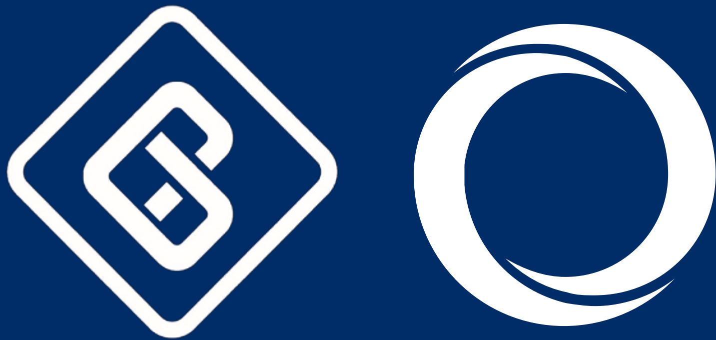

Continuing Disclosure Responsibilities

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INTRODUCTION

During this presentation, we will discuss:

- Overview of Federal Securities Laws
- SEC Rule 15c2-12
- SEC Enforcement Actions regarding Continuing Disclosure
- Policies, Procedures and Training
- Practical Tips and Best Practices

OVERVIEW OF FEDERAL SECURITIES LAWS

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WHY IS DISCLOSURE NECESSARY?

- Investors in municipal securities have rights under federal securities laws
- All “material” information must be disclosed
- Policy: Parties buying and selling municipal securities should have access to information necessary to make an informed investment decision

THE FEDERAL SECURITIES ACTS

- Securities Act of 1933
  - Registration requirement for most securities, but municipal bonds are not included
- Securities Exchange Act of 1934
  - Creates ongoing disclosure requirements for public companies, and regulates brokers and dealers
- Both 1933 Act and 1934 Act contain antifraud provisions, which do apply to municipal securities

SEC RULE 10B-5

“It shall be unlawful for any person . . .

a) To employ any device, scheme or artifice to defraud,

b) 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 the light of the circumstances under which they were made, not misleading . . . .”

Must be “in connection with the purchase or sale of any security”

THE "MATERIALITY" STANDARD

- "[w]hether or not there is a substantial likelihood that a reasonable investor or prospective investor would consider the information important in deciding whether or not to invest"
- Materiality is determined in context of all the facts and circumstances, but usually on a retroactive basis
- Guidance comes primarily from court decisions and SEC enforcement cases
  - SEC has not provided guidance on what constitutes a "material" misstatement of facts outside of SEC enforcement cases

WHEN DO DISCLOSURE RULES APPLY?

- SEC Rule 10b-5 applies whenever an issuer is "speaking to the market"
  - New offerings
  - Reporting under Continuing Disclosure Agreement
  - Voluntary filings on EMMA
  - Other circumstances
    - ✓ Public statements by officials -- whether this will be considered "speaking to the market" will depend on the official making the statement, and the audience. "Political speech" has in the past been viewed as OK, but recent SEC actions suggest using greater caution.
    - ✓ Investor website

SEC RULE 15c2-12

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SEC RULE 15c2-12 – FINAL OFFICIAL STATEMENT

- Rule 15c2-12 was originally enacted in 1989
- Indirect regulation of issuers by preventing a dealer from underwriting an issue of municipal bonds unless:
  - Underwriter has been able to "obtain and review a preliminary official statement that the issuer of such securities or an 'obligated person' deems final as of it date"
- Rule effectively stopped the practice of underwriters agreeing to underwrite a bond issue and prepare offering document later

SEC RULE 15c2-12 – CONTINUING DISCLOSURE

- Rule was amended in 1994 to include continuing disclosure
- Underwriter must reasonably determine that the issuer or an obligor has entered into a binding commitment to provide continuing disclosure
  - Annual reports, including audited financial statements
  - Disclosure of specified "material events"
- Disclosure is now made by filing with the MSRB's Electronic Municipal Market Access (EMMA) system

SEC RULE 15c2-12 – ANNUAL REPORTS

- Annual Reports
  - Audited Financial Statements
  - Financial information and operating data as specified in the continuing disclosure agreement; essentially updates key financial and operating data contained in the original offering document which is available from the issuer or the obligor's records
  - Filing required annually by a fixed date specified in the continuing disclosure agreement
  - If audit not ready by reporting date, can file unaudited financial statements and file audit as soon as ready
  - If don't file any part of annual report on time, must file a separate notice of failure to file

