



# **Presentation to Santa Clara Valley Water District**

## **Disclosure Responsibilities Under the Federal Securities Laws**

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# Why Is Disclosure Necessary?

- The Santa Clara Valley Water District issues securities in the public capital markets
- Investors in municipal securities have rights under federal securities laws
- All “material” information must be disclosed

# The Securities Act Of 1933

- **1933 Act has two substantive rules:**
- **Registration requirement (municipal securities exempt)**
- **Antifraud rule**
- **Antifraud Rule applies to municipal securities**
  - Prohibits any person from, directly or indirectly, obtaining money or property by means of any untrue statement of a material fact or by a misleading omission.
  - “Person” includes state and local public agencies.
  - Negligence standard (should have known)

# Why is Disclosure Compliance Important

- SEC has an active enforcement staff, including in San Francisco
- SEC has brought enforcement actions against public agencies in California as well as throughout the US
  - County of Orange – failure to describe nature of investment portfolio
  - City of San Diego – misleading pension disclosure
  - Westlands Water District – failure to describe certain extraordinary accounting
  - Montebello Unified School District – failure to disclose dispute with auditor
  - Sweetwater Union High School District – misleading budget projections

# Securities Exchange Act Of 1934

## Rule 10b-5

- Also contains antifraud provisions (Rule 10b-5)
- Antifraud provisions apply to government issuers
- Must show intent or recklessness

# Rule 10b5

- “It shall be unlawful for any person . . .
  - a) To employ any device, scheme or artifice to defraud, or
  - 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 . . . .”

# 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 in hindsight
- Guidance comes primarily from court decisions, SEC enforcement cases and SEC legal bulletins.

# What Should Be Disclosed?

- Unlike corporate securities, there is no “line item” set of rules for what goes into an Official Statement (“OS”)
- Various groups have suggested disclosure for particular market segments and general guidelines for OS content
- Look at practices in the industry; recent developments (e.g. Pension, Continuing Disclosure Compliance)
- In the end, Valley Water must use its own good judgment



# When Do Disclosure Rules Apply?

- New offerings
- Annual Report under Rule 15c2-12
- Any other circumstance where an Issuer is “speaking to the market”, including speeches and presentations by senior staff and by elected officials

# Primary Disclosure

- Official Statement is offering document to investors
- Must contain all material information for the particular bond sale
- Underwriters, municipal advisers and lawyers can help develop the Official Statement but Valley Water is ultimately responsible for content

# Disclosure Principles

- Broad description of Valley Water's financial and economic condition
- Description of budget process, major revenue sources and expenditure programs
- Information on recent and current budgets – “structural” deficit?
- Information on debt – types and amounts
- Information on derivatives
- Litigation

## Disclosure Principles – (cont.)

- Description of enterprise
- Description of capital improvement program
- Historical and projected revenues, expenses and debt service coverage
- Rate covenant and additional bonds test
- Regulatory issues
- Information on debt – types and amounts
- Information on derivatives
- Litigation

# Disclosure Principles – (cont.)

- Provide main points but do not overwhelm readers with detail
- Highlight important developments “up front”
- Determine appropriate level of importance for any particular event or budgetary item
- Bringing all these factors together into final product is ongoing process of give and take
- Important to maintain Attorney-Client privilege for sensitive issues

# Timing Considerations For Bond Sale

- **Progression of an offering**
  - POS → sale → final OS → closing
- **Supplements are possible**
  - Not preferred, can be disruptive after sale
- **Be mindful of public actions or releases likely to occur**
  - Budget actions, mid-year reports
  - Status of ongoing litigation or investigations
  - Permit issuance (for revenue issuers)

# Process

- Input from involved departments
- Empower staff at all levels
- Valley Water coordinates; Counsel helps pull information together and maintains document
- Important to maintain attorney client privilege at this stage of development
- Drafts reviewed by working group
- “Due diligence” meeting before distribution of Preliminary Official Statement

# Current Hot Topics

- Cybersercurity
- Status of fund balance and reserves
- Climate Change/Natural Hazards
- Expected increases in retirement related payments; unfunded liabilities (pension and OPEB)
- Accounting practices



# Disclosure Considerations

- Tomorrow's "hot topic" may be different than today's
- Disclosure must evolve to reflect changing circumstances
- Read the disclosure with "fresh eyes"
- If you think something may be a concern, raise the issue with Valley Water staff and legal counsel, consider discussing with the working group
- Political sensitivity and confidentiality considerations are not exceptions to disclosure

# Content of Annual Reports

- Audited Financial Reports
- Information (i.e. tables) identified in Continuing Disclosure Undertaking
- Additional voluntary information
- Consider Rule 10b5 implications – if Valley Water does voluntary disclosure on one issue, are there other material topics to disclose?

