



Continuing Disclosure and Post-Issuance Compliance

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Disclosure: Bondholders have a right to know

- State and Local Governments issue securities in the public capital markets
- Buyers of Municipal Bonds have the same right to information as investors in corporate securities
- The basic right is to receive all “material” information on which an average investor would base an investment decision
- Protection of Markets



Securities Laws

- Federal Securities Laws
 - Securities Act of 1933: Initial Disclosure
 - Registration requirement—municipal securities exempt
 - Antifraud rule: Section 17(a)
 - Securities Exchange Act of 1934: Regulates professionals in the Secondary Market
 - Section 10(b): SEC Rule 10b-5
 - SEC Rule 15c2-12



Antifraud Rules

- Rule 10b-5 states:

“It shall be unlawful for any person...to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading...in connection with the purchase or sale of any security.”

- Rule focuses on Underwriters and Broker/dealers but the term “person” includes a political subdivision



15c2-12 and the Backdoor

- Rule 15c2-12 requires an underwriter:
 - To obtain and review an official statement “deemed final” by the issuer prior to participating in the sale of securities of the issuer. This is the genesis of the “15c2-12 Certificate,” signed prior to the date of the Preliminary Official Statement. Adopted 1989.
 - To not purchase or sell any such securities unless the issuer and/or obligated persons have agreed to provide continuing disclosure in a written agreement, the “Continuing Disclosure Agreement.” Adopted 1994.



Continuing Disclosure

- Continuing Disclosure Undertaking—Continuing Disclosure Agreement
 - Implementation of Undertaking
 - Annual Report
 - “annual financial information”
 - Audited financial if and when available
 - Notice of failure to provide annual information
 - 11 Listed Events Disclosures
- July 1, 2009 “Central Post Office” filings
 - <http://www.emma.msrb.org>



When do Disclosure Rules Apply

1. New offerings
 - This includes remarketing of bonds at the Issuer's choice
 2. Annual Report under Rule 15c2-12
 3. Any other circumstance where an Issuer is "speaking to the market."
 - Has to be an official with responsibility for such disclosures
 - Should not include statements made in other, non market-driven context
- Securities laws do not currently impose a requirement to update or correct any statement previously made, if there is no other reason to be making a statement to the market



Who is Responsible for Disclosure

SEC Report of Investigation in the Matter of Orange County:

“Public entities that issue securities are primarily liable for the content of their disclosure documents and are subject to proscriptions under the federal securities laws against false and misleading information in their disclosure document.”



Enforcement of Disclosure Laws

- SEC Actions
 - investigations, injunctive actions in federal court
 - administrative proceedings, criminal referrals to Justice Department
- Private Enforcement Actions
 - securities class action litigation
- State Attorney General's Actions
- Consequences: Political turmoil; Negative publicity; rating downgrades



General Guidelines

- Financial information must be complete and accurate
- Issuer certifications must match the facts
- Disclosure documents are the Issuer's documents and the Issuer cannot rely solely on the professionals
- Public officials:
 - May not recklessly disregard disclosure of misleading facts
 - Must become familiar with disclosure documents and question officers about disclosure
- Issuers should encourage orderly and regular communication between staff and professionals
- Issuers should implement internal controls to ensure compliance with federal securities law



Implementation

- Roles of financing team members should be clearly delineated
- There is no such thing as “Boilerplate”
- Everything contained in the disclosure documents should be verified by someone on the financing team
 - “Expertising” the document
 - Including the footnotes!
- Use “plain English”



Questions & Answers





Disclosure at the County of San Diego

Don Steuer
Chief Financial Officer
County of San Diego



Disclosure at the County of San Diego

- Disclosure Requirements
 - At the time of bond issuance
 - While bonds are outstanding
- Disclosure Working Group
- Disclosure Controls and Procedures



Risk Overview Committee

- Cross-county group that meets quarterly to assist in identifying, reviewing, monitoring and mitigating significant risks (legal, contractual, financial, operational)
- Disclosure Working Group Sub-committee



