



COVID-19'S IMPACT ON LOCAL GOVERNMENT FINANCES AND DISCLOSURE IN A COVID-19 WORLD

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“No local government could have predicted or adequately prepared for a public health and fiscal crisis like COVID-19.”

-THE BOND BUYER, OCTOBER 9, 2020

Municipal Market Oversight

The municipal securities market is primarily regulated by:

- Securities and Exchange Commission (“SEC”)
- Municipal Securities Rulemaking Board (“MSRB”)

Regulations are enforced by:

- SEC
- FINRA
- Federal Bank Regulators

Regulated entities include:

- Broker Dealers
- Bank Dealers
- Municipal Advisors

Bond attorneys are not regulated under current securities laws

Issuers of municipal securities are not regulated, but directly and indirectly, are subject to a number of requirements.

A Brief History of SEC Regulation of Municipal Securities

Securities Act of 1933

Securities Exchange Act of 1934

- 1975 Amendments est. MSRB to regulate broker/dealers
- Tower Amendment – prohibits regulation of municipal disclosure or prospectuses prior to sale of securities

Basic Objectives:

1. Requires disclosure of material information about securities to allow investors to make informed decisions.
2. Prohibits misrepresentations or other fraudulent conduct in connection with the purchase and sale of securities.

Municipal securities are exempt from the registration requirements of the Acts but not the anti-fraud provisions

Securities and Exchange Commission (SEC) Municipal Market Disclosure

Anti-Fraud Provisions - Rule 10b-5 of Securities Exchange Act of 1934/Section 17(a) of Securities Act of 1933

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Securities and Exchange Commission (SEC) Municipal Market Disclosure

Materiality

➤ What is “Material”?

- ✓ Facts and circumstances analysis
- ✓ What a reasonable investor would (not might) consider important in making an investment decision
- ✓ Information is considered material if there is a substantial likelihood that the omitted information would have been viewed by a reasonable investor as having significantly altered the total mix of the information made available
- ✓ Not just limited to facts; applies to:
 - Forecasts, projections (but can limit liability with forward-looking statement disclosure)
 - Statements that reveal clearly false optimism
 - Financial evaluations which require the exercise of considerable judgment

Securities and Exchange Commission (SEC) Municipal Market Disclosure

Standards of Liability Under Rule 10b-5 of Securities Exchange Act of 1934/Section 17(a) of Securities Act of 1933

- Rule 10b-5 requires “scienter”
 - Mental state embracing an intent to deceive
 - Acting knowingly, intentionally or recklessly

- Section 17(a) requires negligence
 - ✓ Failure to use reasonable care

Securities and Exchange Commission (SEC) Municipal Market Disclosure

Rule 15c2-12

Indirectly obligates government bond issuers to meet specific continuing disclosures standards

1. Primary Market Disclosures through Offering Statements
2. Secondary Market Disclosures
3. Can have liability for Rule 10b-5 violations or Section 17(a) violations in connection with continuing disclosure filings

COVID-19 DISCLOSURE

- Included in almost every primary offering document
- Has evolved since the first disclosures in offering statements
- Covers timeline/executive branch actions, local restrictions
- School closures/re-openings, FDOE actions, hold-harmless/potential loss of funding
- Instructional models
- General economic conditions
- CARES Act funds
- State budget amendments/special session
- Uncertainty regarding long-term impact on school district finances, enrollment, tax collections/timing, etc.
- Some issuers (such as the State of Florida) have posted voluntary disclosures on EMMA, or their website

COVID-19 DISCLOSURE

- Uncertainty is not something investors like;
 - Lack of information can adversely impact appetite for issuer's debt
- Quality and timing of disclosure
- Even with comprehensive disclosure, investors still have many questions on COVID-19 impacts on Florida school districts:
 - Impact of COVID-19 on property tax collections
 - Liquidity levels to deal with any unforeseen drops in revenue or delayed receipt of revenues
 - Other borrowable resources
 - Impact of State pro-ration or mid-year State budget cuts
- Frequently, the answer to these types of questions is unknown
 - Still planning for the unknown; release details regarding steps being taken to address unknown
 - Credit risk vs governance

Voluntary Disclosure

- Has become more frequent during this COVID-19 pandemic
- No duty to communicate to the market outside of primary offerings and continuing disclosure required filings
 - When and why should you release voluntary disclosures?
- No legal requirement to provide interim data (other than what is agreed to by an issuer in a continuing disclosure agreement)
- Should a “subsequent events”-type note be included in CAFRs/Audits, even if they pre-date pandemic?
 - Best practice answer is “yes”; in order to put information in a correct light so it is not potentially misleading;
 - Could accomplish this with a cover letter or statement to the effect that due to the pandemic, historical information is not necessarily an indication of future results;

Voluntary Disclosure

- May 2020 – SEC Office of Municipal Securities released a public statement regarding the importance of municipal disclosure
 - Requested municipal issuers to provide investors with information about current financial and operating data as is reasonably practicable in the form of voluntary disclosures on EMMA
 - Observed that providing historic financial information in annual filings may not enable investors to make informed assessments of the issuer’s current and expected future financial condition
 - Recognized that any voluntary disclosures would not have the benefit of an audit process and would likely be based on estimates and assumptions, as well as projections regarding future circumstances

