

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

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

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# Why Is Disclosure Necessary?

- **The 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

- **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.
  - Negligence standard (should have known)

# **Securities Exchange Act Of 1934**

## **Rule 10b-5**

- **Also contains antifraud provisions (Rule 10b-5)**
- **Antifraud provisions apply to government issuers**

# Rule 10b5

**“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 . . . .”**

# 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 and SEC enforcement cases. In the recent MCDC “self-reporting” program, SEC staff consistently refused to provide advance guidance on what constitutes a “material” misstatement of facts

# 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, the District 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”



# **Content of Annual Reports**

- **Audited Financial Reports**
- **Information (i.e. tables) identified in Continuing Disclosure Undertaking**
- **Additional voluntary information**
- **Consider Rule 10b5 implications – is there more you should be saying?**
- **Has anything happened since the date of the audited financial reports that has materially impacted your financial condition?**

# 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 may be “speaking to the market”

# District Disclosure

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

# Disclosure Principles

- Historical and projected revenues, expenses and debt service coverage
- Additional bonds test
- Information on debt – types and amounts
- 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**
- **Consider maintaining 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**
  - State budget, District budget, mid-year reports
  - Status of ongoing litigation

# Process

- **Input from involved departments**
- **Empower staff at all levels**
- **District coordinates; Counsel helps pull information together and maintains document**
- **Drafts reviewed by working group**
- **“Due diligence” meeting before distribution of Preliminary Official Statement**

# Current Hot Topics

- **Status of fund balance and reserves**
- **Expected increases in retirement related payments; unfunded liabilities (pension and OPEB)**
- **Accounting practices**
- **Continuing Disclosure Compliance**
- **Use of Bond Proceeds**



# 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 District staff and legal counsel, consider discussing with the working group
- Political sensitivity and confidentiality considerations are not exceptions to disclosure

# **Topics of Recent SEC Enforcement Actions**

- **Misleading or Incomplete Financial Disclosures**
- **Failed Economic Development Projects**
- **Inadequate Pension Disclosures**
- **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.)

- **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”)**
- **Top management must support and encourage vigorous disclosure program**
- **Involved officials must receive training; District must maintain rigorous disclosure practices**
- **Protect Attorney-Client Privilege**
- **Adopt formal disclosure policy, including policies and procedures to ensure to ensure continuing disclosure compliance**

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