Disclosure Working Group

- Comprised of key personnel from across the County
 - Financial staff, Risk Management staff, County Counsel
- Ensures complete and accurate disclosure related to the County's long-term obligations is provided
 - For each new financing transaction: Official Statement
 - For outstanding long-term obligations: Annual Report, Material Events Notices
- Reviews disclosure controls on a annual basis



The Disclosure Process

- Outlined in the County's Disclosure Controls and Procedures Manual
- CFO convenes the Disclosure Working Group before the publication of the disclosure document
- Disclosure Working Group performs a review of the County's current situation before reviewing the disclosure document



Review of County Finances and Operations

- Working Group reviews current key County documents, including:
 - County's Risk Report
 - Operational Plan
 - Audited Financials
- Working Group discusses structural balance of the budget and the financial condition of the County
- Working Group reviews and discusses any material risks to its operations and investments and pending litigation



Review of the Disclosure Document

- Does the document accurately present the County's financial condition and operations?
- Does the document include all material information regarding the County's finances or operations?



Disclosure Working Group Membership

- The Disclosure Working Group members are from various departments, and each member has a specific role and certifies to the completeness and accuracy of information specific to their expertise

Member	Focus
<ul style="list-style-type: none"> •Chief Financial Officer •Auditor & Controller •Group Finance Director •Debt Finance Manager 	Financial and operational information
<ul style="list-style-type: none"> •Deputy Controller •Office of Financial Planning Director 	Financial and operational information, also reviews all tabular information, and confirms the accuracy of all amounts, numbers, and other statistical information
<ul style="list-style-type: none"> •Senior Deputy County Counsel 	Litigation, financial and operational information
<ul style="list-style-type: none"> •Chief Deputy County Treasurer •Chief Investment Officer 	Investment pool and other County investments information
<ul style="list-style-type: none"> •Risk Manager 	Insurance policies and coverage information
<ul style="list-style-type: none"> •SDCERA Chief Executive Officer 	San Diego County Retirement Association (SDCERA) information
<ul style="list-style-type: none"> •Disclosure Counsel 	Outside Counsel retained by the County, works with County Counsel to review reports and documents, advises the County regarding disclosure issues and securities laws
<ul style="list-style-type: none"> •Disclosure Coordinator 	Selected by the CFO and responsible for coordinating, monitoring, and documenting disclosure activities at the County



Review of Disclosure Controls

- Performed at least annually
- Evaluation of disclosure controls includes:
 - Confirming that the Disclosure Working Group performs thoroughly
 - Consulting with the Office of Audits and Advisory Services and other advisors (e.g., County's external auditors) regarding the disclosure process or internal controls
 - Confirming that information in the disclosure documents is consistently and properly verified and validated



Questions & Answers





The New IRS Strategic Initiative for Tax-Exempt Bonds: Post-Issuance Compliance

Larry Sobel, partner
Orrick, Herrington & Sutcliffe



What is "Post-Issuance Compliance"?

THE BOND BUYER

The Daily Newspaper of Public Finance
January 24, 2008

Lawyer: 990 Represents 'Sea Change'

New Schedule K Covers Refundings

By LYNN HUME

WASHINGTON — The Internal Revenue Service's new requirements for tax-exempt organizations to provide it with detailed information about their outstanding bonds represents a "sea change" and an expansion of the agency's oversight of the tax-exempt bond area, a former Treasury official and other lawyers said.

The IRS issued a final revised Form 990 with a new Schedule K last month that asks tax-exempt organizations for information about their outstanding bonds, including the use of bonds proceeds and whether the proceeds were invested in a guaranteed investment contract, as well as whether the borrowers have entered into any management or service contracts, or research agreements in connection with bond-financed projects that could result in private business use.

The IRS is requiring exempt organizations with more than \$100,000 of bonds outstanding to list any bonds issued after 2002 that are still outstanding for the 2008 tax year in forms to be filed in 2009. The agency gave the borrowers a one-year delay in responding to the detailed questions in Schedule K. Those questions must be answered for the 2009 tax year in forms to be filed in 2010. The IRS had said the detailed questions also would only apply to bonds issued after 2002.

