

Parsing SEC's Rule Extension For Fixed-Income Issuers

By **J. Alan Bannister, Hillary Holmes and James Moloney**

(December 5, 2022, 2:33 PM EST)

Following the U.S. Securities and Exchange Commission's recent interpretation of Rule 15c2-11 under the Securities Exchange Act, issuers of fixed-income securities, including those initially offered and sold to investors in reliance on registration exemptions under the Securities Act — most notably Rule 144A — will be required to publicly disclose specified current financial and other information in order to allow U.S.-regulated broker-dealers to publish quotations on such securities.

For example, this rule will affect private companies that issue high-yield or other bonds under Rule 144A and that wish to ensure 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.

The SEC's Division of Trading and Markets, however, has now delayed until 2025 the application of the rule to certain fixed-income securities in limited circumstances.

Background

The rule, first adopted in 1971, while not directly applicable to issuers, requires U.S. broker-dealers to collect and review certain issuer information before publishing quotes on the issuer's securities in the over-the-counter, or 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 U.S. broker-dealers to publish quotes on that issuer's securities.

As these amendments were set to come into effect in September 2021, the division, 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 issued a second 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



J. Alan Bannister



Hillary Holmes



James Moloney

markets in limited circumstances.[3]

On Nov. 30, the division extended the deadline for the end of its phased-in application of the rule, in the same limited circumstances, in a third no-action letter.[4]

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 issued the no-action letters, providing a phased-in approach to application of the amended rule to fixed-income securities markets in limited circumstances.[5]

Pursuant to the extension no-action letter, the commission confirmed that, during the period ending Jan. 4, 2025, or Phase 1, it would not recommend enforcement against a U.S. 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,[6] including, most notably for private company issuers, that such securities are being offered pursuant to Rule 144A — provided the U.S. broker-dealer reasonably believes the issuer will provide the Rule 144A(d)(4) information to investors upon request

From Jan. 4, 2025, there will no longer be an exemption available for quotations relating to fixed-income securities sold pursuant to Rule 144A.

Accordingly, from and after Jan. 4, 2025, U.S. 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.

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 that are not registrants under the Exchange Act[7] nor otherwise required to publicly provide current financial and other information in the manner contemplated in that rule.[8]

In addition, private companies that issue fixed-income securities in reliance on certain other exemptions — such as Section 3(a)(9), Section 3(a)(10) or Section 1145 of the U.S. Bankruptcy Code — will also be similarly affected. Those sections exempt:

- Exchanges of one security previously issued by an issuer for another security of the same issuer, for no further consideration;
- Exchanges of securities for existing securities or other claims pursuant to a governmental hearing; and
- 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, respectively.

Securities offered and resold pursuant to Rule 144A are, by their nature, restricted to qualified

institutional buyers, or 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^[9] 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 U.S. 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.^[10]

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, and certain other fixed-income securities, will take effect on Jan. 4, 2025, absent any further action by the commission.

Current Information Required by the Rule

For U.S. 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:^[11]

- 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;
- Information about the issuer's business, i.e., a description of the business, the products and services offered, names and titles of all insiders, etc.; and
- 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 U.S. 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 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.[12]

Notably, the definition in the rule explicitly excludes information to which access is restricted by username, 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.

Next Steps and Considerations

Industry groups such as the Securities Industry and Financial Markets Association and the Investment Company Institute continue to engage with the commission regarding the application of the rule to fixed-income securities.[13] These groups are also advocating publicly against the application of the rule to fixed-income securities generally[14] and, especially, Rule 144A securities.[15]

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 Jan. 4, 2025, 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 U.S. 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 U.S. broker-dealers to quote their securities. Failure to do so could affect the liquidity and trading value of such securities.

For those issuers that 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 Jan. 4. In addition, future private company issuers may also consider whether they 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.

Hillary Holmes is a partner and co-chair of the capital markets practice group at the firm.

James Moloney is a partner and co-chair of the securities regulation and corporate governance practice group at the firm.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] The rule does not (and the prohibition on U.S. broker-dealers discussed herein does not), however, apply to publications or submissions by a U.S. 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. <https://www.sec.gov/files/rule-15c2-11-fixed-income-securities-092421.pdf>.

[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. <https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-121621.pdf>.

[4] Letter from Josephine Tao, Assistance Director, Office of trading Practices, Division of Trading and Markets to Racquel Russel, Senior Vice President and Director of Capital Markets Policy, Office of the general Counsel, FINRA (Nov. 30, 2022) (Temporary Staff No-action Letter 3 Regarding Rule 15c2-11 and Fixed Income Securities), available here.

[5] See supra note 4.

[6] 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) issued by an issuer that has a class of equity securities that is exempt from reporting under the Exchange Act pursuant to Rule 12g3-2(b) thereunder, (iv) for which current and publicly available information about the issuer, (v) issued by a by a bank, a bank holding company or a credit union with certain reporting requirements, and (vi) 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 U.S. 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.

[7] 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 U.S. broker-dealers to be able to provide quotations for such securities.

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

[9] 17 CFR § 230.144A(d)(4).

[10] 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 U.S. broker-dealers may provide quotations in such securities will similarly be required to publicly provide the financial and other information required by the rule.

[11] 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 Crowdfunder under the Securities Act, or (iii) a copy of the information that, since the first day of 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.

[12] 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 U.S. broker-dealers to provide quotations for such issuer's securities pursuant to the rule.

[13] See ICI Joint Letter to SEC on Application of Rule 15c2-11 to Fixed Income (Sept. 23, 2021), available here; <https://www.ici.org/system/files/2021-09/33787a.pdf>; see also ICI Follow-Up Letter to SEC on Rule 15c2-11 and Rule 144A Debt Securities (Oct. 25, 2022), available here. <https://www.ici.org/system/files/2022-10/34325a.pdf>.

[14] See The Detriment of Rule 15c2-11's Application to Fixed Income Markets (Sept. 12, 2022), available here. https://www.sifma.org/resources/news/the-detriment-of-rule-15c2-11s-application-to-fixed-income-markets-the-consequences-of-unilateral-rulemaking-without-public-comment/#_ftn1.

[15] See The Collision of Rule 15c2-11 and Rule 144A (Sept. 19, 2022), available here. [https://www.sifma.org/resources/news/the-collision-of-rule-15c2-11-and-rule-144a/#:~:text=Total%20144A%20issuances%20\(across%20issuer,2021%20was%20over%20%2410%20billion.](https://www.sifma.org/resources/news/the-collision-of-rule-15c2-11-and-rule-144a/#:~:text=Total%20144A%20issuances%20(across%20issuer,2021%20was%20over%20%2410%20billion.)