SEC RULE 15c2-12 – MATERIAL EVENTS

- Material Events Notices
  - Material events notices must be filed "not in excess of 10 business days after the occurrence of the event"
  - Necessary to have system in place to timely identify and report on any of the listed events
- List of Events
  - Note some of the events have a materiality qualifier, others do not (they are deemed automatically material)

SEC RULE 15c2-12 – MATERIAL EVENTS

- Events that require notification within ten (10) business days:
  - Principal and interest payment delinquencies
  - Unscheduled draws on debt service reserves
  - Unscheduled draws on credit enhancement
  - Substitution of credit or liquidity provider or failure to perform
  - Adverse tax opinion, the issuance by the IRS of proposed or final determination of taxability, adverse tax opinions, or Notices of Proposed Issue (IRS Form 5701-TEB)
  - Defeasances
  - Rating changes
  - Tender offers
  - Bankruptcy, insolvency, receivership, or similar event of an obligated person

SEC RULE 15c2-12 – MATERIAL EVENTS

- Events that require notification within ten (10) business days, if material:
  - Nonpayment related defaults
  - Modification to bondholder rights
  - Optional, contingent or unscheduled bond calls
  - Release, substitution or sale of property securing repayment of bonds
  - Merger, consolidation, acquisition, or sale of all or substantially all of the assets of an obligated person, other than in the ordinary course of business, and the entry into or termination of an agreement to undertake such action
  - Appointment of a successor trustee or change in name of a trustee

SEC RULE 15c2-12 – NEW PROPOSED MATERIAL EVENTS

- New "Material Events" are being proposed by SEC
  - Incurrence of a "financial obligation," if material, or agreement to certain covenants or terms in a financial obligation, if material
  - Default, event of acceleration, termination event, modification of terms or other similar events under a financial obligation, if any such event reflects financial difficulties
- Critical to the new rule is the broad definition of "financial obligation"
  - Includes debt instruments, leases, derivatives, guaranties and court or administrative judgments (excluding any debt instrument described in EMMA offering document)
- SEC has received many comment letters objecting to these new amendments

EXCEPTIONS TO SEC RULE 15c2-12

- There are exceptions to Rule 15c2-12
- The exceptions primarily relate to limited offerings and short maturities
- Prior to 2010 certain variable rate bonds were not subject to the annual and enumerated events reporting requirements of Rule 15c2-12

NEW ISSUES OF BONDS: WHAT THE ISSUER MUST DO TO COMPLY?

- The undertaking to comply with continuing disclosure requirements must be contained in a legal document enforceable by bondholders
- Standard practice is to include details of the undertaking in a separate continuing disclosure certificate
- Official Statement must
  - Describe Continuing Disclosure Undertaking (attach as exhibit) and
  - Disclose if issuer has failed to substantially comply with any continuing disclosure obligations in last 5 years
- Issuer must promise underwriter to execute the continuing disclosure certificate (in BPA or Notice of Sale)

NEW ISSUES OF BONDS: WHAT WILL UNDERWRITER REQUIRE?

- Before it offers bonds for sale or commits to purchase any bonds, the underwriter must obtain and review the POS and determine if issuer has "deemed" it to be nearly final, excepting only final pricing information
- Underwriter must determine that issuer has properly promised to enter into a continuing disclosure undertaking which meets SEC Rule 15c2-12
- Underwriter must determine if issuer has failed to comply with any continuing disclosure undertaking in last 5 year (and if yes, make sure it is disclosed in the POS and final OS)
- Underwriter must make its own inquiry, not rely solely on statements by the issuer

CONTRACTUAL AGREEMENTS TO DISCLOSE BEYOND WHAT SEC RULE 15c2-12 REQUIRES

- Timing and Content
  - Timing: by fixed date each year provided in continuing disclosure agreement
  - Content: set forth in continuing disclosure agreement
- Quarterly Reports
  - Not mandated by Rule 15c2-12 - but could be contractually obligated
  - Driven by investor demands

CONTINUING DISCLOSURE AND THE ANTI-FRAUD RULES

- The anti-fraud rules under the securities laws apply to disclosures reasonably expected to reach investors and the trading markets
- Annual reports, quarterly reports, if any, and material event disclosures must therefore be accurate and not omit any material information needed to make the disclosures not misleading
- This does not mean a full Official Statement needs to be provided with every annual report or quarterly report – take into account full mix of information in light of the circumstances
- Obligors may voluntarily provide more information than 15c2-12 requires. Such information is, of course, also subject to the anti-fraud rules

