

**JH**

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# What Issuers of Municipal Securities Should Know about Initial Disclosure and Federal Securities Laws

**Developing an Official Statement**

**Best Practices**

**Views of the SEC**

# Outline

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Preparing the Official Statement

Release of Preliminary Official Statement/Official Statement

Suggested Disclosure Processes and Policies

Posting of Preliminary and Final Official Statements and Other Information

SEC White Paper and Recent Speeches

# Preparing the Official Statement

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## Goal: Disclosure of Material Facts

- ▣ Participants in the Process: Issuer and/or Obligated Party, Disclosure Counsel, Underwriter, Financial Advisor
- ▣ Focus on the Credit- What Investors Want to Know and Need to Know
- ▣ Contents and Purpose of Official Statement

## Think About Continuing Disclosure

- ▣ Relevant at Time of Issuance Because Sets the Factual Foundation

# Preparing the Official Statement

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## Anti-Fraud provisions of Securities Exchange Act of 1934

- ▣ State Facts and not Opinions
- ▣ Rule 10b-5: communications to “marketplace” cannot contain untrue statement of material fact or omission of material fact “necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading”
- ▣ “Material”: a fact is material if there is a substantial likelihood that, under all the circumstances, the fact would have actual significance in the deliberations of the reasonable investor

# Preparing the Official Statement

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## Due Diligence Process

- ▣ Get the Big Picture- Find Out What You Need to Find Out
  - What is the Credit
  - Previous Official Statement May be Helpful
  - Continuing Disclosure Reports
  
- ▣ Create a Plan
  - Request Information, Questionnaire, Meeting, Phone Call/Conference Call?
  - Identify Key Information Sources/People
  - Set up a Skeleton
  
- ▣ Distribute Drafts and Get Input
  - Are They Looking At It?
  - - Sub-distributions to Key Participants? Calls to Key Participants?
  - - Follow Up is Critical

# Releasing the Preliminary Official Statement/Official Statement

- ▣ Preliminary Official Statement (POS)
  - Used to market the securities by the underwriter and, in the case of a competitive sale, is used by bidders to determine its bid for the securities
  - Prepared by financing team and approved by governing board of issuer
  - As it is the issuer's document, it is ultimately the issuer's responsibility to assure the accuracy and the completeness of the POS

# Releasing the Preliminary Official Statement/Official Statement

- ▣ Official Statement (OS)
  - Completed upon the sale of bonds
  - In most cases, only changes to POS is to include final pricing information
  - Occasionally, between the printing/posting of POS and preparation of final OS, an event occurs that requires updating the final OS (e.g., updated State budget information or the release of an issuer's CAFR)

# Suggested Disclosure Processes and Policies

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## Establish Internal Controls and Systems

- ▣ Identify “disclosure documents”: information that is reasonably expected to reach investors/trading markets
  - Initial disclosure
  - Continuing disclosure
  - Other information (such as press releases and web site postings)
- ▣ Identify who is responsible for what
- ▣ Establish checks and balances

Adapted from “Lessons Learned from San Diego”, Linda Chatman Thomsen, Director, Division of Enforcement, SEC, December 11, 2007



# Suggested Disclosure Processes and Policies

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## Establish Internal Controls and Systems (continued)

- ▣ Define process for drafting and reviewing disclosure
- ▣ Require brainstorming sessions to discuss “big picture”
  - Financial problems and other issues
  - Scrutinize disclosure documents: could average investor read the disclosure documents and understand the issue?
- ▣ Give legislative body time to review the POS
- ▣ Transmit the POS to the legislative body with a cover letter highlighting security for bonds, repayment risks

Adapted from “Lessons Learned from San Diego”, Linda Chatman Thomsen, Director, Division of Enforcement, SEC, December 11, 2007

# Suggested Disclosure Processes and Policies

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Hire competent auditors and other professionals

Disclose bad news

Provide practical training to officials and employees (from council/board members to staff members)

- ▣ Disclosure requirements of federal securities laws
- ▣ GASB financial reporting provisions
- ▣ Each person's role in disclosure/financial reporting process

Adapted from "Lessons Learned from San Diego", Linda Chatman Thomsen, Director, Division of Enforcement, SEC, December 11, 2007

# Posting of Preliminary and Final Official Statements and Other Information

Now customary to post Preliminary Official Statements and print few, if any, copies

When first proposed, concerns over staleness of information if POS not promptly removed following sale

Final Official Statements now commonly posted on issuers' websites

# Posting of Preliminary and Final Official Statements and Other Information

## Concerns regarding staleness of final Official Statements and other information

- ▣ Disclaimers regarding final Official Statements being accurate and complete only as of their date
- ▣ Need to monitor other information on issuer website that is “reasonably expected to reach investors and trading markets”

# SEC White Paper

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Asks whether nature of municipal marketplace still justifies less regulation than corporate market

- ▣ Highlights size/nature of municipal market
- ▣ 50,000+ municipal issuers nationwide
- ▣ \$2.4 trillion of securities outstanding (2 million bond issues)
  - Individuals own 36% directly
  - Individuals own 33% indirectly, e.g., mutual funds
  - Median trade: \$25,000
- ▣ \$430 billion issued in 2006

# SEC White Paper

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## Concerns

- ▣ Municipal disclosure less comprehensive than corporate disclosure
- ▣ Issuers lack policies or procedures adequate to ensure accurate/full disclosure
- ▣ Legislative body often approves disclosure with little or no review
- ▣ Issuer not required to certify the accuracy of disclosure
  - Contrast CEO/CFO certifications of quarterly/annual reports under Sarbanes-Oxley (which imposes civil and criminal penalties)
- ▣ Professionals are often hired on a transaction-by-transaction basis and lack factual knowledge derived from ongoing relationship with issuer

# SEC White Paper

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## Concerns (continued)

- ▣ Lack of Generally Accepted Accounting Standards
  - GASB funded with voluntary payments
  - GASB compliance is voluntary
  
- ▣ Some issuers include audited financial statements in disclosure documents without consent of auditor (or without disclosing that consent has not been obtained)\*
  
- ▣ Underwriters disclaim responsibility for statements
  - SEC believes underwriters should review OS and have “reasonable basis for belief in accuracy and completeness”

\* See GFOA “Recommended Practice: Auditor Association with Financial Statements...” 2/24/06

# SEC White Paper

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## Steps that should be taken

- ▣ EMMA for free access to offering documents, periodic reports
  - New rule effective July 1, 2009
  - Only Cox initiative that does not require Congressional action
  
- ▣ Mandatory generally accepted governmental accounting standards



# SEC White Paper

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## Steps that should be taken (continued)

- ▣ Issuers of municipal securities should establish policies/procedures for disclosure appropriate for the particular issuer
- ▣ Legal responsibilities of issuer officials for disclosure documents they authorize should be clarified
  - Miami Cease and Desist Order: “The City Manager actually admitted he wasn’t familiar with disclosure requirements ... and dismissed importance of bond offering documents” (citing reliance on ratings)
  - Dauphin County: legislators “read little, if any,” of POS before approval.
  - Ira Weiss case (finding bond counsel liable for securities law violation for failing to disclose incorrect tax-exemption opinion): school district business manager “had no understanding” of contents of arbitrage certificate

# Post-White Paper

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October 23, 2008 - SEC testimony to Committee on Oversight and Government Reform (House of Representatives)

2009/10 - Obama Administration Initiatives

# Questions

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