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Disclosure Responsibilities Under the Federal Securities Laws

San Mateo County Transportation Authority

When do Disclosure Rules Apply?

- Primary Disclosure/new offerings
- Continuing disclosure under Rule 15c2-12
- Any other circumstance where an Issuer is “speaking to the market” such as voluntary disclosure. *Generally no requirement to update or correct statements previously made – even Rule 15c2-12 does not require a notice filing for “other material events.”*

Why this Training?

- SEC repeatedly emphasizes that disclosure is primarily the issuer's responsibility because issuer officials and staff are in the best position to know material facts
- Training on disclosure roles and responsibilities as well as disclosure policies can demonstrate the "reasonableness" of an issuer's actions

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Primary Market Disclosure (focus for today)

- *Federal securities laws* - Although municipal issuers are exempt from the registration provisions of federal securities laws, they are subject to the anti-fraud provisions

Rule 10b-5 states "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 ..."
 - No material misstatements
 - No materially misleading omissions

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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 in court cases or SEC enforcement actions
- When information pertains to a possible future event, “materiality will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event”

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Disclosure Principles

- Provide main points but do not overwhelm readers with detail – remember the big picture of explaining what revenue sources (security) is being used to repay the bonds and disclosing things that can affect the availability of that revenue source
- Highlight important developments or events that could affect the pledged revenue source appropriately
- Determine appropriate level of importance for any particular event, revenue source or budgetary item
- Importance of accurate disclosure of bond terms and especially redemption provisions
- Focus on developments specific to borrower and not general market forces
- Bringing all these factors together into final product is ongoing process of give and take.

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Board Responsibility

SEC Report (1996)
regarding conduct of Orange
County Board of Supervisors

- a. Board should have investigated and ensured adequate disclosure of the County's finances
- b. Public officials cannot authorize disclosure known to be false or in reckless disregard of the facts
- c. Board cannot rely on their professional advisors for information within their knowledge, i.e. budget information

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Official Responsibility

City of San Diego

SEC:
"Municipal officials have a personal obligation to ensure that investors are provided with complete and accurate information about the issuer's financial condition."

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Control Person Responsibility

- Allen Park, Michigan – **Control Person Liability for Municipal Officials.**
- **What happened?** In Allen Park, the Mayor championed a movie studio project that had been substantially reduced in scope by the time bonds went to market. The Mayor appointed the City Administrator who reported daily to the Mayor. The City Administrator largely handled the bond offering process with outside advisors.
- **What did the SEC do?** In 2014, the SEC for the first time imposed “control person” liability on a municipal official, which provides that a control person may be held liable for the securities law violations of the persons over whom he or she exercises control.

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Primary Offering Process

- Input from involved staff and officials with the best knowledge about issues that materially affect disclosure
- Empower staff at all levels to critically examine information to be provided to investors
- Politically sensitive information still must be disclosed if material
- When in doubt discuss issues with disclosure counsel and other professional advisors

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