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SEC Leaders Ask Municipal Issuers for Voluntary COVID-19 Disclosure.

On May 4, Securities and Exchange Commission Chairman Jay Clayton and Rebecca Olsen, Director of the SEC's Office of Municipal Securities, issued a statement entitled "The Importance of Disclosure for our Municipal Markets"¹ stating that "in light of the potentially significant effects of COVID-19 on the finances and operations of many municipal issuers" municipal issuers should provide investors "as much information about their current financial and operating condition as is reasonably practicable," noting "the fluid and unpredictable nature of the public health crisis and its financial and economic impacts on municipal issuers." The May 4 Statement offers "observations and requests" to help municipal issuers provide such disclosures and intentionally parallels the Corporate Issuer Statement made in April by Chairman Clayton and William Hinman, Director of the Division of Corporation Finance.² For municipal issuers experienced in making voluntary disclosure, little should be surprising and much reassuring.

The May 4 Statement lists certain disclosures which the authors believe are important to investors and market participants during the ongoing pandemic: (i) information regarding the impact of COVID-19 on operations and financial condition, (ii) sources of liquidity, such as cash on hand and access to various reserves or other funds, (iii) the availability of federal, state and local aid, and (iv) reports prepared for other governmental purposes "that may be significant sources of current information" in primary offering documents such as contractually required disclosure filings or voluntary public statements on EMMA, their investor relations webpage, or other "place or places at which they regularly make information available."³ Acknowledging the liability risk associated with decisions to voluntarily disclose or expand required disclosure, the authors "believe there are various factors that generally weigh in favor of making [such] disclosures." Key among them is that the authors "would not expect good faith attempts to provide appropriately framed current and/or forward-looking information to be second guessed by the SEC." The Statement does not specifically discuss federal securities law antifraud provisions, which are omnipresent in the context of municipal disclosure, and so is best read together with the Staff Legal Bulletin No. 21 (OMS) of February 7, 2020 reviewing those provisions as applied to municipal issuer public statements.⁴

The May 4 Statement begins with a description in detail of the size, importance, complexity, and specialized nature of the municipal securities market and states that municipal issuers and investors should recognize the materiality of both issuer-specific and security-specific disclosure. Likewise, financial professionals should discuss the importance of both kinds of disclosure with their customers and also when providing recommendations and investment advice.

The May 4 Statement goes on to recognize that the COVID-19 pandemic requires an increased focus on the finances and operations of municipal issuers, and requests increased voluntary disclosure of such information. "The fluid and unpredictable nature of the public health crisis and its financial and economic impacts on municipal issuers has placed investor need for timely financial information into stark relief" and so "the typical practice of providing historic financial information in the form of an annual information filing or similar disclosure may not enable investors to make informed assessments of the municipal issuer's current and expected future financial condition." In other

words, an issuer fully satisfying existing disclosure requirements required by law may not be providing investors all they need in today's circumstances. The solution is voluntary disclosure, but even the authors acknowledge that there are risks accompanying such disclosure because "certain financial disclosure would be based on estimates and assumptions as well as projections regarding future circumstances."

The authors recognize that consideration of voluntary disclosure or any expansion of required disclosure may include consideration by the issuer (with advice of counsel) of potential antifraud liability. They describe "various factors that generally weigh in favor of making these disclosures" including practices frequently employed by counsel in the preparation of forward-looking or non-routine disclosures:

- Accompanying those disclosures with meaningful cautionary language will not only improve the quality of the disclosure but will also reduce legal and other risks. This would include, for example:

(1) a description of relevant facts or assumptions affecting the reasonableness of reliance on, and the materiality of, the information provided;

(2) a description of how certain important information may be incomplete or unknown; and,

(3) the process or methodology (audited vs. unaudited) used by the municipal issuer to produce the information.

- While the safe harbors for forward looking statements that are available to certain corporate issuers are not available to issuers of municipal securities, the authors believe that a municipal issuer's "approach to forward-looking disclosures should be informed by the judicially developed 'bespeaks caution' doctrine."

Issuers, counsel and other municipal market participants are familiar with the use of these techniques in preparing offering documents. The Statement notes that municipal issuers may be required to disclose similar information to other parties in connection with:

- efforts by federal and state governments to assess the financial impact of COVID-19 on states, municipalities and special purpose entities; and,
- the pursuit by municipal issuers of funding or other support from governmental authorities and private parties.