CONSEQUENCES OF NON-COMPLIANCE WITH CONTINUING DISCLOSURE UNDERTAKING

- Non-compliance is not an Event of Default under bond documents or continuing disclosure agreements but bondholders have right to sue for compliance with continuing disclosure obligations
- Must disclose such failure in future Official Statements for the period of 5 years following the failure
- Can give rise to a securities law fraud case if misstatement about past compliance in an offering document
- Including only the information specifically required under the continuing disclosure agreement may not be deemed sufficient to satisfy the anti-fraud rules and could result in securities fraud under Rule 10b-5

SEC ENFORCEMENT ACTIONS REGARDING CONTINUING DISCLOSURE

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SEC ENFORCEMENT ACTIONS REGARDING CONTINUING DISCLOSURE

- Failures of Continuing Disclosure
  - City of Harrisburg, PA – misleading statements and omissions about City's budget problems in public statements by officials because City had not made required annual financial filings; settled (2013)
  - West Clark Community Schools, IN – issuer falsely stated in an O.S. that it had complied with annual financial disclosure filings from an earlier deal; settled (2014). This led to SEC's MCDC initiative
  - Kings Canyon Joint Union School District, CA – similar failure as West Clark; District voluntarily reported to SEC under MCDC; settled (2014)

SEC ENFORCEMENT ACTIONS REGARDING CONTINUING DISCLOSURE

- Failures of Continuing Disclosure (continued)
  - City of Beaumont, CA – Failure to file complete and timely annual reports; City didn't voluntarily report to SEC under MCDC; sanctions more severe than under MCDC; settled (2017)
    - ✓ Significant because (i) City required to hire independent consultant on securities procedures and (ii) individual official was sued; agreed to permanent injunction against participating in any muni securities offering; paid fine of $37,500
  - Municipal Financial Services, Inc., OK – SEC brought an administrative action against a municipal advisor for violating its duty to city by failing to advise city that amending the reporting period on three prior CDAs violated the CDAs and did not advise City to notify bondholders of those prior issues that the CDA deadline had been changed.
  - ✓ Firm was fined $50,000 and each of the two principals were fined $8,000 each

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

- In March 2014, SEC established the Municipalities Continuing Disclosure Cooperation Initiative (“MCDC”)
- Voluntary program designed for underwriters and issuer/obligors to “self-report” instance of “material” inaccurate statements in final OS’s regarding an issuer/obligors historical continuing disclosure compliance
- Self-Reporting was available until September 10, 2014 for underwriters and December 1, 2014 for Issuers/Obligors
- Standard settlement terms under the MCDC program were provided
- SEC indicated that if it found material misstatements that were not reported, sanctions would be more severe

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

- Program was based on the West Clark Community Schools circumstances
  - Issuer falsely stated in an OS that it has not failed to comply with its continuing disclosure requirements over the past 5 years
- Underwriters and issuers/obligors performed thorough reviews of OS's to determine if material misstatements were made
- Each underwriter established its own criteria for self-reporting transactions
  - number of days late
  - event notices (insurer rating changes, defeasances, etc.)
  - availability of disclosure (NRMSIRs, EMMA, CUSIPs, etc)
- Issuers performed review and generally had the benefit of knowing whether the underwriter self-reported their transaction

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

- Settlement Terms for Underwriters
  - consent to “cease and desist” proceedings
  - retain an independent consultant (“IC”) to conduct a due diligence review of process and procedures and provide recommendations within 180 days
  - enact IC recommendations within 90 days
  - cooperate with any SEC investigation, including roles of individuals/other parties
  - provide compliance certification to SEC within one (1) year
  - CIVIL PENALTIES – between $20K-$60K per violation, $500,000 cap

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

- Settlement Terms for Issuers/Obligors
  - consent to “cease and desist” proceedings
  - establish policies and procedures and training regarding continuing disclosure within 180 days
  - correcting past delinquent filings within 180 days
  - disclose the settlement terms in future official statements over the next five (5) years
  - provide compliance certification to SEC within one (1) year
  - <u>cooperate with any SEC investigation, including roles of individuals/other parties</u>
  - NO CIVIL PENALTY

MCDC PROVIDED NO PROTECTION FOR INDIVIDUALS

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

SETTLEMENTS

- 72 Underwriters and over $18 million in penalties
- 71 Issuers (included 2 states, 7 state authorities, 29 local agencies, 9 schools, 6 universities, 5 healthcare, 5 utilities, 1 retirement community, and others)
- Cited both affirmative false statements and omissions to disclosure non-compliance with the past 5 years

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

SETTLEMENTS (cont.)

