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SEC Urges Disclosure of COVID-19 Impact in the Municipal Market: Orrick

On May 4, 2020, Securities and Exchange Commission Chairman Jay Clayton and Director of the Office of Municipal Securities Rebecca Olsen issued a statement encouraging municipal securities issuers and obligors (each referred to herein as "issuer(s)") to provide robust, timely and accurate disclosures, in light of the effects of and uncertainties created by COVID-19. This statement echoes a statement issued on April 8 by the SEC Chairman and the Director of the Division of Corporation Finance regarding disclosures by public companies in light of the COVID-19 pandemic, and encourages a similar approach to the provision of current and, to the extent practicable, forward-looking disclosure as outlined in the corporate issuer disclosure statement.

WHAT DOES THIS MEAN FOR ISSUERS IN THE MUNICIPAL MARKET?
As most issuers in the municipal market only file annual reports and notice of specifically listed events, and COVID-19 on its own is not a listed event under Rule 15c2-12 1, the SEC has urged issuers to make additional, voluntary disclosures concerning both the current and projected impacts of COVID-19. Issuers that plan on being in the market or that are filing annual reports, quarterly reports or event notices (or the next time a required filing is due) should disclose the impact of COVID-19 on their financial and operating condition in offering documents or required filings. All other issuers should consider (i) providing voluntary disclosure on the current and reasonably anticipated future impact of COVID-19 on their financial condition and operating results and (ii) the risks associated with providing such voluntary disclosure. However, issuers should note that there is no requirement to make such a voluntary disclosure. The SEC does not have the power to require issuers to make this voluntary disclosure.

To date, issuers have made several thousand filings on EMMA concerning the effects of COVID-19. The MSRB publishes a list of these filings weekly, so issuers can review other filings and compare what other entities similar to themselves have done.

If an issuer decides to make a voluntary disclosure, the disclosure can either be posted on EMMA or posted on the issuer's website. If the information is posted in both places, the same information should be posted in each place. Any information posted must be consistent with any other information in the public domain, such as reports made to public officials or public bodies.

SUMMARY OF SEC STATEMENT
The municipal disclosure statement requests issuers to provide investors with "as much information about their current financial and operating condition as is reasonably practicable" and encourages issuers to make "voluntary, unaudited and non-routine disclosures regarding current financial status and operating conditions." The statement emphasizes the "need for timely financial information" and notes that due to the unpredictable nature of the health crisis and its impact in today's markets, the practice of providing historical financial information in an annual information filing may not be enough for investors to make assessments of an issuer's current and expected financial condition in order to make an informed investment decision. The statement also encourages issuers to provide forward-looking information on the potential impact of COVID-19 on their financial and operating

condition. Regarding timing, the statement encourages issuers to include these disclosures in disclosure for bond offerings or required filings, and also to consider providing voluntary disclosure.

The statement acknowledges that the issue of liability for voluntary or expanded required disclosures is often raised, and lists some factors that weigh in favor of making those disclosures in light of the concern of potential liability:

- The statement notes that accompanying these disclosures with "meaningful cautionary language – including, 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—will not only improve the quality of the disclosure but also will reduce legal and other risks."
- Issuers may already be required to disclose similar information to other parties in connection with government programs or in the pursuit of funding and disclosure should be consistent and reach all potential investors when appropriate.
- According to the statement, the Chairman and the Director "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 notes that "[w]hile the safe harbors for forward looking statements that are available to certain corporate issuers are not available to issuers of municipal securities, we believe that a municipal issuer's approach to forward-looking disclosures should be informed by the judicially developed "bespeaks caution" doctrine, which is discussed below.

CONSIDERATIONS WHEN DRAFTING COVID-19 DISCLOSURE

An issuer's disclosure about the impacts of COVID-19 should not merely recite the history of COVID-19 related actions it has taken. Rather, its disclosure should address the myriad potential effects of COVID-19 on the operations and finances of the issuer as an entity and on the issuer's securities.

In addition to any historical results that may be required for a particular reporting period, the disclosure should address the current condition of the issuer in light of the COVID-19 pandemic, and issuers should consider whether to include future projections regarding its financial and operating results as the SEC is urging.

Considerations for Disclosure of Current Conditions. Disclosing the current condition of the issuer is based on known and verifiable factual information and is important, especially if its current condition differs from historical results. Issuers should consult with legal counsel but some items to address are:

- How have its operations been affected? Have operations ceased or are they limited?
- How have revenues, expenses and investments been affected?
- Can the issuer make timely debt service payments and does it have enough resources to fund essential operations?
- Have any programs been instituted to reduce expenses and address any unbudgeted costs? (e.g. labor or salary reductions)
- Has the issuer incurred new debt?
- Has the issuer obtained new liquidity facilities or drawn on existing liquidity facilities?
- Has the issuer received any governmental funding or does it plan to seek aid and if so what type and amount and are there any unique terms or conditions?
- Is the issuer a defendant in any litigation related to COVID-19?

Considerations for Disclosure of Projections. In addition to disclosing the past and current state of

the issuer, the SEC has encouraged issuers to assess the future impact that COVID-19 will have on their financial and operating condition by using forward-looking statements and projections. Unlike the corporate market, there is no safe harbor for municipal securities for forward-looking statements. Rule 10b-52 liability still applies to any forward-looking statements or projections.

The SEC points out in its municipal disclosure statement that forward-looking statements should be informed by the "bespeaks caution" doctrine which has been created by a series of federal Circuit Court decisions. This doctrine says that a forward-looking statement accompanied by sufficient cautionary language is not actionable because a reasonable investor could not have found the statement materially misleading. However, issuers should be aware of the enforcement and litigation risks associated with such statements, especially in this evolving and uncertain environment. For that reason it is important to internally vet all projections and assumptions with experts, legal counsel and other advisers, as well as include all assumptions and appropriate disclaimers in such disclosure. This will be critical in order to mitigate any litigation or enforcement risk should projections materially differ from actual results.

REMINDER
As with any communication by an issuer to the market, Rule 10b-5 liability applies to any issuer statements regarding the effects of COVID-19, whether it be in an offering document, annual or quarterly filing, event notice, voluntary event notice, public statement (for example statements made in connection with presenting budgets for upcoming fiscal years) or investor website. Issuers should consult with legal counsel and other advisors when making any disclosures or other public statements about the effects of COVID-19 on the issuer and its securities.

It is important to assess whether your disclosure is material and complete. And it is imperative that any forward-looking statements or projections contain the underlying assumptions and necessary disclaimers.

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1 SEC Rule 15c2-12, 17 C.F.R. § 240.15c2-12 (2020).
2 SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2020).

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