However, IRS officials told members of the American Bar Association's tax-exempt bond committee at a meeting in Las Vegas Friday that the new requirements apply to refundings, which could include underlying bonds issued before 2003.

Ed Oswald, a partner at Orrick, Herington & Sutcliffe LLP, who was Treasury attorney-advisor for bonds in the late 1990s, said that the IRS action represents a "sea change" because "the IRS is broadening its focus to address whether applicable tax rules are being followed after bonds are issued."



Ed Oswald

Historically, he said, the IRS has mostly focused on bonds at the time they were issued — the structure of the bond transaction, the parties involved, and the set of facts that was in place at that time. The agency has touched on post-issuance compliance issues in some respects during the past year or two.

But Schedule K marks the first time the IRS will collect detailed post-issuance compliance information that could provide the foundation for audits in some cases, and encourage borrowers to set up post-issuance compliance procedures and policies.

"There's somewhat of a paradigm shift and maturation in terms of oversight and review" as the IRS expands its focus to the post-issuance period, Oswald said. The IRS wants to know "how that project has been financed and is operating, are the conduit borrowers and issuers following the broad set of rules and living up to

their responsibilities as these bonds are outstanding for the next 10, 15, 20 years down the line," he said.

The IRS and its advisors have clearly been moving in this direction, Oswald and other lawyers said.

Until recently, the agency tried to collect some post-issuance information from tax-exempt entities in Form 990, but its requests were in the instructions for the form and, as a result, were overlooked by many borrowers.

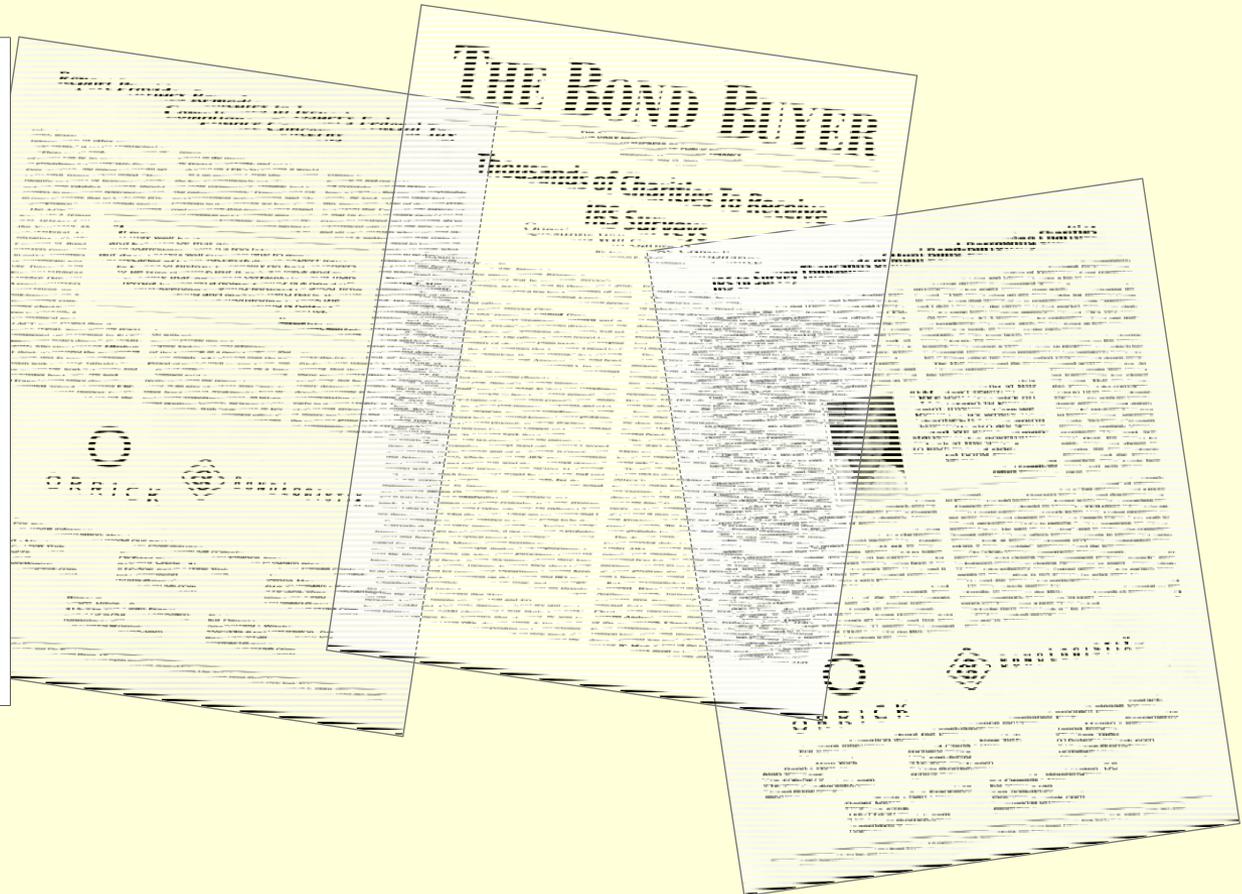
"It was actually a subject of confusion," said Maxwell "Mike" Solet, a partner at Mintz Levin Cohn Ferris Glovsky and Pappas, PC in Boston. "They wanted information about it, but you had to read the instructions and it wasn't obvious from the form itself. I think there was fairly widespread ignorance about what was buried in the instructions and I don't believe the IRS did much of a job in following up on that."

