

Municipal Disclosure Practices for COVID-19 – Trends and Considerations

On May 4, 2020, SEC Chair Jay Clayton and SEC Director of the Office of Municipal Securities Rebecca Olsen issued the public statement, [“The Importance of Disclosure for our Municipal Markets.”](#) The statement encourages municipal issuers to voluntarily file information on the status of their operations and financial condition; sources of liquidity; the availability of federal, state, and local aid; and interim financial reports that are already compiled and available to governing boards.

This request applies to new offerings under consideration now and in the coming months, to upcoming required continuing disclosure reports, and to voluntary filings specifically made to report on COVID-19 impacts. This statement is not a new rule, regulation, or statement of the SEC—nor is it a requirement to make such voluntary disclosure.

The purpose of the Clayton and Olsen’s public statement is to promote and enhance the information available to investors, even if municipal issuers are not required to do so under their existing continuing disclosure agreements. Most continuing disclosure agreements require only an annual financial filing plus an audit, typically within six months following their fiscal year end. Historical financial information is not as useful or meaningful to investors in the current environment. The lack of specific and current information gives investors little means to make informed investment decisions.

Voluntary Disclosure – Things to Consider

The determination on whether to file, when to file, and what to disclose in a voluntary filing depend on the municipal issuer’s specific circumstances and should address issuer- and security-specific material information. For example, a fact is material if there is a substantial likelihood a reasonable investor believes the information in question would significantly alter the total mix of information available. Issuers should also consider noting in any voluntary filing that they are not obligated to prepare and file subsequent updates in relation to that filing.

Voluntary disclosure should address the known facts, and the management and operational planning taking place to address financial impacts. The purpose is not to answer all the anticipated questions, but to communicate what is known. Voluntary disclosure should also confirm the issuer is making debt service payments on time. Other items to consider is information that shows trends or statements about what is or is not being impacted, cuts to the current budget for both revenues and expenditures, and planning for next year’s budget.

Evaluating the Numbers and Their Impact

Issuers may not know the full impact of COVID-19. However, based on the mix of their revenue sources and controllable expenditures, issuers may use available information to determine potential impacts and resulting action plans. Estimating the financial impacts of the COVID-19 pandemic is a challenge for governments because of the way some revenues are collected and distributed. For example:

- Sales tax is collected at the retail level in one month, reported to the state the following month, and the local percentage is disbursed to governments in the next month. The sharp drop in retail sales will have an immediate impact on this revenue for some issuers.

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- Utility revenues may be unaffected initially, but as people are unable to pay utility bills because of job loss, that revenue source may slow or decline.
- Universities and colleges may see a significant drop in enrollment for the fall, a corresponding drop in revenues, and a subsequent ramp-up in online enrollment.
- Transit and transportation issuers' revenue decline has been immediate and sharp as local and regional travel came to a halt.
- Property tax collections for the year may be mostly complete, but values for the upcoming year may be impacted, and future collections are an unknown.

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SEC Statement Recommendations for Disclosure for COVID-19

In their public statement, Clayton and Olsen provide examples of information that the SEC believes may be important to investors and the marketplace. Whether in a primary offering document, a required disclosure filing, or a voluntary filing, municipal issuers state how COVID-19 has impacted their operations and financial condition. They recommended that statement include the following:

- The issuer's current operational and financial status, including decreases in revenues and delays in collection of revenues.
- How the COVID-19 response—including efforts to protect the health and well-being of residents and employees—has impacted their operations and financial condition.
- Information on sources of liquidity—including cash on hand, reserves or other accessible funds, and access to liquidity facilities—and whether current liquidity is expected to fund essential services and make timely debt service payments.
- Information regarding the availability of federal, state, and local aid that has been applied for and the timing of such aid. Or, if aid has already been received, disclosure of the nature, amount, and other material terms if they materially affect the issuer's operational or financial condition.
- Interim financial statements or reports prepared for other governmental purposes that are usually available to governing bodies.

It's important to note that, unlike corporate issuers, issuers of municipal securities do not have the benefit of safe harbors for forward-looking statements.

Mitigate Potential Risks of COVID-19 Disclosures

Issuers should review voluntary disclosures with their legal counsel and advisors. Voluntary disclosure should be accompanied by meaningful cautionary language in the form of an appropriate legal disclaimer regarding assumptions and projections used.

It's important to note that, unlike corporate issuers, issuers of municipal securities do not have the benefit of safe harbors for forward-looking statements. In this case, voluntary disclosure would be informed by the judicially developed "bespeaks caution doctrine," which means that a good faith attempt to provide information would not be expected to be second-guessed by the SEC. Issuers should follow their existing disclosure procedures to provide consistent information for all parties including the governing body, citizens, government agencies, lenders, and investors.

No Relief from Reporting Under SEC Rule 15c2-12

The SEC is not relieving municipal issuers from their existing filing requirements under SEC Rule 15c2-12. The SEC lacks the authority to provide relief if there is a violation of the continuing disclosure agreement, including failure to timely file annual financial information due to COVID-19.

As the cumulative financial impacts of the pandemic are realized, issuers should remain aware of any reportable material events that may occur. Issuers may be tapping alternative financing methods—such as bank loans or private placements—in order to address immediate costs or to provide interim liquidity associated with COVID-19. Depending on the issuer, this may be a reportable material event. If there is an occurrence of any of the SEC 15c2-12 16 material events, an issuer is required to file a notice within 10 business days.

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The 16 material events are as follows:

1. Principal and interest payment delinquencies
2. Non-payment related defaults, if material
3. Unscheduled draws on debt service reserves reflecting financial difficulties
4. Unscheduled draws on credit enhancements reflecting financial difficulties
5. Substitution of credit or liquidity providers, or their failure to perform
6. Adverse tax opinions, IRS notices, or material events affecting the tax status of the security
7. Modifications to rights of security holders, if material
8. Bond calls (if material) and tender offers
9. Defeasances
10. Release, substitution, or sale of property securing repayment of the securities, if material
11. Rating changes
12. Bankruptcy, insolvency, receivership, or similar event of the obligated person
13. Merger, consolidation, or acquisition of the obligated person or issuer, if material
14. Appointment of a successor or additional trustee, or name change of a trustee, if material
15. Incurrence of a financial obligation 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
16. 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

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Conclusion

As the financial and operational impacts of the COVID-19 pandemic evolve, voluntary disclosure is a way for issuers to share information with investors and the market. Issuers should work with their legal counsel and advisors to consider carefully the content, timing, and frequency of COVID-19 voluntary disclosure.

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