



# **California Municipal Treasurers Association 2015 Annual Conference Continuing Disclosure**

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# Disclosure Rules

- Securities Act of 1933 – the “Anti-Fraud Provisions”
  - ❖ Section 17(a)
- Securities and Exchange Act of 1934
  - ❖ Section 10(b)
- Rule 10b-5
- Rule 15c2-12

## Securities Act of 1933 – Section 17(a)

- Prohibits fraud in the offer or sale of securities – “It shall be **unlawful** for any person **in the offer or sale of any securities** by the use of any means . . . of . . . communication in interstate commerce or by the use of the mail, directly or indirectly
- To employ any device, scheme or artifice to defraud, or
- to obtain money or property by means of *any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or*
- to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”

## Securities and Exchange Act of 1934

- Section 10(b)(i) – “It shall be **unlawful** for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange to use or employ, **in connection with the purchase or sale of any security** . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.”

## Rule 10b-5

- Makes it “**unlawful** for any person, directly or indirectly, by the use of any means . . . of interstate commerce, or of the mails . . .
  - ❖ to employ any device, scheme, or artifice to defraud,
  - ❖ 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, or
  - ❖ to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, **in connection with the purchase or sale of any security.**”

## Application of Rule 10b-5

- Whatever you do say, be accurate
- Don't omit any **material** information
- Applies whenever the issuer "speaks to the market" with respect to:
  - ❖ initial disclosure in the official statement
  - ❖ continuing disclosure filed under Rule 15c2-12 discussed below
  - ❖ voluntary filings
- In its August 2010 Order against State of New Jersey the SEC repeated its long-stated position that Rule 10b-5 also applies to "[continuing] disclosure and to any other statements to the market."

# Materiality

- Definition - Supreme Court says: A statement or omission is material
  - ❖ “if there is a substantial likelihood that a reasonable [not “any”] investor would [not “could”] consider it important [not “interesting”] in making the decision to purchase or sell the securities.”
  - ❖ “there is substantial likelihood that having the information would have been viewed by the reasonably investor as having significantly altered the total mix of information available.”

➤ Elements of Materiality

- ❖ Unusual, Alarming, Worrisome
- ❖ Red Flags
- ❖ Probability Versus Magnitude
- ❖ In any SEC enforcement or other securities law proceeding the determination of what is “*material*” is made looking back and in light of any “*bad*” things which happened/developments after the original disclosure

## Rule 15c2-12 – Municipal Securities Disclosure

- Designed to prevent fraudulent, deceptive or manipulative acts or practices by participating **underwriters** of municipal bonds.
- Requires participating underwriters to:
  - ❖ Obtain and review an official statement deemed final by the issuer as of its date
  - ❖ Obtain a written agreement of the issuer to provide continuing disclosure

## ➤ **Original 1996 Rule Requiring Continue Disclosure (Rule 15c2-12(b)(5))**

- ❖ Adopted by the SEC pursuant to its regulatory authority of **underwriters**
- ❖ Effective July 3, 1996
- ❖ Required Underwriters to obtain a written agreement by Issuers to file:
  - **Annual Reports** disclosing financial and operating information specified in a written continuing disclosure undertaking (CDU), including audited financial statements
  - **Notices** of the **occurrence** of certain **Specific Events**, if material

## ➤ **2010 Amendment to Rule 15c2-12(b)(5)**

- ❖ Applies to all municipal securities that closed on or after December 1, 2010
- ❖ Requires Underwriters to obtain a written agreement from Issuers to file Notices within **10 Business Days** following the **occurrence** of certain **Specified Events**
- ❖ Modifies **six Specified Events** to require filing of Notices upon occurrence, **without regard to materiality**
- ❖ Adds four additional Specified Events to be disclosed, including two Specified Events to be disclosed, **if material**
- ❖ **No longer exempts** from Variable Rate Demand Obligations issued or remarketed on or after December 1, 2010

# Summary of Rule 15c2-12(b)(5) Requirements to Report Specified Events

Description of Specified Event	Original Reporting Requirements Effective July 3, 1996	Reporting Requirements For All Municipal Securities Issued on or After December 1, 2010
Principal and interest payment delinquencies	If Material	Report without regard to materiality
Non-payment related defaults	If Material	If Material
Unscheduled draws on debt service reserves reflecting financial difficulties	If Material	Report without regard to materiality
Unscheduled draws on credit enhancements reflecting financial difficulties	If Material	Report without regard to materiality
Substitution of credit or liquidity providers, or their failure to perform	If Material	Report without regard to materiality
Tax status issues	If material, report adverse tax opinions or events affecting the tax-exempt status of the security.	Report any of the following, without regard to materiality: adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax status of the security  Report, if material, any events affecting the tax status of the security (including Build America Bonds)
Modifications to rights of security holders	If Material	If Material
Bond calls	If Material	If Material
Defeasances	If Material	Report without regard to materiality
Release, substitution, or sale of property securing repayment of the securities	If Material	If Material
Rating changes	If Material	Report without regard to materiality
Failure to file Annual Report by deadline	Report without regard to materiality	Report without regard to materiality
Tender offers	N/A	Report without regard to materiality
Bankruptcy, insolvency, receivership or similar event of the obligated person	N/A	Report without regard to materiality
Consummation of a merger, consolidation, or acquisition involving an obligated person, or the sale of all or substantially all the assets of the obligated person, other than in the ordinary course of business, the entry of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms	N/A	If Material
Appointment of a successor or additional trustee or the change of name of a trustee	N/A	If Material

- **The statement in the official statement under “Continuing Disclosure” must accurately reflect compliance by the issuer with its prior CDUs**
- **Consequences of Failure to Comply with Continuing Disclosure Undertakings**
  - ❖ Issuers are required to make the missing filings and disclose for **5 years** in all of its Official Statements all failures to comply, in all material respects, with previous obligations to provide continuing disclosure
  - ❖ SEC emphasized in the adoption of the December 1, 2010 amendments that underwriters may be prohibited by the Rule from buying bonds of a municipality that has **“on multiple occasions during past five years failed to provide on timely basis”** annual and events notices required by the Rule

- ❖ In 2012 the SEC issued a National Examination Alert highlighting failures in the due diligence process for municipal securities which included an emphasis on underwriting processes to verify compliance with continuing disclosure obligations
- ❖ Underwriters must have a reasonable belief in the truthfulness and completeness of the key representations made in the disclosure documents, including reasonably determining that the issuer will comply with its continuing disclosure obligations
- ❖ Failure of underwriters to establish such reasonable belief so may be grounds for a violation of the anti-fraud provisions of federal securities laws