CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION

DEBT LINE Off Prints

California Debt And Investment Advisory Commission
Philip Angelides, Chair

Volume 21, No. 1 January 2002

USAGE AND PERCEPTIONS OF ELECTRONIC DISCLOSURE: A SURVEY

Frank Moore
CDIAC Policy Research Unit

As a follow-up to a previous article on electronic disclosure, the California Debt and Investment Advisory Commission (CDIAC) recently mailed a survey to select cities and to all of the state's counties to gauge municipalities' usage and perceptions regarding electronic disclosure practices. This article gives a background on the electronic disclosure issues, discusses the methodology used in this survey, and presents the survey results. The article concludes with observations on the data analyzed. For example, both cities and counties, by an overwhelming majority, responded that they have not implemented electronic disclosure. For both cities and counties, technical issues were the leading hindrance to establishing electronic disclosure programs, while most municipalities did not consider regulatory issues to be a barrier to establishing these programs.

Background

In general, SEC Rule 15c2-12 requires an underwriter, for offerings in excess of $1 million, to obtain, review, and distribute to investors, copies of the issuer's preliminary official statement (POS) and final official statement (OS). In turn, the underwriter is required to send the POS to any potential customer until the OS is available. Also under Rule 15c2-12, for continuing disclosure, the SEC requires underwriters, with limited exceptions, to determine that the issuer has signed an agreement to provide annual financial information and material event notices.

There are a number of ways the municipal bond community uses electronic delivery for disclosure purposes. One area is delivery of an OS. The innovation of the Internet has made electronic dissemination of an OS much more widespread and cost-effective. Now, many underwriters routinely provide an OS electronically and some issuers post their OS and/or annual financial information on their web sites.

On April 28, 2000, the SEC published guidance in the form of an Interpretation on the use of electronic media under federal securities laws [File No. S7-11-00]. The SEC Interpretation affects all issuers and addresses the use of electronic media in three ways: 1) updates previous guidance, 2) discusses an issuer's liability for web site content, and 3) outlines basic legal principles that issuers and market intermediaries should consider in conducting online offerings. The Interpretation also sought comments on a number of technical concepts to determine whether further regulatory action is necessary. The SEC Interpretation was met with a number of questions from some members of the municipal bond community. Some believe that the Interpretation did little to clarify the SEC's stance on electronic disclosure.

Methodology

CDIAC's survey asked a standardized set of multiple choice questions. These questions included the following:

- How, if at all, have you implemented disclosure through electronic means?
- If you have an electronic disclosure program, how has the SEC's recent "Use of Electronic Media" Interpretation helped or hindered your electronic disclosure program?
- What barriers do you have to implementing electronic disclosure?
- Which of the following issues (hyperlinking from your OS or web site, republication, choice of media, or others) have prevented you from implementing electronic disclosure?
- What would have to occur for you to implement electronic disclosure, if you are not already doing so now?

Because of the large universe of California cities, CDIAC decided to select a representative sample of cities to make our task less cumbersome. The state's 475 cities were stratified by population to insure representation of cities of all sizes. Thus, a sample size of 121 cities was selected. Because of the relatively workable number of counties in the state, CDIAC surveyed all 58 California counties.

Survey Results

Thirty-three percent of cities and 43 percent of counties responded to the survey. See Table 1 for a breakdown of the response rate by population size for cities and counties.

Table 1
Response Rate by Population Size (thousands)

Population	Number of Local Agencies	Number of Surveys Sent	Number Responding	Percentage Responding
Cities [1]				
443 and above	5	4	3	75.0 %
124-442	35	9	3	33.3
58-123	86	21	7	33.3
0-57	349	87	27	31.0
Cities Total	**475**	**121**	**40**	**33.1** %
Counties				
2,927 and above	1	1	1	100.0 %
1,725-2,926	3	3	1	33.3
775-1,725	7	7	4	57.1
1-774	47	47	19	40.4
Counties Total	**58**	**58**	**25**	**43.1** %

[1] San Francisco, both a city and a county, was included in the county group.

