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SEC Discussion of Secondary Market Municipal Securities Disclosure Practices.

Spotlight on Transparency: A Discussion of Secondary Market Municipal Securities Disclosure Practices

Tuesday, June 16, 2020

Opening Statements & Introduction

In his opening remarks, Securities and Exchange Commission (SEC) Chairman Jay Clayton summarized the notable changes in the municipal securities market since the last conference held by the Office of Municipal Securities, specifically referencing the increases in new issuances, retail ownership of municipal securities, and municipal inflows into managed products. He discussed the impact of the COVID-19 pandemic on the municipal securities market before announcing that in light of market conditions and to facilitate timely and efficient access by smaller municipal issuers to capital, the SEC decided to issue an order providing temporary conditional relief to municipal advisors from the potential application of broker-dealer registration requirements in connection with certain direct placement of municipal securities until December 31, 2020. Clayton noted that the intent of this relief is to assist smaller municipal issuers and the relief is only available in connection with a direct placement in the aggregate principal amount of $20 million or less. Clayton then turned to the importance of this conference, stating that the topic of secondary market disclosure practices is more important than ever given the recent period of economic uncertainty. He referenced the May joint statement issued in conjunction with Rebecca Olsen, Director of the Office of Municipal Securities, which recognized the effects and uncertainties created by COVID-19 and highlighted the importance of municipal issuers providing both current financial and operating status information in times of increased uncertainty. Clayton continued that the importance of disclosure was also recently highlighted by the Office of Municipal Securities in a Staff Legal Bulletin summarizing the staff's views on the application of the antifraud provisions to statements made by municipal issuers in the secondary market. Clayton concluded with a discussion of the two disclosure-related recommendations put forth by the Fixed Income Market Structure Advisory Committee (FIMSAC) at their February meeting and noted that the Office of Municipal Securities is currently considering such recommendations.

In her opening statement, Commissioner Hester Peirce said that the dislocations in the municipal markets over the past several months underscore the importance of disclosure. She emphasized that there is an increased need for investors to be granted sufficient access to transparency about pricing and underlying fundamentals. She concluded by reaffirming the importance of good disclosure practices in providing investor protection and facilitating capital formation by municipal issuers in both normal and stressed markets.

In his opening statement, Commissioner Elad Roisman noted that he is interested in exploring what lessons can be learned from this recent period of uncertainty in more broadly considering ways to improve the timeliness and quality of secondary market disclosures. He emphasized that the SEC should continue to pursue policies related to transparency that support the continued evolution of the municipal securities markets to ensure fair access for all investors. Roisman said that in this uncertain environment, municipal issuers could benefit from further understanding the type of information they should be disclosing to the market and when they should be disclosing that information.

In her opening statement, Commissioner Allison Herren Lee noted the benefit of the temporary conditional relief for municipal advisors, specifically referencing her support for the scope being narrower than the original proposed order.

Rebecca Olsen, Director, SEC Office of Municipal Securities, provided a summary of the agenda and noted the timeliness of a discussion regarding secondary market disclosure practices. She stated that the goals of these discussions are to: 1) gather information about disclosure practices in the secondary market; 2) discuss what, if any, changes in disclosure practices are needed to meet the needs of investors; 3) consider whether there are any opportunities for regulatory improvements to facilitate such changes in disclosure practice. She concluded that market participant feedback is essential in assisting the SEC in following developments in the municipal securities market and evaluating whether the regulatory framework is appropriate.

Discussion: Voluntary Disclosure Practices in the Secondary Market

- Moderator: Adam Wendell, Senior Special Counsel, Office of Municipal Securities, SEC
- Jennifer Brown, Director of Finance, City of Sugar Land, Texas
- James McIntyre, Director of Capital Markets, New York State Homes and Community Renewal
- Chris Meister, Executive Director, Illinois Finance Authority
- Stacey Lewis, Partner, Pacifica Law Group

Wendell kicked off the discussion asking for the panelists' perspectives on the various types of disclosures and the utility of how such disclosures are provided. Of note, McIntyre emphasized that his organization focuses on what is material, what investors need, and what the issuers can reasonably provide. He continued that in response to the COVID-19 economic environment, he took a "wait and see" approach in terms of portfolio impact and that he is now preparing current data, that is also most useful, to be released as voluntary disclosure on EMMA. Brown then provided her view, specifically noting that they provide a financial transparency section on their website where they post a monthly unaudited financial report. She said that she has also placed an emphasis on educating city residents to help them better understand municipal bonds and why they are being issued. Meister supplied the perspective of a state-based conduit issuer, highlighting their unique role and noting that they have observed an uptick in voluntary disclosures.

In response to a question regarding the benefits of increased disclosures, various panelists noted the importance of issuers coming together develop best practices and disclosing commonalities as opposed to focusing on differences. McIntyre and Meister specifically noted that they have viewed tangible benefits, such as additional investors and pricing benefits, from this best practice approach. Lewis said that from a legal perspective, many public entities have increased transparency as a general principal and that increased disclosure decreases the likelihood that one errant statement is viewed as material.

In conclusion, the panelists highlighted the importance of voluntarily putting forth as much information as possible, while ensuring that such information is relevant to investors, to increase transparency without overburdening staff.

