

CENTER FOR PUBLIC INVESTMENT MANAGEMENT



A PROGRAM BROUGHT TO YOU BY:



FIN 240: **Continuing Disclosure** from an Underwriter's Perspective

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#### **General Post-Issuance Requirements**

Investment of Bond Proceeds

Annual Rating Surveillance Annual Debt Service Budget and/or Tax Collection Discussions with County Auditor

Federal Tax Rules (Rebate / Arbitrage) Continuing Disclosure (SEC Rule)

FIN 240: Continuing Disclosure from an Underwriter's Perspective

# Municipal Issuer Disclosure – A Brief History

- Securities Act of 1933 passed with the objective of providing investors full disclosure of material facts about securities offered and sold
- Securities Exchange Act of 1934 created the Securities and Exchange Commission (SEC)
  - While municipal securities are exempt from the registration and reporting requirements of the Securities Acts, issuers are subject to liability under the anti-fraud provisions of the Securities Acts (principally Rule 10b-5 of the Securities Exchange Act of 1934)
- In spite of rule 10b-5, full disclosure was not frequently practiced by municipal issuers prior to the 1960s
- The 1960s through 1980s saw dramatic changes in the municipal market including revenue bonds, housing bonds, advance refundings, variable rate bonds, and other provisions dramatically increasing the complexity of municipal securities
- Public sentiment for increased disclosure reached new heights in 1975 with the default of New York City and in 1983 with the default of Washington Public Power Supply System
- In 1988 the SEC began several initiatives designed to improve quality, timing, and dissemination of disclosure in the municipal securities market in response to a widely held belief that there were problems in the timeliness of and access to Official Statements
- On January 1, 1990, Rule 15c2-12 went into effect which required greater access to Official Statements for primary offerings
  - While the quality of disclosure for primary offerings significantly improved with the passage of Rule 15c2-12, there was a continuing concern with the adequacy of disclosure in the secondary market

Source: https://www.sec.gov/spotlight/municipalsecurities/statements072911/borg.pdf

# Municipal Issuer Disclosure – Continuing Disclosure Requirements

- To address continuing disclosure for municipal issuers in the secondary market the SEC amended Rule 15c2-12 on November 10, 1994
- Under the amended rule, broker-dealers are barred from buying municipal securities unless the issuer has agreed, in writing, to provide **ongoing disclosure** 
  - This provision is the basis for a required Continuing Disclosure Agreement (CDA)
- This CDA requires municipal bond issuers to prepare and disseminate "Annual Financial Information" and notices of material events
  - Annual Financial Information: Usually an Annual Information Statement & Audited Financials
  - Material Event Notices: Various events (14 currently contained in the Rule) must be disclosed not in excess of ten business day after the occurrence of the event

# SEC Rule 15(c)2-12 - General

- Rule 15(c)2-12: governs primary offering disclosure and continuing disclosure, including submission of annual financial information and material event notices
  - Primary offering of municipal securities in principal amount of \$1 million or more, subject to exceptions
  - Directly governs underwriters and indirectly governs issuers and obligated persons



#### SEC Rule 15c2-12

#### SUMMARY:

The Securities and Exchange Commission ("SEC" or "Commission") is adopting amendments to Rule 15c2-12 under the Securities Exchange Act of 1934 ("Exchange Act") to **deter fraud and manipulation in the municipal securities market** by prohibiting the underwriting and subsequent recommendation of securities for which adequate information is not available. The amendments prohibit a broker, dealer, or municipal securities dealer ("Participating Underwriter") from purchasing or selling municipal securities or an obligated person has undertaken in a written agreement or contract for the benefit of holders of such securities to provide certain annual financial information and event notices to various information repositories; and **prohibit a broker, dealer, or municipal securities dealer from recommending the purchase or sale of a municipal security unless it has procedures in place that provide reasonable assurance that it will receive promptly any event notices with respect to that security. (emphasis added)** 

- 15c2-12 requires dealers to "obtain and review" the official statement, and also to have "reasonably determined" that the issuer or obligated party has entered into a continuing disclosure undertaking
- According to the SEC, for issuers that have persistently failed to comply with an undertaking, it is unlikely the dealer could form a reasonable basis to rely on the representations by the issuer that they will comply going forward.