Both cities and counties, by an overwhelming majority, responded that they had not implemented electronic disclosure. Eighty-eight percent of cities and 72 percent of counties responding have never utilized electronic disclosure. For some (four cities and two counties), this was a result of the fact that they have no outstanding debt. Two cities and four counties emailed a POS or OS while two cities and three counties posted a POS or OS on their web sites. Two cities and three counties posted financial information on their web sites. None of the municipalities surveyed posted material event notices. The cities that use electronic disclosure are relatively populous cities; the same can be said of counties. Of the counties that use electronic disclosure, four are large and two are relatively small. See Table 2 for an illustration of the use of electronic disclosure.

Table 2
Cities/Counties Utilizing Electronic Disclosure[1]

	Have not Implemented Electronic Disclosure	Emailed POS/OS	Posted POS/OS	Posted Financial Information	Posted Material Event Notices	Other
Cities						
Number	35	2	2	2	0	2
Percentage	87.5%	5.0%	5.0%	5.0%	0.0%	5.0%
Counties						
Number	18	4	3	3	0	1
Percentage	72.0%	16.0%	12.0%	12.0%	0.0%	4.0%

[1] Percentages are based on total number of respondents (see Table 1).
Some respondents provided multiple responses to this question.

Although, as stated above, several cities and counties have used electronic media of some sort for disclosure purposes, only three (one city and two counties) stated that they have actual "electronic disclosure programs." Of these, the city stated that the SEC's Interpretation moderately helped its electronic disclosure program. One county said that it helped a little and the other said that it neither helped nor hindered its program.

The overwhelming majority of respondents stated that they did not have an electronic disclosure program. For both cities and counties, technical issues were the leading hindrance to establishing an electronic disclosure program. Sixty-three percent of cities and 52 percent of counties responding to our survey listed technical issues as a barrier to implementing electronic disclosure programs. The second most common barrier was financial considerations. Forty-eight percent of cities and 40 percent of counties reported financial considerations as a key barrier to electronic disclosure implementation. Another large barrier, especially for cities, was the corporate or legal culture of a municipality that prevented a jurisdiction from implementing electronic disclosure.

Twenty-eight percent of cities and 8 percent of counties described this as a contributing factor. Most interestingly, regulatory concerns were not, overall, a significant barrier. Only 5 percent of cities and 12 percent of counties believe that regulatory concerns have prevented them from implementing an electronic disclosure program. See Table 3 for an illustration of the barriers to implementing electronic disclosure.

Table 3
Barriers to Implementing Electronic Disclosure [1]

	Technical	Financial	Corporate/ Legal	Regulatory	Other
Cities					
Number	25	19	11	2	6
Percentage	62.5%	47.5%	27.5%	5.0%	15.0%
Counties					
Number	13	10	2	3	0
Percentage	52.0%	40.0%	8.0%	12.0%	0.0%

[1] Percentages are based on total number of respondents (see Table 1). Some respondents provided multiple responses to this question.

Of those jurisdictions with regulatory concerns, "hyperlinking" from a POS/OS or web site and "republication" were mentioned most often as issues that prevented them from implementing a program. Choice of media (PDF, HTML, or other file types) was mentioned as a contributing factor by one municipality. (See the text box for a description of some of these issues.) Table 4 provides a summary of the regulatory issues preventing the implementation of electronic disclosure.

Table 4
Regulatory Issues Preventing the Implementation of Electronic Disclosure [1]

	Hyperlinking from POS/OS	Hyperlinking from Web Site	Republication	Choice of Media	Other
Cities					
Number	1	1	2	0	2
Percentage	2.5%	2.5%	5.0%	0.0%	5.0%
Counties					
Number	1	2	0	1	2
Percentage	4.0%	8.0%	0.0%	4.0%	8.0%

[1] Percentages are based on total number of respondents (see Table 1). Some respondents provided multiple responses to this question.

