SOLVING THE CONTINUING CHALLENGE OF CONTINUING DISCLOSURE

In today's public finance bond arena, there is an increased pressure on getting it right
The requirement for public finance bond issuers to disclose certain information is a promise made to investors — and a prescriptive practice placed upon underwriters by SEC rule 15c2-12, which means the scrutiny of timely, accurate and complete disclosure filings is not going away. When underwriting specific types of municipal securities, underwriters compel necessary disclosures with bond issuers through agreements around ongoing reporting requirements. And, in the wake of the 2014 Municipal Continuing Disclosure Cooperation (MCDC) initiative, in which the SEC allowed underwriters and issuers to self-report on past disclosure violations, if there had ever been a mood for leniency or a lack of emphasis on these requirements, it no longer exists. Today, there is less of an appetite for muddiness and its consequences. Underwriters want clarity — and due diligence.

This means the pressure to adhere and conform to disclosure agreements is at a fever pitch, and for many state and local governments, particularly smaller bond issuers, what may have been a historically complex and confusing process now has even greater significance and considerably higher stakes.

For many reasons, consistently delivering on the obligations of transparency and disclosure can be challenging. If there isn’t a formal continuing disclosure process in place, incorrect practices can often become institutionalized, leading to the same mistakes being made year in and year out. And there may be a lack of understanding around ongoing deadlines for annual financial disclosures and material event filings, which can also hinder compliance. With state and local governments juggling a variety of critical issues, the necessity of structuring a robust continuing disclosure process can be superseded by other priorities. But the negative impact of non-compliance can be real. And, lasting.

The impact of non-compliance.

The consequences for non-compliance, incomplete compliance, or a lack of conformity to promised disclosure filings are significant and can impact an institution’s ability to access the bond market today and in the future. A few of the more damaging consequences can include:

Underwriting risk. If for some reason an issuer has not complied with previous disclosure commitments, when the bond issue comes to market, the underwriter may simply say “no” and take a pass because of non-compliance. Some issuers, in fact, have only discovered their non-compliance when they’ve gone to market. But whether previous non-compliance was known or unknown, the result can be the same: If the issuer must take time to get into compliance, the interest rate may potentially be higher. Issuers can also limit their buyer universe by not doing their due diligence with correct and timely filings.

Reputational risk. In the tax-exempt market, an entity that is chronically negligent in filing continuing disclosure information and meeting necessary requirements can get a reputation for doing so. In today’s low-tolerance environment, there are more and more underwriters refusing to bid on bond deals where there is a history of non-compliance. Non-compliant behavior can cast doubt on future bond programs. Without a concerted effort at remediation, it can stymie long-term initiatives and hamper infrastructure projects, placing a hurdle on growth.
Best practices for continuing disclosure.

Mitigating risk is an intentional process. Without oversimplifying the complexity of ongoing disclosure, these are a few best practices that public finance bond issuers can follow that can improve compliance performance.

1. Conduct a 5-year look back. The requirement to disclose information is not just for the last bond issue — it’s cumulative. That’s why it’s important to establish a historical record of compliance from the most recent filing to five years back. There may be varying requirements from one issue to the next so a thorough review of reports and filings can offer a window into the accuracy of documents during this period and make remediation possible. The goal is to have complete knowledge of and transparency into five years of bond issues to protect current and future bond programs.

2. Focus on the quality of the documents. The quality of the documents is key. Continuing disclosure reporting is not just about fulfilling a list of requirements — it’s about preparing a comprehensive document that is both thorough and concise, so an investor can find what they need.

3. Educate around the 14-item disclosure event reporting requirement. The SEC has two kinds of disclosure filing requirements. The first is a routine annual financial information filing. And, because it is routine, compliance is more easily supported. The second type of filing is event driven, and is based on a strict set of 14 events that must be reported on within 10 days after an event occurred. Many compliance errors arise because these events are not routine and happen throughout the year. Unless there is a defined process that tracks and/or triggers a reporting response, event notices may not be filed in the required amount of time. Educating staff around this very specific reporting requirement can alleviate a known compliance pitfall.

4. Disclose private placements and bank loans. There is increased SEC focus on disclosure of municipal alternative financings, such as private placements, bank loans and leases that currently do not have formalized disclosure requirements. Future rule changes may require these to be reported as disclosure events. Regardless, it is advisable that institutions provide the terms of any alternative financings to enhance transparency, as they may be of material importance to an investor.
The bottom line.

For institutions, ongoing disclosure is a critical pain point. Not only is it a complicated issue, but in today’s municipal bond arena there is an increased emphasis on getting it right. By being aware of the pitfalls of non-compliance and the best practices for mitigating exposure to those pitfalls, a municipality can better determine a policy for oversight and a plan for continued adherence.

Continuing Disclosure and HilltopSecurities.

At HilltopSecurities, we think of compliance support as a continuation of our relationship with our clients. As one of the only municipal advisory firms in the United States with a dedicated continuing disclosure practice, our goal is to not just advise and educate, but to also alleviate the ongoing pressures and challenges associated with compliance. Our professionals work closely with state and local governments and non-profits at every stage of the bond issuance process, utilizing a deliberate, focused and turn-key approach to continuing disclosure.

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