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The Financial Data Transparency Act: Orrick

The Financial Data Transparency Act of 2022 (Act) will change the way issuers and obligors of municipal securities report required disclosure information on the Municipal Securities Rulemaking Board's Electronic Municipal Market Access website (EMMA). In short, the Act requires the Securities and Exchange Commission (SEC)[1] to create organizational standards for information reported by issuers and obligors on EMMA. The goal of the Act is to provide users with an easier way to view, access, and explore the contextual information of the underlying data.

Here's what you need to know:

What Happened?

The Act was passed into law on December 23, 2022. The Act directs certain regulatory agencies (including the SEC) to jointly issue proposed rules for public comment that establish new data reporting standards within 18 months of enactment of the Act. These new SEC rules will impact entities that post on EMMA. Proponents of the Act believe it will make the information collected and made publicly available by regulatory agencies easier to access, analyze and compare by requiring data to be posted in a machine-readable format, similar to the requirements for the information posted to the Electronic Data Gathering, Analysis and Retrieval system (EDGAR) by publicly traded companies, mutual funds and other regulated entities. The Act only changes how information is submitted; it does not contain any new disclosure requirements.

What Will the Law Change for Affected Issuers and Obligors?

The Act will require that information posted on EMMA be structured so that it is fully searchable and consistently identifiable by machine-readable technologies through the use of identifier codes or tags (i.e., structured data). Structured data allows the reader to access more granular information about the data presented, such as the accounting codifications and guidance associated with the information.[2] Additionally, the Act requires information to be made available in an open data format that allows for digital access and bulk downloads with no restrictions.

It is anticipated that the SEC will require data collection in a structured format such as the extendible business reporting language (or XBRL) format, with each piece of data being tagged/barcoded to enable simpler comparisons between sets of data. XBRL is an open standard, commercially available software language that is nonproprietary and royalty free. Benefits of XBRL are that it can identify what is and is not reported and any data quality errors.[3] XBRL can also compare results across data sets and generate time series charting and benchmarking.[4] The SEC first implemented structured data requirements in 2009, and currently, both the SEC and the Federal Energy Regulatory Commission require information reported by their regulated entities to be in the Inline XBRL format, which allows readers to download information directly into spreadsheets for comparison and analysis purposes.

To implement the structured data standard, the SEC must develop taxonomies or classifications to create standard tags for the reporting of information. Each reporting entity must translate data from

its accounting system into a format consistent with the classifications developed by the SEC. Once the initial translation is complete, if an entity's financial statements include unique line items, it may create an "extension" to a standard tag to modify the nomenclature so that it corresponds to its existing unique line items.[5] For example, if an entity refers to "net revenues" as "operating revenues," it may extend the "net revenues" tag to refer instead to "operating revenues." [6] Although extensions provide entity-specific information that may facilitate meaningful analysis, extensions diminish the comparability of data across entities, which is one of the main purposes of structured data.

Who Does the Law Most Affect?

The Act, once implemented after the rules are finalized, may significantly alter the way issuers and obligors format the information posted to EMMA. Specifically, the translation of financial information into a format consistent with the classifications developed by the SEC may be different from the format currently required by the Government Accounting Standards Board (GASB), Financial Accounting Standards Board (FASB) and Generally Accounting Standards Board (GAAP). The National League of Cities[7] and the Government Finance Officers Association[8] (GFOA) recently raised concerns about the new reporting requirements, including cost concerns and concerns that information unique to a specific type of issuer such as a state, city, public utility provider or hospital will be lost in the standardization of information.