# Investor Communications

- No obligation to communicate with investors
- Tension between market (and SEC) desire for transparency and potential issuer liability
- Establish a single point of contact
- Speeches and presentations by officers of Valley Water (Chief Executive Officer, etc.) as well as Board Members may be “speaking to the market”

# Highlights of the SEC staff legal bulletin issued on February 7, 2020

- All statements of a municipal issuer reasonably expected to reach investors are subject to antifraud provisions, regardless of compliance with continuing disclosure obligations;
- Fact that the information was not published for the purpose of informing the markets is not relevant;
- Legal bulletin is not legally binding but is a statement of SEC staff view and may be used by SEC staff in enforcement actions.

# Recent SEC Legal Bulletin

- **Types of statements which are subject to anti-fraud rules:**
  - A. Websites – would include Valley Water owned/operated websites and sub/micro web pages, including links to external websites
  - B. Public Reports Delivered to Governmental and Institutional Bodies – would include Board meeting agendas and public reports issued to external regulators, etc. – Recent SEC enforcement action
  - C. Statements made by municipal issuer officials – both verbal and written made by Valley Water officials (Chief Executive Officer, etc.) as well as Board Members

# Topics of Recent SEC Enforcement Actions

- Misleading or Incomplete Financial Disclosures
- Inadequate Pension Disclosures
- Disputes with Auditors
- Failure to disclose missed Continuing Disclosure Filings

# Increasingly Aggressive Actions by SEC in Recent Years

- **Filings against States:** N.J., Illinois, Kansas
- **Levying fines against issuers:** Wenatchee, Westlands
- **Increasingly charging issuer officials along with the issuer:** Miami, Allen Park, Harvey, Wenatchee, Victorville, Westlands, RIEDC, Ramapo
- **Levying fines against individual defendants:** San Diego, Allen Park, Harvey, Westlands, RIEDC
- **Officials barred from future involvement in municipal finance:** Allen Park, Harvey; sought in Ramapo

# Increasingly Aggressive Actions by SEC in Recent Years *(cont.)*

- **Official who did not participate in bond deal charged as “controlling person” because he directed actions of others:** Allen Park; Ramapo
- **Individuals charged with “aiding and abetting” securities law violations:** RIEDC, Ramapo
- **Criminal charges against issuer officials:** Ramapo
- **Charging securities law violations in a situation which did not involve a bond offering:** Harrisburg



# Increasingly Aggressive Actions by SEC in Recent Years *(cont.)*

- **Mayor and Financial Advisor (unregistered) charged with securities law violations for providing false projections to the State of Louisiana to obtain approval of bond issuance by a state agency and failed to disclose prior misuse of bond funds to investors: Sterlington, Louisiana**
- **School District finance director and CFO and financial advisor charged with failing to disclose School District's deteriorating financial condition and municipal advisor failed to disclose conflicts of interest with other municipal clients: Rochester City School District, New York**

# Increasingly Aggressive Actions by SEC in Recent Years (*cont.*)

- **Most settlements require implementation of remedial actions and training; in some cases issuer required to hire outside disclosure counsel for a period of years: Harvey, sought in Ramapo**
- **SEC brings actions even when there was no default, no rating downgrade, or any evident market impact on the bonds. (Port Authority; MCDC cases) Unlike in a private action, the SEC does not need to prove damages or reliance.**

# Consequences of Bad Disclosure

- SEC Investigation – fees for lawyers and consultants
- Adverse publicity
- Personal Fines
- Reduced market access
- May have to impose new procedures and oversight to settle SEC actions
- Rating Downgrades (triggers increased credit/liquidity provider fees)

# Summary

- Investors must be provided all material information—When in doubt, disclose
- Officials participating in the disclosure process must be in a position to know material information (i.e., “the right people must be in the room”)
- Valley Water should support and encourage vigorous disclosure program
- Involved officials must receive training; Valley Water should maintain rigorous disclosure practices
- Protect Attorney-Client Privilege
- Adopt formal disclosure policy, including policies and procedures to ensure to ensure continuing disclosure compliance
- SEC Legal Bulletin regarding public communications by senior staff and elected officials