe harbor for issuers who make the financial and other information publicly available in order to permit US broker-dealers to provide quotations for such issuer's securities pursuant to the Rule.

[10] *See supra* note 4.

[11] In Phase 1, these criteria include fixed income securities (i) issued by an issuer that is not a Private Company, (ii) issued by certain foreign private issuers, which are foreign sovereign debt or are guaranteed by a foreign government, (iii) for which current and publicly available information about the issuer, (iv) issued by a by a bank, a bank holding company or a credit union with certain reporting requirements, and (v) offered and sold in accordance with Rule 144A (see Appendix A of the No-Action Letter). Phase 2 covers the same list, with the exception of fixed income securities offered and sold in accordance with Rule 144A, which will no longer be exempted (see Appendix B of the No-Action Letter). In Phase 3, a US broker-dealer will need to have determined that the security or its issuer satisfies the requirements of Phase 2 and either (i) the fixed income security is foreign sovereign debt or a debt security guaranteed by a foreign government; or (ii) there is a link on the quotation medium to the on which the security is being quoted, directly to the current and publicly available information about the issuer.

[12] *See* ICI Joint Letter to SEC on Application of Rule 15c2-11 to Fixed Income (Sept. 23, 2021), available here; *see also* ICI Follow-Up Letter to SEC on Rule 15c2-11 and Rule 144A Debt Securities (Oct. 25, 2022), available here.

[13] *See* The Detriment of Rule 15c2-11's Application to Fixed Income Markets (Sept. 12, 2022), available here.

[14] *See* The Collision of Rule 15c2-11 and Rule 144A (Sept. 19, 2022), available here.

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