Inherent with the new standards will be the increased costs of preparing, reviewing and validating that the information presented in the new form is an accurate representation of the underlying data. The GFOA predicted that the transition to standardized reporting categories will be costly, and the "unfunded mandate [will] require extensive staff time along with the need for consulting resources and potentially risky updates to governmental financial systems." [9] In 2017, the CFA Institute conducted a study of companies required to report in a structured data format and found that although implementation of structured data was initially costly, over time larger companies reduced the number of outsourcing services used to create their XBRL filings as they became more confident in preparing and reviewing their reports in-house.[10] However, smaller companies found the costs of the structured data reporting requirement as a consistent burden given their limited resources.[11]

To minimize the burden of implementation of the structured data standards, the Act directs the SEC to consult with market participants, scale the data standards in order to reduce any unjustified burden on smaller entities and minimize disruptive changes to the affected entities. These requirements were added to the final version of the Act to address concerns from municipal market participants about the increased costs of implementing the structured data format, including increased capital costs for the purchase of software, increased operating expenses for entities that contract with a third-party vendor to perform data tagging services and increased personnel costs for the preparation and review of the data. In the municipal securities market, the Act applies only to issuers and obligors that are required to file continuing disclosure reports on EMMA. As such, it remains to be seen whether the increased costs associated with implementing the new rules will create a barrier to entry in the municipal market for smaller governmental issuers and nonprofit organizations who may choose to avoid the new requirements by opting for private placement offerings that are exempt from such continuing disclosure obligations.

What Happens Next?

The SEC will work with the other regulating entities named in the Act to draft rules for public comment within the next 18 months. The Act does not mandate a specific time period for public comments to be received and reviewed by the regulated entities. Once the public comment period

ends and the final rules are issued, issuers and obligors that are required to post on EMMA will have two years before they must comply. This means that the earliest possible date for when affected entities will need to transform their EMMA filings is over 3 ½ years away (and likely much longer given that time will be needed for public comments and the release of the final rules). It remains to be seen what consequences might apply to municipal issuers and obligors that fail to report in the new machine-readable, structured data format when required, although it is expected that the new rules will likely explain the effect of non-compliance with the reporting requirements. In the corporate world, for public companies already subject to structured data requirements, non-compliance means the subject company is non-compliant with statutory reporting requirements and is deemed to not have adequate public information available for purposes of Rule 144 of the Securities Act of 1933.

Affected entities should get involved in the design of the data standards by participating in the public comment process with the SEC. To minimize implementation costs, aligning the new standards with current reporting requirements under GASB, FASB or GAAP is crucial. Additionally, as the national data standards are promulgated, local issuers should contact state agencies to work towards synchronizing any state reporting requirements with the new national reporting requirements. Issuers and obligors of municipal securities may also consider earmarking resources to implement the requirements of the Act as the implementation date approaches.

[1] The Act as first passed by the House of Representative originally provided for the MSRB to set and implement the new rules. However, municipal bond issuers expressed their concerns about expanding the MSRB's current authority over state and local governments as bond issuers in contravention of the Tower Amendment. Under the Act as passed, the SEC, which is subject to congressional oversight, will design and implement the new rules for the municipal market.

[2] Caroline A. Crenshaw, Commissioner, U.S. Sec. and Exch. Comm'n, The Lessons of Structured Data, November 10, 2021, located at <https://www.sec.gov/news/speech/crenshaw-lessons-structured-data-111021>.

[3] Id.

[4] Id.

[5] U.S. Sec. and Exch. Comm'n, Interactive Data for Financial Reporting, <https://www.sec.gov/corpfin/infosmallbussecginteractivedata-secg> (last visited Dec. 16, 2022).

[6] Id.

[7] Michael Gleeson, Proposed Legislation Includes Costly Unfunded Mandates for Local Governments, National League of Cities, <https://www.nlc.org/article/2022/12/15/what-you-need-to-know-about-the-financial-data-transparency-act/>, (last updated Dec. 15, 2022).

[8] New Financial Reporting Requirements for Governments Proposed in U.S. Senate: A Costly and Burdensome Unfunded Mandate, Government Finance Officers Association, <https://www.gfoa.org/new-financial-reporting-requirements-proposed> (last visited Dec. 19, 2022).

[9] Id.

[10] Mohini Singh, ACA, The Cost of Structured Data: Myth vs. Reality, CFA Institute, <https://us.aicpa.org/content/dam/aicpa>

/interestareas/frc/accountingfinancialreporting/xbrl/downloadabledocuments/cfa-institute-the-c-st-of-structured-data.pdf, (last visited Dec. 16, 2022).

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