Discussion: Perspectives from the Buy Side

- Moderator: Ahmed Abonamah, Deputy Director, Office of Municipal Securities, SEC
- Nicole Byrd, Senior Investment Professional, Nationwide Mutual Insurance
- Sandy Pae Goldstein, Director, Fundamental Credit Opportunities
- Hugh McGuirk, Portfolio Manager, T.Rowe Price
- Maryann Santos, Business Operations Manager, Capital One Public Funding, LLC

Abonamah solicited responses from the panelists as to their views on the May 5th Clayton/Olsen joint statement that encouraged issuers to provide current and forward-looking information. All praised the statement and noted its utility in helping them better analyze the pricing of bonds due to the subsequent increase in voluntary disclosure. Santos said that increased disclosure has granted critical insight to the true impact of COVID-19, specifically regarding how issuers are cutting their expenses and the impact on revenue streams. McGuirk stated that in essence, increased disclosure, both in terms of frequency and variety of information, makes for significantly more attractive investments.

Regarding the actual impact of COVID-related disclosure on business decisions (buy, sell or hold), Byrd asserted that weaker credits in the portfolio with weaker disclosures are the first to be offloaded. She continued that in the secondary market, if she is unable to adequately evaluate an offering, she will simply pass and that she would much prefer a weaker credit with enhanced disclosure as opposed to a higher credit with weaker disclosure. McGuirk echoed this sentiment and added that with such revenue shortfalls as can be observed as a result of the COVID-19 pandemic, if adequate disclosure is not present, he will pass on the investment.

In discussing the February 7th Office of Municipal Securities' Staff Legal Bulletin, Byrd and Goldstein stated that they did not observe significant movement in the market itself in terms of disclosure. Goldstein added that issuers must continue to receive the message that there is a need for timely and consistent disclosures. Turning more generally to ongoing disclosures writ large, McGuirk noted that unaudited financial disclosures are tremendously beneficial as long as they are not intended to deceive. All panelists agreed that the primary source of information is compiled through EMMA, as well as various investor websites, and added that there is a clear desire for information more frequent than the annual disclosure. Santos specifically outlined that increased insight as to why certain trends are occurring would go a long way in assisting the investing public. McGuirk echoed this sentiment and called for increased context and justification for the information and numbers that are being put forward.

In response to a question from Abonamah concerning the asymmetry of disclosure that exists between public bondholders and private lenders, Byrd noted that in her estimation, it is very important to know the terms and conditions of any agreement that issuers enter into. Santos added that she has observed a trend that issuers do not want to disclose anything to direct lenders that they are not also disclosing to the public market.

Discussion: Secondary Market Disclosure Hot Topics

- Moderator: Rebecca Olsen, Director, Office of Municipal Securities, SEC
- Patrick Brett, Managing Director, Citigroup
- Dan Deaton, Partner, Nixon Peabody LLP
- Mark Kim, Executive Vice President and Chief Operating Officer, MSRB
- Lisa Washburn, Managing Director, Municipal Market Analytics, Inc.

The third discussion of the day began with Kim presenting this deck on continuing disclosures from the MSRB's perspective. Of note, Kim highlighted the significant increase in the number of event 15 disclosures over the last three months due to issuers increasingly turning to the private markets in the COVID-19 environment. He concluded that the MSRB has been monitoring, and will continue to monitor, the impact of COVID-19 on market participants and market function. Following this presentation, Washburn presented this deck and noted that the outlook for the higher education, student housing and retirement facilities sectors is somewhat bleak with additional challenges ahead. Washburn recommended the ability to search for COVID-19 related disclosures directly on EMMA as a way to improve transparency.

Deaton discussed the May 5th Clayton/Olsen joint statement and the February 7th Office of Municipal Securities' Staff Legal Bulletin, asserting that both items have worked well together to increase the overall sensitivity to investors in the current marketplace and their pressing need for information. He continued that the joint statement provided critical guidance, in a plain-English fashion, that allowed issuers to better understand they should be putting forth whatever information they could despite the uncertainty. Deaton stated that the public statement encouraged issuers to approach COVID-19 related disclosure from an iterative perspective. Regarding the staff legal bulletin, Deaton said that it encouraged issuers to take control of their "credit narrative." Deaton concluded that while the joint statement has been much more impactful compared to the staff legal bulletin, both have served to promote the critical importance of voluntary disclosures.

In addressing how to make disclosure agreements more uniform and predictable, Kim noted that the challenge for the MSRB is validating the continuing disclosure agreement (CDA) due date and dealing with the various submission errors when information is entered incorrectly on Form G-32. Deaton expressed that the current CDA regime can obstruct quality disclosure in two ways: 1) it does not permit multiple, and varied, kinds of data being released when it is ready due to the annual report being fixated on one date and 2) by being tied to financial and operating information in a final official statement, the process is overly mechanistic and prevents issuers from providing the most useful information in a timely manner.

Brett discussed the impact of the COVID-19 pandemic on the LIBOR transition. He that while LIBOR is present in the municipal securities market on both the debt and derivatives side, the more complex issue in need of resolution is the derivatives problem due to the duration of exposures and the fact that municipal bonds tend to go out much longer. He continued that there is awareness of the issue amongst issuers but there are other things that need to happen before issuers can truly move towards the end of this process. Brett said that in terms of a path forward, the adoption of the ISDA protocol is most likely easier from an execution perspective when compared to bilaterally negotiating an exit. On this topic, he concluded that there will be a significant amount of market development over the next 18 months. Deaton concurred that issuers are aware that LIBOR is being phased out but that there are many questions that still need to be resolved.

The final question of the conference addressed the Municipal Liquidity Facility. Brett stated that pricing of the facility has been disappointing for many issuers but that investors assert that there is a psychological benefit to having this backstop intended to stop cash flow issues from snowballing into credit issues.

For more information on this event, please click here.