Voluntary Disclosure

- Also encouraged use of forward-looking information regarding potential future impact of COVID-19 on issuer's financial and operating conditions
- Releasing voluntary disclosure does not obligate issuer to continue to provide updates
- Examples of information an issuer could provide:
 - Current operational and financial status, including decreases in revenues and delays in collection of revenues
 - How COVID-19 has impacted their operational and financial condition, including un-budgeted costs
 - How their operational and financial condition may change as efforts to fight the spread of COVID-19 evolve
 - Information regarding sources of liquidity
 - Information regarding availability of Federal, State and local aid
 - Reports prepared for other governmental purposes

Voluntary Disclosure

- Any voluntary disclosure should be accompanied by cautionary language
 - Description of relevant facts or assumptions affecting the reasonableness of the information provided
 - Description that certain information may be incomplete or unknown
 - Process used by the issuer to produce the information (audited vs. unaudited)
 - Be consistent with other similar information provided to other parties, i.e., Federal govt
 - SEC would not expect to second-guess good faith attempts to provide adequately framed current and/or forward looking information
 - “Besppeaks caution” doctrine
 - Estimates of economic projections, estimates of future performance and similar forward looking statements in a disclosure document are not actionable when meaningful cautionary language elsewhere in the document adequately discloses the risk involved

Selective Disclosure to Investors

Selective Disclosure – when certain individual investors, or certain classes of investors, are given access to information, but other investors are not.

- Examples in primary offerings can include road shows, investor conferences and one-on-one investor calls or meetings.
- Not problematic per se, unless information conveyed to select investors is **non-public** and **material**

Recall - What is Material?

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Selective Disclosure to Investors

Non-public:

- Investor direct contact:
 - Planning on refunding debt
 - Not disclosed or generally available to the public
 - In minutes
 - Agendas
 - Large investor has rights to review books and records for a specific issuer
- Spreadsheet that CFO has?
 - Public records request
 - Is that non-public?

Selective Disclosure to Investors

- Selective disclosure of material non-public information is more likely when presentation of information is not consistent from one communication to another
 - For instance, investor calls with Q&A sessions place issuer at risk of discussing material non-public info
- Selective disclosure can occur in the secondary market too
 - Official Statement is complete and accurate
 - Provide new material non-public information to certain investors which is not required under the applicable continuing disclosure agreement
 - Impedes market fairness and therefore investor confidence in the market

Regulation FD

- Applies to corporate securities, not municipal securities
- Regulation provides that when an issuer, or person acting on their behalf, discloses material non-public information to certain persons (i.e., brokers, dealers, investment advisors, investment companies) it must publicly disclose that information
 - If disclosure was intentional, public disclosure must be simultaneous
 - If disclosure was unintentional, public disclosure must occur promptly
- While SEC can't regulate municipal securities disclosure directly, the anti-fraud provisions of the '33 and '34 Acts do apply to municipal issuers
 - If selective disclosure of material non-public information was not in the OS, documents have likely have a material omission or material misstatement of facts
 - If an individual makes selective disclosure in breach of a duty to the issuer, and the recipient of that disclosure purchases or sells the issuer's securities on the basis of such information, it may constitute insider trading

Best Practices to Avoid Selective Disclosure

- POS and OS should contain all material information
 - Issuers are ultimately responsible for disclosure
 - View events in your district through a potential investor's eyes – would a reasonable investor want to know such information when making an investment decision about your securities?
 - Constant communication with your disclosure counsel throughout transaction
 - Have disclosure counsel review investor presentations, road shows, etc.
 - Present information between POS/investor presentations consistently
 - If you receive a request for material non-public information, issuers can choose to provide to the market through an EMMA voluntary disclosure or supplement to the POS.

Best Practices to Avoid Selective Disclosure

- Filing of Notice on EMMA prior undertaking a cash defeasance of bonds
 - File after approval by governing body
 - Allows information to be known to broader market
 - Facilitate proper pricing of to-be refunded bonds

COVID-19 RAISED INVESTOR CONCERNS ABOUT OTHER CHALLENGES AS WELL

- CLIMATE CHANGE
- NATURAL DISASTERS
- CYBERSECURITY
- CIVIL UNREST



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Cybersecurity Disclosure

A major cyber attack can impede or shut down the ability of a local government to perform its essential functions, and result in financial or other losses

- Current cybersecurity policies or protocols
- Internal or external IT/security staffing
- Threat awareness/testing
- Recent cybersecurity incidents/attacks
 - Impact of such on operations and finances
- Cybersecurity insurance
 - Whether to disclose that you have it or not?

Natural Disasters

A natural disaster can damage educational facilities, displace students/staff and result in financial losses

- Description that State of Florida is subject to hurricane activity
- Recent impacts of hurricanes on the district
- Property and casualty insurance coverage and deductibles
- FEMA reimbursement
- Stafford Act Letter from OIR

Climate Change

Rising sea levels, warming of oceans may have a significant impact on Florida, particularly coastal counties/districts, in the future

- Description of any intergovernmental coordination regarding climate change
- Potential impact to district facilities
- Potential loss of tax base and/or student enrollment