The IRS also sent a questionnaire to between 200 and 300 tax-exempt charitable organizations last year to gauge their compliance with municipal bond-related tax requirements. The questionnaire asked if the organizations had guidelines in place to ensure their bonds remain in compliance with the tax requirements, which officials are primarily responsible for monitoring such issues, and how copies of records are maintained.

IRS officials told ABA panel members Friday that only about 3% of those that responded to the survey said they did not have post-issuance compliance procedures in place.

The agency is expected to send a similar questionnaire to state and local governmental issuers this year.

In addition, Cliff Gannett, director of the tax-exempt bond office, and Steve Chamberlin, the head of TEB's office of compliance and program management, have talked about the importance of post-issu-



Post-Issuance Compliance

A process which provides an organization with a record retention and reporting system ... which enables it to identify actions that could potentially render the interest on the bonds taxable.

Cliff Gannett
Director, IRS Office of Tax-Exempt Bonds



Why You Should Care About the IRS Post-Issuance Initiative?

- IRS is looking to make sure that federal subsidy provided by the interest exclusion on bonds is properly applied.
- Defending tax-exempt status of bonds in an IRS audit is expensive and time consuming.
- Reputation in credit markets and beyond.
- Financial settlement to protect bondholders.



History of IRS Tax-Exempt Bond Audit Program

- Audits of tax-exempt bonds rare prior to 1992.
- Focus of early IRS enforcement efforts were on perceived problems on the date of issue of the bonds.
- Examples, arbitrage driven structures, purchase of investments with bond proceeds (“yield burning”).



History of IRS Tax-Exempt Bond Audit Program

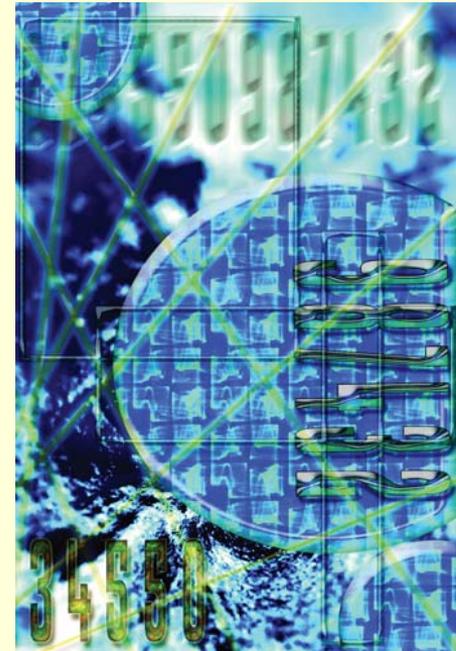


- In 1998, a separate IRS division devoted to tax-exempt bonds and governmental entities was created – Tax-Exempt and Government Entities Division (TE-GE).



