

**CDIAC**

**CALIFORNIA  
DEBT AND  
INVESTMENT  
ADVISORY  
COMMISSION**

# **OVERVIEW: SEC REGULATIONS AND THE DISCLOSURE PROCESS**

**Relevant Laws and Regulations**

**Best Practices**

**Views of the SEC**

**Lessons from Orange County and  
San Diego**

# Outline

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Key Laws

Preliminary Official Statement/Official Statement

Suggested Disclosure Processes and Policies

Posting of Preliminary and Final Official Statements and Other Information

Continuing Disclosure: Rule 15c-12

# Key Laws — *Securities Act of 1933*

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Generally requires registration of securities with SEC

Exempts most municipal securities from registration

Prohibits fraud in offer or sale of securities (Section 17(a))

- ▣ Municipal securities are not exempt from Section 17(a)

# Key Laws — *Securities Exchange Act of 1934*

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## Anti-Fraud provisions

- ▣ Section 10(b): prohibits fraud in purchase or sale of securities
- ▣ 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

# Key Laws — *Securities Exchange Act of 1934*

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Rule 15c2-12: directly regulates underwriters (and indirectly governmental issuers)

- ▣ Regulates

- Initial disclosure
- Continuing disclosure (see Appendix A)

# Key Laws — *Securities Exchange Act of 1934*

## Rule 15c2-12: New Issue Disclosure

- ▣ Preliminary Official Statement (POS)
  - Must contain
    - Information concerning the terms of the securities
    - Financial information or operating data material to an evaluation of the securities
  - Must be reviewed by underwriter before it bids for, offers/purchases/sells bonds
  - Must be “deemed final” by the issuer
  
- ▣ Official Statement (OS)
  - Same as the POS except it includes pricing-related information
  - Delivered to underwriter within 7 business days after pricing and in time to accompany buyer confirmations

# Preliminary Official Statement/Official Statement

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- ▣ 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

# Preliminary Official Statement/Official Statement

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## ▣ 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

# 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

# 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

# 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”

# Continuing Disclosure — *Rule 15c2-12*

## Rule 15c2-12

- ▣ Applies only to issues of \$1 million+
- ▣ Underwriter may not purchase/sell primary offering of securities unless issuer or an “obligated person” undertakes to provide continuing disclosure
- ▣ “Obligated person”: person, including issuer, generally or through an enterprise, fund or account committed by contract or other arrangement to support payment of all or a part of the obligations on the municipal securities

- ▣ Two types of reporting

- Annual report**

- Financial information or operating data of the type included in the OS
    - Audited financial statements, when and if available

- Listed event disclosure**

- Failure to file annual report
    - 14 material events

# Continuing Disclosure — *Rule 15c2-12*

## Rule 15c2-12

### ▣ 14 Material Events

- Principal and interest payment delinquencies
- Non-payment related defaults, if material
- Unscheduled draws on debt service reserves reflecting financial difficulties
- Unscheduled draws on credit enhancements reflecting financial difficulties
- Substitution of credit or liquidity providers, or their failure to perform
- Adverse tax opinions or events affecting the tax-exemption
- Modifications to rights of security holders, if material
- Bond calls, if material, and tender offers
- Defeasances
- Release, substitution, or sale of property securing repayment of the securities, if material
- Rating changes
- Bankruptcy or insolvency of Issuer
- Merger or consolidation, if material
- Appointments of successor or additional trustee, if material

# Continuing Disclosure — *Rule 15c2-12*

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Rule 15c2-12 primary exemptions:  
securities with \$100,000+ denominations  
and-

- ▣ Private placement: securities are sold to no more than 35 sophisticated investors who buy for investment and not distribution
- ▣ Short-term bonds:
  - Bonds maturing in 9 months or less: exempt from all requirements
  - Bonds maturing in 18 months or less (e.g., TRANS): subject only to material event disclosure

# Continuing Disclosure — *Rule 15c2-12*

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## Recent Rule 15c2-12 Amendments

- ▣ Effective July 1, 2009, all continuing disclosure filings must be filed with MSRB through its Electronic Municipal Market Access (“EMMA”) system.
- ▣ Amendments effective for deals closing after December 1, 2010:
  - **Removed the exemption from primary offering disclosure for variable rate tender bonds**
  - Removed the materiality determination from most listed event disclosure
  - Added new events to the listed event disclosure
  - Listed event notices now must be filed within 10 business days after the event occurs

## Rule 15c2-12 - Enforcement

- ▣ Imposes liability for secondary market statements
  - Continuing disclosure reports
  - Statements “reasonably expected to reach investors and trading markets”
    - Press releases
    - Web site postings

# Questions

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