- Examples of Material Items Discussed
  - Vast majority of examples were late and missing filings, including missing operating data (months to years to never)
  - instances in which an OS included the information and was available by the deadline but the issuer had not provided on EMMA a cross-reference to the OS
  - late quarterly filings (not required under Rule 15c2-12 but were in the CDA)
  - Inaccurate disclosure (some missing filings not discussed)
  - failure to file "notice of failure to file on time"
  - failure to file "defeasance" notice

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

SETTLEMENTS (cont.)

- Underwriter settled orders cited 1-3 examples of improper disclosure (anonymous)
- The settled orders cited examples that reflected the range of conduct that was submitted to the SEC
- SEC indicated that the examples were designed to provide broad guidance to the market (unlike the Kings Canyon USD settlement which was vague)
- SEC further stated that each example bullet point in each order is considered material, but that if multiple events were mentioned, only the cumulative action mentioned in the bullet point should be considered material

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

REASON FOR MCDC

- SEC Rule 15c2-12 was designed to make available current market information for investor and improve trading in the secondary market
- SEC aware of lack of continuing disclosure compliance
- Inaccurate statements in official statements regarding continuing disclosure compliance could also lead to inaccurate statements regarding other information contained in the official statements and gives false implications issuer or obligor can be expected to comply with the new CDAs

MCDC (S.E.C. SELF-REPORTING INITIATIVE)

WHAT HAS COME FROM MCDC

- Revealed that many official statements falsely stated that the issuer was in full compliance, including deals as late as 2014
- Much greater awareness of the importance of continuing disclosure
- Sound policies and procedures developed
- Hiring of outside consultants, like BLX, to assist in compliance particularly for issuers with prior compliance failures
- Improved underwriter due diligence in primary offerings
- Careful attention to future continuing disclosure filings
- Increase in continuing disclosure filings

MCDC was about “disclosures” which lead to better “compliance”

INCREASINGLY AGGRESSIVE ACTIONS BY SEC IN RECENT YEARS

- Filings against States
- Levying fines against issuers
- Increasingly charging issuer officials along with the issuer
- Levying fines against individual defendants
- Officials barred from future involvement in municipal finance
- Criminal charges against issuer officials

INCREASINGLY AGGRESSIVE ACTIONS BY SEC IN RECENT YEARS

- Most settlements require implementation of remedial actions and training; in some cases issuer required to hire outside disclosure counsel for a period of years
- SEC continues to bring actions even when there was no default, no reduction in rating or any evident market impact on the bonds
- Unlike private action, SEC does not have to prove reliance or damages

POLICIES, PROCEDURES AND TRAINING

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ESTABLISHING POLICY AND PROCEDURES

Why?

- Shows organization cares about compliance
- Shows organization is actively managing its compliance
- May be a mitigating factor when SEC calls
- May lessen the risk for personal liability for staff if policies are followed
- Greater attention to disclosures made for continuing disclosure compliance and for new offerings

ESTABLISHING POLICY AND PROCEDURES

- Establish internal written procedures to comply with Continuing Disclosure Agreements ("CDA")
- Identify key personnel and their responsibilities for CDA compliance
  - Disclosure Team
    - ✓ review annual reports and event notices
    - ✓ review historical compliance with CDA undertakings
  - Coordinator (point person)
    - ✓ monitor compliance
    - ✓ information gathering
    - ✓ communication with third parties
    - ✓ training

ESTABLISHING POLICY AND PROCEDURES

- Internal Communication is Key
  - communication must be established and maintained between those who become aware of the material events and those who file the event notices
- Make your CDA required reading for any new employees that will be involved in providing information for continuing disclosure purposes

ESTABLISHING POLICY AND PROCEDURES

- Create a template/chart for annual compliance and event notices to be reported
- Review each CDA and identify the following:

For Annual / Quarterly Reports

- what information is required to be included in the annual/quarterly reports
- when are annual/quarterly reports due
- what information will need to be obtained from third parties
- who should receive copies of the annual/quarterly reports (EMMA, insurers, underwriters, rating agencies, etc.)