History of IRS Tax-Exempt Bond Audit Program

- TE-GE has 40 revenue agents devoted to auditing tax-exempt bonds. Any time during the year, up to 400 bond issues are being audited.
- In 2007, TE-GE collected \$45 million in settlements.



Maturation of the IRS Bond Audit Program

- Now that the audit program is more than 10 years old, TE-GE is moving away from solely looking at facts and circumstances as of the date of issue of the bonds.
- Recent IRS Publication “After the Bonds are Issued: Then What?”



New IRS Paradigm - Review of Post-Issuance Matters

- The average tax-exempt bond issue has a weighted life of 20 years or more.
- Issuers and conduit borrowers must comply with federal tax rules for the life of the original bonds and any refunding bonds.
- Easy for foot faults and errors to occur or for issuers to lack requisite records and detailed information to rebuff IRS in an audit challenging the tax-exempt status of bonds.



Evidence of IRS Focus on Post-Issuance Compliance

- IRS Post-Issuance Compliance Questionnaire for 501(c)(3) Organizations - August 2007
- New Annual Post-Issuance Reporting requirements for 501(c)(3) organizations (Schedule K to be filed with IRS Form 990)
- IRS Post-Issuance Compliance Questionnaire for Governmental Bonds - Sent out in February-2009



IRS 501(c)(3) and Governmental Post-Issuance Questionnaires

The Questionnaire was distributed to several hundred 501(c)(3) Organizations in 2007 and approximately 200 governmental issuers in 2009. Responses were due in late April.

The Questionnaires are broken into 5 Categories:

1. General Questions
2. Recordkeeping
3. Investments and Arbitrage Compliance
4. Expenditures and Assets
5. Private Business Use



Example of General Questions

- Do you have written procedures to ensure that governmental bond financings remain in compliance with the following federal tax requirements after the bonds are issued? In particular, how do you monitor:
 - Use of proceeds and bond financed property
 - Timely expenditure of proceeds and arbitrage matters
- Do you provide training or educational resources to personnel that are responsible for ensuring compliance with the post-issuance private use limitations for bond financed property?



Example of General Questions

- Who is primarily responsible for monitoring post-issuance compliance of bond financings?
 - Elected or appointed official
 - Non-elected or non-appointed official
 - Staff person
 - None



Example of Recordkeeping Questions

- Do you maintain records pertaining to your tax-exempt bonds?
 - If yes, how long?
 - Less than life of bonds
 - Life of bonds;
 - Life of bonds (including and refunding bonds) plus 3 years



Example of Recordkeeping Questions

- Do you maintain copies of:
 - Federal tax or information returns
 - Audited financials
 - Transcripts, official statements, etc.
 - Minutes and resolutions
 - Issue price certifications
 - Appraisals; demand surveys; feasibility studies
 - Trust statements
 - Correspondence, letters, e mails etc., about bonds, swaps, etc.
 - Publications, brochures, newspaper articles about the project



Example of Arbitrage Compliance Questions

- Do you maintain records documenting the allocation and earnings and investments related to:
 - Investment contracts
 - Credit enhancement, e.g., insurance or LOC's
 - Derivative products; e.g., swaps
 - Bid documents of the above
- Do you have written procedures for monitoring yield restriction compliance, temporary period rules, spending exceptions?
 - Describe your procedures and how they are implemented
 - If there are no written guidelines, explain what guidelines are in place to ensure compliance



What Can We Learn From the IRS Questionnaire?

- Indicates high expectations of the IRS regarding internal controls and policies regarding tax-exempt bonds.
- If you did not receive the questionnaire, it is beneficial to review and prepare a draft response which will reveal areas that need attention.



Benefits of an Effective Post-Issuance Program

- Remove risk of non-compliance and associated hazards.
- Generate efficient and prompt response to any IRS inquiry. Very helpful in an IRS audit.
- Easy and cost-effective review process at time of a refunding.
- Identify remaining portion of bond proceeds allowed for private use.