Source: https://www.sec.gov/rules/final/adpt6.txt

#### SEC Rule 15(c)2-12 – Primary Offering

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#### SEC Rule 15(c)2-12 – Primary Offering

- Offering Document/Official Statement
  - Issuers generally work with professionals (underwriters, municipal advisors, bond counsel) to determine necessity of an offering document/Official Statement
    - Exceptions to offering document requirement:
      - Selling less than \$1 million; or
      - Selling in \$100,000 denominations to 35 or less accredited investors
  - If Issuer uses an offering document, Rule 15(c)2-12 will apply to the Issuer and the Underwriter
  - Underwriter can only market the securities if reasonably believes Issuer will provide continuing disclosure

# Broker-Dealer (Underwriter) Responsibilities – Due Diligence

- Dealers (Underwriters) are responsible for due diligence regarding compliance by Issuers
- Has the Issuer filed an annual report pursuant to Rule 15c2-12 for each of the last five (5) years? (If so, please provide evidence of such filings.)
- Has the Issuer filed any material event notices in any of the last five (5) years? (If so, please provide evidence of such filings and describe the circumstances surrounding the filing(s).)

# SEC Rule 15(c)2-12 – Continuing Disclosure – Issuers

- Issuer subject to Rule 15(c)2-12 must enter into a continuing disclosure undertaking
  - Continuing Disclosure Agreement
- Continuing Disclosure Agreements
  - Annual Filing date(s)
  - Sets forth what needs to be filed:
    - Audited financials\* Best practice is to file material event notice at this time if audited financials are not available OR file unaudited financials with this data OR disclose on the cover of AIS filing that audited financials are not available. In all instances disclose that audited financials will be filed as soon as they are available.
    - Selected annual financial/operating data from the Official Statement (largest taxpayers, tax collection rates, assessed valuation, etc.)
    - Material Event Notices (rating change, late payment, etc.)

\*if audit not available by filing date, is to be filed "when and if available"

# **Continuing Disclosure**

#### • Not all Continuing Disclosure Agreements are the same

- After current issuance of a security, if have outstanding debt:
  - \$10,000,000 or more ——— Audited financials plus financial/operating data
  - Less than \$10,000,000 —> only financial information that is "customarily prepared" (often audited financials)
- Each debt issuance has its own Continuing Disclosure Agreement
  - Example: 3 outstanding bond issues (each subject to 15(c)2-12)
     3 Continuing Disclosure Agreements
  - Ideally all 3 Continuing Disclosure Agreements have the same required filing date and are substantially the same in all material respects

# Continuing Disclosure – Underwriters Due Diligence

- Typically diligence requires an independent review of EMMA to ensure the issuer is in substantial compliance
  - Underwriters may require third party (e.g. DAC) reports using CPA to verify what securities were outstanding in the last five years for the Issuer (<u>all credits of the Issuer</u>) and to review completeness of the filing with the continuing disclosure undertakings
  - Problems exist including, but not limited to:
     Mislabelling data posted, unconnected CUSURs for varia
    - Mislabelling data posted, unconnected CUSIPs for various credits (GO Bonds vs. Revenue Bonds, COPs etc for the same Issuer), missing data or missing years

#### Continuing Disclosure – Offering Document

- Offering Document/Official Statement
  - Must summarize the requirements of the Continuing Disclosure Agreement
  - Issuer must disclose if they have <u>failed</u> to comply with prior continuing disclosure obligations any time within the past <u>5 years</u>
  - While not required many issuers include a statement in the offering document stating their compliance with continuing disclosure

Example: Rule 15c2-12 (the "Rule"), promulgated by the Securities and Exchange Commission, requires continuing disclosure with respect to new offerings of municipal securities of \$1,000,000 or more. The District is obligated to provide such continuing disclosure with respect to one or more previously issued and currently outstanding bond or note issues. The District has been in material compliance with its continuing disclosure obligations for the past 5 years. The audited financial statements of the District are not always available by the annual filing date of October 15; therefore, historically, the District filed all required operating data by the filing date and filed the audited financial statements within forty-five days after they became available on the Ohio Auditor State's website. The District's latest required operating data disclosure was filed in October 2014 for fiscal year ending June 30, 2014. The District plans to file the FY14 Audit after it becomes available on the Ohio Auditor of State website.

### Continuing Disclosure – Offering Document

- This disclosure should include a detailed description of non compliance with prior continuing disclosure obligations including:
  - Failures to publish annual information filings to EMMA by the stated deadline
  - Failures to post audited financials to EMMA once they are available
  - Failures to post required information related to "material events" to EMMA within 10 days of the material event
- It may also list in detail what steps the district has taken to ensure compliance with their continuing disclosure obligations going forward. These may include:
  - Implementing a written post issuance compliance policy
  - Signing up for EMMA continuing disclosure email reminders
  - Hiring a dissemination agent

### Continuing Disclosure – Offering Document

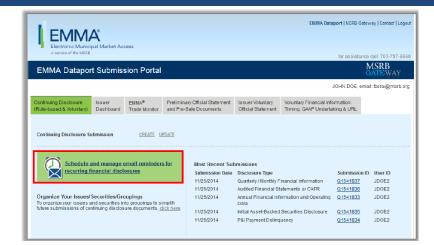
- For Issuers who have <u>persistently failed to comply</u> an objective change should be documented
  - Dissemination Agent
  - Written policy adopted
  - EMMA Reminders
- Needs to be a reasonable basis for Underwriter to rely on that Issuer will comply going forward