For Event Notices

- what are the SEC listed events
- when are listed events due
- who is responsible for identifying when a listed event has occurred
- defeasance, bond call, and rating changes are the most common events, especially when a refunding occurs

ESTABLISHING POLICY AND PROCEDURES

- For Voluntary Notices
  - discuss with counsel – determine materiality
  - carefully review the notice before submitting to EMMA
- Internal Tickler System
  - establish an internal tickler system for reporting due dates
  - utilize EMMA automated tickler system of approaching deadlines
  - third-party consultants

ESTABLISHING POLICY AND PROCEDURES

- Annual Reports
  - consider providing a “roadmap” or “cross-reference” of where the required information is contained in the disclosure filing (Audit, CAFR, OS, etc.)
- Investor Communication
  - If you respond to one investor, make available to all investors
  - only communicate what’s already been disclosed
  - work with counsel

BEST PRACTICES AND PRACTICAL TIPS

BEST PRACTICES

- Ensuring Future Compliance
  - Adopt policies and procedures and follow them
    - ✓ reduce chances of making a material misstatement or omission
    - ✓ establish a reasonable care defense for such statements or omissions
  - Know what was committed to be disclosed in the CDA and the timing of the filings (understand the Rule and what you contracted to do in your continuing disclosure agreement and by when)
  - Set up a tickler system for timing of reports
  - Assign one or two point people responsible for putting together the annual report filing and for actually posting on EMMA
  - Conduct training
  - Consider hiring a third party to assist

PRACTICAL TIPS

- CDA is your Responsibility!
  - after submitting your disclosure documents to the dissemination agent, check to make sure the disclosure documents appear on EMMA
  - request / retain EMMA confirmations as evidence of compliance
  - if an OS represents your annual report, provide a notice indicating such and make sure the OS is available on EMMA by the required due date
  - EMMA is a "submitter-based" platform so make sure description of the disclosure documents is accurately reflected
  - if the annual/quarterly reports provide cross-reference to other documents (i.e. audits, budgets, etc), make sure such other documents are also available on EMMA
  - if you cannot file your annual report on time, file the "notice of failure to file on time" on or before the required due date
  - remedy missing disclosures as soon as practicable

FUTURE CONTINUING DISCLOSURE AGREEMENTS

- Future Continuing Disclosure Agreements
  - make it easy to comply
  - make it easy for third party to determine if you've complied
  - avoid using "X" number of days after fiscal year
  - choose a date that you can comply with
  - discuss "content" with underwriter prior to executing CDA
  - what information is important for future investors to trade the bonds
  - are you able to provide such information for the life of the bonds (30 years)
  - consider availability of information from third-party sources
  - consider attaching a "template" of the report in the CDA
  - if there are multiple obligated persons, clearly identify each party's obligations

EMMA

- Posting Documents of EMMA
  - CUSIP-based system – Documents are posted only under the CUSIPs specified by the submitter
  - User-based system – Documents are posted under the categories specified by the submitter
  - Submitter can modified submission by changing the CUSIPs or the description of the document.
  - Only the submitter can make amendments to the document submitted
  - Once a document is posted on EMMA, it cannot be removed but can be "archived"

EMMA

- Posting Documents of EMMA
  - CUSIPs – can be retained from the original bond transcripts or shown on the cover of the official statement
  - Pre-refunded / Unrefunded CUSIPs – for partially refunded bonds, original CUSIP is typically reassigned a “prerefunded” CUSIPs and an “unrefunded” CUSIP – future submissions should include these new CUSIPS, in particular the “unrefunded” CUSIP
  - EMMA Confirmation – e-mail confirmation submitted by EMMA – review and confirm the CUSIPs on the confirmation and retain for internal records

EMMA

- EMMA Categories
  - Financial / Operating Filing
  - Event Filing – 15c2-12 events and additional voluntary events
  - Bank Loan / Alternative Financing Filing – no associated CUSIPs
  - Asset-Backed Securities Filing
- Use the resources on EMMA
  - Tickler system – Email reminders, tutorials
  - Issuer Customized Home Page
  - Political Contributions of registered MAs

ISSUER CONSIDERATIONS

- Dissemination Agent vs. Disclosure Consultant
- Registered Municipal Advisor?
- Criteria established by underwriters
  - Post-MCDC underwriting policy and procedures
    - ✓ Competitive transactions – criteria more rigid
  - Compliance with MCDC “independent consultant” recommendations
  - Compliance with “cease and desist” order

SUMMARY

- Full and transparent disclosure is essential
- Investors must be provided all material information when making their investment decision
- Issuers must continue to be vigilant in training involved officials and maintaining rigorous disclosure practices

QUESTIONS?

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