DEBT LINE *Off Prints*

California Debt And Investment Advisory Commission
Philip Angelides, Chair

Volume 20, No. 6 June 2001

SURVEY OF STATE, COUNTY, AND CITY WEB SITES: USE OF ELECTRONIC DISCLOSURE

Frank Moore
CDIAC Policy Research Unit

Last year, the Securities and Exchange Commission (SEC) released an interpretation on the use of electronic media by issuers (File No. S7-11-00). The release addressed the use of electronic media in three ways: 1) it updated previous guidance on the use of electronic media to deliver documents under federal securities law, 2) it outlined basic legal principles that issuers and market intermediaries should consider in conducting online offerings, and 3) it discussed an issuer's liability for web site content.

With respect to web site content in particular, the interpretation stated that hyperlinked information in official statements is considered part of the official statement and that paper and electronic versions of the official statement should be identical. Further, the interpretation stated that historical information posted on a web site may be considered to be "republished" every time that it is accessed, thus giving rise to potential anti-fraud liability for outdated information.

For some, this release resulted in more questions than answers. Issuers, bond lawyers, and analysts continue to warn SEC that failure to provide written guidance clarifying statements made in the release is discouraging issuers from posting official statements and other disclosures on web sites. For instance, the capital finance director of Wisconsin stated that the republication issue has caused him to question posting official statements on the state's web site. As a result, the state has halted its practice of providing a direct link from official statements posted on its web site to other disclosure documents such as annual financial reports.

This article looks at the use of issuer web sites that provide disclosure to investors by surveying state, county, and city web sites. It also examines how closely these web sites follow SEC disclosure requirements and looks at some of the pros and cons of the ways disclosure information is presented.

Survey Design

CDIAC surveyed the California State Treasurer's Office (STO) web site as well as the web sites of 51 of the State's 58 counties and the ten largest cities in terms of population. According to the California State Association of Counties, 51 counties have operating web sites. All ten of the state's largest cities have working web sites. Although there are hundreds, if not thousands, of issuers of municipal debt in the State of California, this sample was chosen to simplify this effort while still giving a good representation of different types of issuers. Very few issuers surveyed had continuing disclosure sections on their web sites. Consequently, the survey attempted to find evidence of electronic disclosure by looking for the following on issuer web sites:

- Initial Disclosure (i.e., preliminary official statement (POS) and final official statement (OS))

- Continuing Disclosure (i.e., annual financial information and material events)

General Disclosure

SEC Rules 10b-5 and 15c2-12 provide the general basis for municipal securities disclosure. Rule 10b-5 makes it unlawful for a person to make untrue statements or omit material facts in connection with the purchase or sale of a security. Rule 15c2-12 requires two forms of disclosure – initial (or primary) and continuing (or secondary) – unless an issue is exempted, as defined.

Initial Disclosure

Initial disclosure requires the underwriter to obtain the preliminary official statement (POS) and final official statement (OS) from an issuer. In turn, the underwriter is required to send the POS to any potential customer until the OS is available. The OS is required to be sent to customers until ninety days after the underwriting period or, if the OS is available from a nationally recognized municipal securities information repository (NRMSIR), twenty-five days after the underwriting period.

Continuing Disclosure

Continuing disclosure regulations require the underwriter to obtain a written agreement (the continuing disclosure agreement) from the issuer to provide certain information to each NRMSIR, state information depositories, or, in some cases, the Municipal Securities Rulemaking Board (MSRB). Information required to be provided to the market includes annual financial information or audited financial statements, material event notices (when applicable), and notices of failure to provide annual financial information (also when applicable).

There are eleven defined material events requiring disclosure, they include such major negative occurrences as principal and interest payment delinquencies, non-payment related defaults, unscheduled draws on debt service reserves or credit enhancements, and failure to provide annual financial information as required.

There are also a variety of other events, such as bond calls; defeasances; release, substitution, or sale of property securing repayment; and rating changes that are not necessarily negative events.

Material misstatements or omission in the POS, OS, annual financial information, or event notices may be the basis for claims of securities fraud under Rule 10b-5 and other federal or state securities laws. This could result in action taken by the SEC or private plaintiffs (bondholders or other investors) with substantial potential liability for issuers or other obligated persons.

- Other (more generally, anything on an issuer's web site can be considered electronic disclosure if it can be relied upon by investors in their decision-making processes)

State and local issuers can use the Internet to supplement the normal method of transmitting information to investors for initial and continuing disclosure.

State of California

A review of the STO web site found that the STO utilizes its site routinely to post POSs. When a final OS is published for an issue, STO takes the old POS off of its web site and eventually replaces it with a POS for a new financing. POSs are usually posted with the caveat that they are made available as public information and do not constitute offers to sell or solicitations of an offer to buy. The caveat goes on to say that potential investors should contact brokers if interested in purchasing bonds. The STO requires that hard copies of OSs be mailed to potential investors, so does not provide this document on its web site.

The STO web site also has the following continuing disclosure documents: audited General Purpose Financial Statements, the audited 2000 California Comprehensive Annual Financial Report (CAFR), and an Overview of the State Economy, Finances, Indebtedness, and Litigation (from the latest POS).

