



## SEC Enforcement: Are All Bond Issues Vulnerable?

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## What does the SEC do?

### Quotes from the SEC website:

- Protect investors
- Make sure investors have access to certain basic facts about an investment prior to buying it, and so long as they hold it.
- Encourage the steady flow of timely, comprehensive, and accurate information so people can make sound investment decisions.
- First and foremost, the SEC is a law enforcement agency.

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## Recent SEC Enforcement Activity

- Significant activity by SEC's Enforcement Division in 2013-2014:
  - Harrisburg, PA – settlement for fraudulent misstatements in budget reports and Mayor's State of the City address
  - Wenatchee (WA) Regional Events Center – fine assessed for misleading statement in Official Statement
  - State of Kansas – settlement for failure to disclose underfunding of pension liabilities
  - West Clark Schools (IN) – settlement for failure to disclose in Official Statement that District had never provided continuing disclosure to investors
- **Municipalities Continuing Disclosure Cooperation Initiative**
  - Kings Canyon School District (CA) – settlement for failure to disclose in Official Statement that not all required continuing disclosure information was timely provided to investors

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## Key SEC Rules: Anti-Fraud

### Section 10(b) and Rule 10b-5 under Securities Exchange Act

- 1) Misrepresentation or omission of a material fact;
- 2) in connection with the purchase or sale of a security; and
- 3) with "scienter" (intent to deceive/recklessness).

### Section 17(a) of the Securities Act

- 1) Material misrepresentation or omission of a material fact;
- 2) in the offer or sale of securities; and
- 3) made with negligence.

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## Key SEC Rules: Anti-Fraud

The District is **primarily liable for all statements in Official Statements, Continuing Disclosure filings and other communications to investors.**

- Financing professionals (Bond Counsel, Underwriters, Financial Advisors) can help, but using experts does not limit the District's responsibilities or liability.
- The SEC does not necessarily need to demonstrate an investor's reliance or to prove there were any investor losses for a successful enforcement action.

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## SEC Rule 15c2-12

- 1989 – Original rule adopted requiring **underwriter** to obtain and review an **official statement** before public offering of municipal securities
- 1994 – Rule amended (effective July 3, 1995) to require **underwriters** to obtain **continuing disclosure undertakings** in connection with public offering of municipal securities
- 2008 – Rule amended (effective July 1, 2009) to require continuing disclosure filings to be filed on the **EMMA website** ([www.emma.msrb.org](http://www.emma.msrb.org))
- 2010 – Rule amendments to expand disclosure requirements
- 2012 – SEC Report on Municipal Securities Market: Identified widespread shortcomings in disclosure by issuers; recommended legislative, regulatory and self-policing changes to improve disclosure to investors

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## SEC Rule 15c2-12

- Applies publicly sold bond issues over \$1 million
- Official Statement Must Contain:
  - Description of the terms of the proposed issue of securities;
  - Information, including financial information or operating data, concerning the issuer of municipal securities and any other entities, enterprises, funds, accounts and other persons **material** to an investment decision;
  - A description of the continuing disclosure undertaking, if applicable; and
  - A description of any instances in the previous five years in which the entity entering into the continuing disclosure undertaking failed to comply, **in all material respects**, with any previous continuing disclosure undertakings.

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## SEC Rule 15c2-12

- Continuing Disclosure Undertaking must be a written commitment to provide at least annually:
  - Operating Data: Annual financial information *of the same type* of financial information or operating data presented in the Official Statement
  - Audit: When and if available, audited financial statements
    - Unaudited financial statements must be provided if audit unavailable
  - Material Event Notices: Notice of certain listed events



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## SEC Rule 15c2-12 – Material Events

1. Principal and interest payment delinquencies;
  2. Non-payment related defaults, if material;
  3. Unscheduled draws on debt service reserves reflecting financial difficulties;
  4. Unscheduled draws on credit enhancements reflecting financial difficulties;
  5. Substitution of credit or liquidity providers, or their failure to perform;
  6. Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TIS) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security;
  7. Modifications to rights of security holders, if material;
  8. Bond calls, if material, and tender offers;
  9. Defeasances;
  10. Release, substitution, or sale of property securing repayment of the securities, if material;
  11. Rating changes;
  12. Bankruptcy, insolvency, receivership or similar event of the obligated person;
  13. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into 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, if material;
  14. Appointment of a successor or additional trustee or the change of name of a trustee, if material.
- And, in a timely manner, notice of a failure to provide required annual financial information, on or before the date specified in the written agreement or contract.