Lastly, municipalities listing "regulatory" as a contributing factor for not implementing electronic disclosure were asked what would have to occur for them to implement such a system. The city and county solutions included a new SEC Interpretation, industry group standard practices, and bond counsel guidance. One county said that it first would need to see case law establish a precedent before it would start electronic disclosure. See Table 5 for an illustration of the solutions to the lack of use of electronic disclosure.

Table 5
Solutions to the Lack of Use of Electronic Disclosure [1]

	Specific SEC Interpretation	Industry Group Standard Practices	Bond Counsel Guidance	Other
Cities				
Number	3	3	3	1
Percentage	7.5%	7.5%	7.5%	2.5%
Counties				
Number	2	0	1	1
Percentage	8.0%	0.0%	4.0%	4.0%

[1] Percentages are based on total number of respondents (see Table 1). Some respondents provided multiple responses to this question.

Observations

This survey provides a number of interesting observations regarding the development of local government electronic disclosure programs.

As noted above, the most surprising survey response was the answer to the question, "What barriers do you have to implementing electronic disclosure?" Rather than citing "regulatory" issues, respondents chose technical, fiscal, and, to a lesser extent, corporate or legal culture issues (such as management or legal counsel reluctance to use electronic disclosure) as the predominant barriers to program implementation. In other words, municipalities lack either the information technology staff to maintain an electronic disclosure section on their web sites or the money to establish and maintain an electronic disclosure program. The financial barrier is unlikely to be alleviated anytime soon given the current fiscal environment. Some municipalities also stated that they would not establish an electronic disclosure program until they were required to do so.

Finally, those respondents listing "regulatory" as a contributing factor believed that hyperlinking and republication are the two main concerns with the SEC Interpretation. However, they did not feel strongly about any of the potential "solutions" to these problems listed in the survey.

CDIAC will continue to track emerging electronic disclosure issues that may impact state and local government agencies and report these findings in future issues of ***DEBT LINE***.

ISSUES AFFECTING ELECTRONIC DISCLOSURE

Hyperlinking

The process of making a link in an electronic document or file that enables a user to access particular locations in web sites or other electronic documents by clicking on it. The SEC Interpretation states that when an issuer includes a hyperlink within a document required to be filed or delivered under the federal securities laws, it is appropriate for the issuer to assume responsibility for the hyperlinked information as if it were part of the document. In addition, the inclusion of a hyperlink to an external web site or document demonstrates the hyperlinking party's intent to make the information part of its communication with investors, security holders and the markets. Some feel that information referred to in issuer documents but not maintained by the issuer should not be required to be updated.

Republication

Refers to the fact that information posted on an issuer's web site potentially has a longer life than a traditional press release which is issued only once, because, according to the SEC Interpretation, the web site "provides a record that can be accessed by investors at any time and upon which investors potentially could rely when making an investment decision without independent verification. The Interpretation further states that "a statement may be considered to be 'republished' each time that it is accessed by an investor, or…each day that it appears on the web site."

The practical effect of the Interpretation would be to impose a continuous disclosure obligation on governmental issuers different that the obligation imposed on a paper document merely because they make information available on a web site. An issuer would be required to continuously (daily) review its web site and determine if anything had changed to make the information misleading.

Recent non-official SEC statements indicate that the SEC had not adopted any "republication" position. Instead, the Interpretation simply referenced the theory and then expressly asked for comments. SEC officials believe that innovative uses of new technology by issuers and their professional advisors should be encouraged, so long as there is no compromise of compliance with the antifraud provisions of the federal securities laws and no compromise of investor protection.

Electronic Media Format

Portable Document Format (PDF) is a type of format for displaying documents electronically. It is the native file format for Adobe Acrobat. PDF documents preserve fonts, layout, and graphics exactly as the designer intended. Documents appear in printed material exactly as they appear on screen. In contrast, hypertext markup language (HTML) documents may not appear in print as they appear on screen. Depending on the browser you use and the system software you're running, the formatting for a printed HTML page may vary greatly. HTML, however, can be viewed without special software.

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.