The May 4 Statement notes that it is "extremely important" to ensure that disclosure of this type is "consistent across all contexts, regardless of the purpose," and "kept confidential until disclosed and, when disclosed, disclosed broadly." This admonition may be understood as a reminder of the assertion in the February 7, 2020 Staff Legal Bulletin that such statements made by an issuer in public reports to other government bodies may be covered by the antifraud provisions.⁵

The authors of the May 4 Statement state that they "would not expect good faith attempts to provide appropriately framed current and/or forward-looking information to be second guessed by the SEC." This assertion seems unusual and worth noting. The Statement from the outset cautions that it:

represents the views of the Chairman and the Director of the Office of Municipal Securities of the U.S. Securities and Exchange Commission ... It is not a rule, regulation, or statement of the SEC. The Commission has neither approved nor disapproved its content. This statement does not alter or amend applicable law and has no legal force or effect.

While it may be unusual for SEC representatives to suggest that the SEC will not “second guess” disclosure that later proves to be inaccurate, this statement does not (and could not) change existing law. Aside from statements made in offering documents, municipal issuers would only be subject to antifraud liability for statements in voluntary disclosures and expansion of disclosures required by continuing disclosure agreements if they acted with scienter. Municipal issuers employing the steps identified in the Statement, following effective disclosure policies and procedures and the assistance of experienced disclosure counsel, would be unlikely to intentionally or recklessly misstate their financial or operating conditions, and therefore would be unlikely to act with scienter. Understood in that light, the statement, while rare, may not be surprising.

1 Available at: <https://www.sec.gov/news/public-statement/statement-clayton-olsen-2020-05-04>. Unless otherwise identified, matters in quotations in this update are text from the Statement.

2 Chairman Jay Clayton and William Hinman, the Director, Division of Corporation Finance, The Importance of Disclosure - For Investors, Markets and Our Fight Against COVID-19 (Apr. 8, 2020), available at: <https://www.sec.gov/news/public-statement/statement-clayton-hinman>.

3 As provided in the May 4 Statement:

Information Regarding the Impact of COVID-19 on Operations and Financial Condition.

Disclosures should reflect the issuer’s assessment of this state of affairs and outlook and, in particular municipal issuers should provide information regarding: (1) their current operational and financial status, including decreases in revenues and delays in collection of revenues; (2) how their COVID-19 response including efforts to protect the health and well-being of residents and employees has impacted their operational and financial condition, including un-budgeted costs; and (3) how their operational and financial condition may change as efforts to fight COVID-19 evolve. In these circumstances, comparisons to historical information may be relatively less significant.

Information Regarding Sources of Liquidity.

A description of cash on hand, access to reserves or other funds (and to what extent such access is limited), access to liquidity facilities and whether current liquidity is expected to be adequate to fund essential services and make timely debt service payments. If not otherwise disclosed, we encourage municipal issuers to disclose the material terms of any liquidity facility the issuer has used or expects it may use.

Information Regarding Availability of Federal, State and Local Aid.

A description of available federal, state or local aid the issuer has sought or is planning to seek and the anticipated timing of such aid. In addition, if the municipal issuer has obtained any such aid, it should disclose the nature, amount, and other material terms of the aid if it materially affects or reasonably likely will materially affect its operational or financial condition.

Reports Prepared for Other Governmental Purposes.

Municipal issuers routinely prepare reports for governance purposes that may be significant sources of current information. As front-line responders, these reports could provide powerful insight into local, regional, and sector-specific strategies to fight and recover from COVID-19. Accordingly, municipal issuers should consider making these reports more readily accessible to investors. [As noted previously in the Statement, “For various legal and other reasons, ensuring that disclosure of this type is (1) consistent across all contexts, regardless of the purpose and (2) kept confidential until disclosed and, when disclosed, disclosed broadly, is extremely important.”

4 Application of Antifraud Provisions to Public Statements of Issuers and Obligated Persons of Municipal Securities in the Secondary Market: Staff Legal Bulletin No. 21 (OMS) (Feb. 7, 2020), available at: <https://www.sec.gov/municipal/application-antifraud-provisions-staff-legal-bulletin-21>.

5 Id.

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