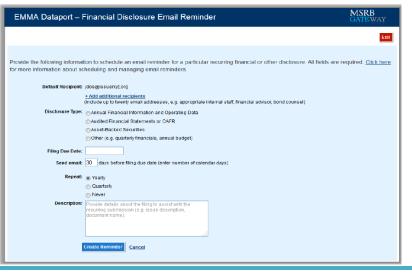
# **Continuing Disclosure - EMMA**

- Continuing Disclosure filings to be made on EMMA
  - Electronic Municipal Market Access System
  - http://emma.msrb.org/
- EMMA provides details on each publically offered security including:
  - Official Statement
  - CUSIP, maturity information, interest rate, principal amounts, initial offering price and yield
  - Continuing disclosure broken into Audited Financials, Financial/Operating Data, Event Notices
  - Trade Activity

#### **MSRB EMMA – Email Reminders**

- The MSRB EMMA site allows users to set up email alerts in advance of required filings
- Signing up for these can provide peace of mind that required filing dates will not be missed
- For example, an email reminder alert can be scheduled for 60 days before required annual filings
- This reminder will occur annually unless canceled





### **Compliance Strategy – Written Post Issuance Compliance Policy**

- In order to ensure compliance with continuing disclosure requirements going forward districts should consider adopting a written policy covering continuing disclosure
- Written policy to monitor continuing disclosure (along with other post debt issuance compliance)
- This policy should include the following information:
  - Who is in charge?
  - A file of all Continuing Disclosure Agreements, review reporting requirements and reporting dates
  - Confirm all necessary data is filed timely
  - Annual review
  - Monitor material events
  - Periodic training
- Even if a dissemination agent is hired it is ultimately the district's obligation to confirm required filings are made on time and with complete and accurate information

#### Compliance Strategy -Dissemination Agent

- A disclosure dissemination agent is hired by the District to manage the posting of required continuing disclosure
- A dissemination agent can fill the following roles:
  - Remind and assist in required filings
  - Provide disclosure templates for annual filings
  - Provide corrective action for failed filings
  - Assist with filings of voluntary or material event filings
- Dissemination agents usually cannot monitor if there has been a material event
  - District must notify dissemination agent of a material event

#### **Results of Non-Compliance**

- SEC Charges Cease and Desist Orders
- Fines against Underwriters
- Fines against Issuers
- Prosecution of officials for securities fraud
- Barring of officials and issuer itself from securities market

#### 2014 MCDC

- Municipalities Continuing Disclosure Cooperative: Violations include SEC Act of 1934 (The Exchange Act, Rule 15 c 2 -12), SEC Act 1933 (The Securities Act, 17 (a), 10 (b)
  - "The Municipalities Continuing Disclosure Cooperation Initiative (the "MCDC Initiative") is intended to address potentially widespread violations of the federal securities laws by municipal issuers and underwriters of municipal securities in connection with certain representations about continuing disclosures in bond offering documents."
  - Additional concern was if the "underwriters for these bond offerings may also have violated the anti-fraud provisions to the extent they failed to exercise adequate due diligence in determining whether issuers have complied with such obligations, and as a result, failed to form a reasonable basis for believing the truthfulness of a key representation in the issuer's official statement." (Indiana school district example)
- Requirements: Complete the SEC Questionnaire and reviewing past 5 years of offerings and compliance with existing CDAs outstanding for the issuer
  - **"Issuers who may have made materially inaccurate statements in a final official statement** regarding their prior compliance with their continuing obligations as described in Rule 15c2-12 should consider self-reporting to the Division to take advantage of the MCDC Initiative."
  - Issuers (due December 1, 2014)
  - Broker dealer as underwriters (due September 10, 2014)
- Favorable settlement terms if issuers and underwriters self report

#### **MCDC** Results

- Underwriters: Retain Independent Consultants, Cease and Desist Orders, Fines levied
- Issuers: Establish policies and procedures, including training; compliance with existing CDUs, disclose settlement terms

# Private Placements – Reporting Considerations

- While private placements are exempt from continuing disclosure, the best practice is to publish private placement information to EMMA
- Information to be posted to EMMA
  - Full Issuer Name, Name of Issue, Closing Date, Maturity Date, Interest Rate (If multiple maturities provide debt schedule), Security Type (general obligation/ revenue
- The District's placement agent or bond counsel can assist with publishing this information to EMMA
- If the District maintains a credit rating from Moody's, Standard & Poor's or Fitch they require private placement information to be sent to them