Counties

According to the latest available information from CDIAC's Debt Issuance Database, only one county did not issue debt last year. Of the 51 county web sites, 16 (31%) contain annual financial reports or statements. The majority of web sites that contain financial information have either the CAFRs, General Purpose Financial Statements, or Annual Financial Reports (most of these audited).

One major concern with the financial information presented is that half of the counties that provided financial information provided outdated information. If information that might be material to investors is provided on a web site, it is important to ensure that it is regularly updated with the time of the update noted so that an investor does not act on outdated information, especially if more current information exists. The SEC release stated that a press release, for instance, posted on an issuer's web site potentially has a longer life because it provides a record that can be accessed by investors at any time and upon which investors could rely when making an investment decision without independent verification (the "republishing" concept). Commentators to the SEC release suggest that if a statement is deemed to be republished, it may potentially give rise to liability under SEC Rule 10b-5 if that information is outdated.

Another concern with the financial information provided on county web sites is the posting of unaudited information. For example, one county posted three years of revenues and expenditures but didn't specify whether the information was audited. In another example, a county only provided a first quarter financial report, which, understandably, was unaudited. It is important to use audited information when available because audits quite often adjust interim revenues and expenditures and could conceivably reduce a county's bottom line. Nonetheless, if unaudited financial information is posted, it is important to label it as such.

Sacramento County, in particular, did a commendable job in the presentation of its financial data. Sacramento presented two years of CAFR's, a report entitled "Certain Financial, Economic, and Demographic Information," and a hyperlink disclaimer. The report gives additional important, non-financial information seldom covered in common financial statements. Also, the disclaimer states that the web site includes hyperlinks to other sites on the Internet that are neither controlled by, sponsored by, nor endorsed by the County of Sacramento. The disclaimer goes on to say that the county does not guarantee the accuracy of any links nor does it endorse any hyperlinked products. The SEC release stated that there may be less likelihood of confusion about whether an issuer has adopted hyperlinked information if the issuer ensures that access to the information is preceded by or accompanied by a clear and prominent statement from the issuer disclaiming responsibility for, or endorsement of, the information.

Alameda County's web site contains its latest CAFR and a prior year Annual Financial Information Statement, as well as a different disclaimer that informs investors that the county makes no assurance about the reliability of the information on the web site, that the most current information can be obtained by requesting an OS from the Municipal Securities Rulemaking Board (MSRB) or nationally recognized municipal securities information repository (NRMSIR), and that investors agree that they will not sue the county if the information turns out to be inaccurate. This assumes that there is a recent OS. If there has not been a recent financing, an OS would not contain up-to-date financial information.

A review of DPC Data Inc. (one of the four current NRMSIR's) material event notice information issued since the beginning of the calendar year by California counties found that there were twenty material events reported to this NRMSIR. The majority of these events were defeasances, bond calls, or other non-negative events. CDIAC found that these material event notices were not provided by the issuers on their web sites. Issuers should either provide material event notices on their web sites or direct investors to where this information can be obtained.

Cities

CDIAC surveyed the web sites for the ten largest cities in California in terms of population (according to the Department of Finance). Nine out of the 10 cities (90%) had web sites. Of these, one provided primary disclosure information to investors in the form of OSs. Eight of the nine (89%) had some form of financial information on their web sites. Most of these documents were audited. Of the nine, seven (78%) had reported material event notices to DPC Data Inc. since the beginning of the year. Most of these were bond calls, but one was a failure to provide financial information and another was a substitution of credit or liquidity providers. CDIAC found that cities were not providing material event notices on their web sites, although one claimed to provide the notices as news releases.

Conclusion

SEC regulations do not require issuers to provide electronic disclosure information directly to investors as part of either initial or continuing disclosure. Those municipalities that provide this information do so only as an elective service to the public. Only the STO provides POSs to the public through its web site as part of its basic disclosure process, and only one city posts OSs. For continuing disclosure, it appears that the only information that is regularly being provided to the public through electronic means are annual financial statements. CDIAC found that event notices and failure to provide financial information notices are not posted on most issuer web sites.

If municipalities go through the effort of putting disclosure information on their web sites, here are a few points they should consider to enhance their electronic disclosure efforts:

- Electronic disclosure provides a valuable tool for investor relations. Posting POSs and OSs can provide helpful information.
- Initial and continuing disclosure go hand-in-hand. If initial disclosure information is provided on an issuer's web site, continuing disclosure information also should be provided or the investor directed to where such information can be obtained.
- Consider the liability issues related to hyperlinks and consult legal counsels for ways to limit liability.
- Ensure that information is regularly updated and state the date when it was last updated.
- Use audited financial information if available. Otherwise, issuers should clearly label the information as unaudited.

This Offprint was previously published in DEBT LINE, a monthly publication of the California Debt and Investment Advisory Commission (CDIAC). CDIAC was created in 1981 to provide information, education, and technical assistance on public debt and investment to state and local public officials and public finance officers. DEBT LINE serves as a vehicle to reach CDIAC's constituents, providing news and information pertaining to the California municipal finance market. In addition to topical articles, DEBT LINE contains a listing of the proposed and final sales of public debt provided to CDIAC pursuant to Section 8855(g) of the California Government Code. Questions concerning the Commission should be directed to CDIAC at (916) 653-3269 or, by e-mail, at cdiac@treasurer.ca.gov. For a full listing of CDIAC publications, please visit our website at http://www.treasurer.ca.gov/stocda.htm.