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## MCDC Initiative

- The SEC used its anti-fraud authority as a way to enforce Continuing Disclosure in the municipal market
- Opportunity for Districts to self-report to the SEC:
  - material misstatements
  - in Official Statements delivered since December 1, 2009
  - about the District's compliance with Continuing Disclosure Undertakings in the 5 years prior to the date of the self-reported Official Statement
- Self-Reporting deadline was December 1, 2014
- Districts agree to Cease & Desist Order with SEC in exchange for no monetary penalty



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### Continuing Disclosure Compliance

Step #1:

Locate copies of Continuing Disclosure Undertakings for all Outstanding Bonds

*Tip: Look in the transcript for the Bond issue. The "undertaking" may be included in the Bond Resolution or may be a separate Undertaking or Agreement.*

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### Continuing Disclosure Compliance

Step #2:

Determine filing deadline for Audit and Operating Data

*Tip: For most Nebraska school districts, the filing deadline will be a period of months after the fiscal year end (e.g., 7 or 9 months).*

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### Continuing Disclosure Compliance

Step #3:

Prepare Operating Data Filing that contains all required information, in required format

*Tip: Create separate continuing disclosure report with all operating data tables that are required to be updated, in same format the tables appear in the Official Statement.*

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Continuing Disclosure Compliance

Step #4:

File Audit and Operating Data on EMMA before the filing deadline

Tip: If audit is not available, do not wait to file! Instead, file unaudited financial statements, and file audit when available.

Tip: File Annual Report against District's Base (6-digit) CUSIP to ensure no bonds are missed.



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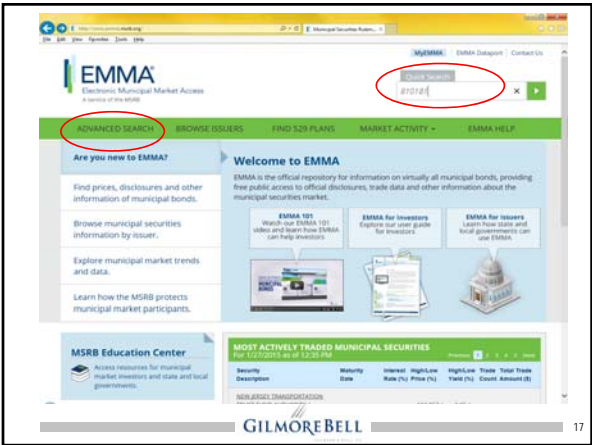
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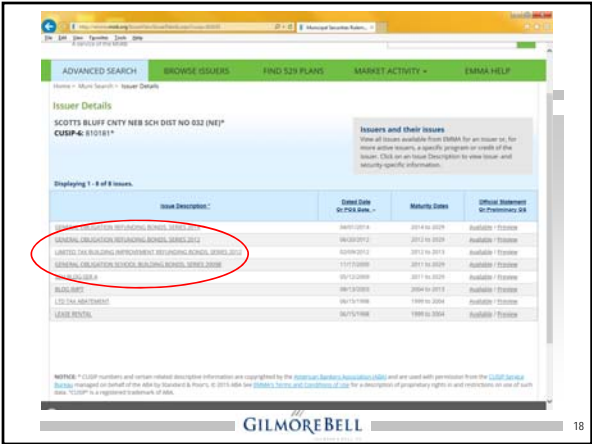
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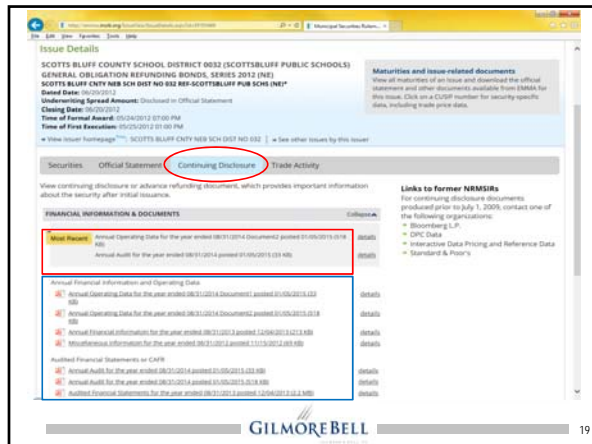
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## Continuing Disclosure Compliance

**Step #5:**

Review list of material events to be sure no inadvertent missed filings in prior year

*Tip: Rating changes for the District and for any Bond Insurer who insures the District's bonds must be disclosed.*

*Tip: Make sure District staff is familiar with the material event list, and know that filing deadline is 10 business days after event.*

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## Take-Aways

- Good disclosure is often a team effort among District staff, advisors, underwriters and legal counsel
  - However, at the end of the day, under the law, the District is 100% responsible for communications to investors
  - **Know what's in the documents!**
  - In late 2014, SEC brought unprecedented action against a Mayor individually as a "Control Person" under securities laws
  - SEC is looking for new ways to use its enforcement authority
- Consider adopting written policies and procedures to promote compliance with Federal securities laws

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Questions?



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