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TRANSPARENCY OF INFORMATION AND CONTINUING DISCLOSURE COMPLIANCE/ENFORCEMENT (DODD-FRANK ACT WAS CATALYST)

- 2013 Legislative Session
- Transparency, Consistency and Accuracy of Information
- Tell the Truth Texas
- Timely Filing of Reports
- 2015 Legislative Session

PRIMARY AND CONTINUING DISCLOSURE

➤ Primary Disclosure (PD)

- Official Statement
- Representations to rating agencies
- Initial sale of the obligations
- Defines your CD Obligation

➤ Continuing Disclosure (CD)

- Annual obligation to file timely and accurate information
- Timely filings of material events

➤ Municipalities Continuing Disclosure Cooperation Initiative (MCDC)

- Voluntary Program for Underwriters and Issuers to self report to SEC
“Material” misstatements concerning prior compliance regarding Continuing Disclosure

IMPORTANCE OF PRIMARY AND SECONDARY DISCLOSURE/COMPLIANCE: RECENT HEADLINES FROM *THE BOND BUYER*

- **MCDC Architect Chan: Rethink Tower Amendment** – October 7, 2014
 - Chan, former SEC Enforcement Officer. He created MCDC
- **Ex-Wayne County CFO Indicted Over Bond-Funded Detroit Jail Project** – September 15, 2014 (Primary Disclosure)
 - Misrepresented Financial information to rating agencies
- **SEC: Lines Open for MCDC Underwriters** – October 6, 2014 (Primary & Secondary)
 - Report yourself to SEC
- **Appeals Denial's MCDC Implications** – September 16, 2014 (Primary)
 - Used Bond Proceeds to hide shortfall
- **SEC Could Halt Muni Bond Sales** – September 18, 2014 (Secondary)
 - Fraudulent Disclosure in OS – Did not meet requirements
- **SEC Trumpets Record Enforcement Year** – October 16, 2014
 - 755 Enforcement Actions - \$4.16 Billion in fines
- **Chan Warns of secondary market crackdown** – October 29, 2014 (Secondary)
 - Pricing in secondary market sales and continuing disclosure

CONTINUING DISCLOSURE - SEC RULE 15C2-12 (ANNUALLY)

➤ **Obligates issuers to file accurate annual financial information and notices of material events to improve disclosure in Secondary Market**

- Audits, budgets, notice of certain events (defined in OS)
- Compliance with Prior Undertakings (defined in OS)
- Normally within 6 months of the fiscal year end
- Specifically determined from what is provided in Official Statement

➤ **Prohibits dealers and underwriters from buying new offering of municipal securities unless the 15c2-12 obligation is met**

REQUIRED MATERIAL EVENTS (10 DAYS FROM OCCURRENCE - EFFECTIVE JANUARY 1, 2011)

The following must be filed regardless of materiality:

1. Principal and interest payment delinquencies
2. Unscheduled draws on debt service reserves reflecting financial difficulties
3. Unscheduled draws on credit enhancements reflecting financial difficulties
4. Substitution of credit or liquidity providers, or their failure to perform
5. Adverse tax opinions
6. Defeasances
7. Rating changes
8. 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 securities
9. Tender offers
10. Bankruptcy, insolvency, receivership or similar proceeding

REQUIRED MATERIAL EVENTS (CONT.)

The following must be filed if deemed material:

11. Non-payment related defaults
12. Modifications to rights of security holders (changes to bond covenants or the continuing disclosure agreement)
13. Bond calls
14. Release, substitution, or sale of property securing repayment of the securities
15. Mergers, consolidations, acquisitions, the sale of all or substantially all of the assets of the obligated person or their termination
16. Appointment of a successor or additional trustee or the change of the name of a trustee

IMPORTANCE OF DISCLOSURE

- The SEC has direct authority over investment banking firms and MA's - **currently, it does not directly oversee the municipalities** (Tower Amendment)
- The SEC has urged Congress to grant them direct authority over municipal issuers, Congress has not yet acted
- The SEC has turned to one of its most powerful tools - **“enforcement actions”**
- The SEC filed its first securities case against a state in 2010, charging it with misleading investors about two major pension funds and also fined four former City officials for misleading investors about the city's fiscal problems
- The SEC is motivated, and is devoting the resources necessary to detect and prosecute violations

SEC's MCDC SELF-REPORTING INITIATIVE

- **In March 2014, SEC passed the Municipalities Continuing Disclosure Cooperation (MCDC) Initiative**
- **Opportunity for underwriters and issuers, to self-report materially inaccurate statements regarding CD in the last five years**
- **Limits the penalties to issuers and underwriters if they self-report**
 - September 9, 2014 deadline for underwriters
 - December 1, 2014 deadline for issuers
 - SEC has threatened harsher settlement/penalties for material violations that are not self-reported
- **Materiality**
 - Key Factor, how do you define material?
 - What a reasonable investor would want to know before making investment

SEC's MCDC SELF-REPORTING INITIATIVE

➤ For underwriters, among other items, a monetary penalty that is capped for each firm

- Total revenues less than:

\$20 Million - \$100,000

\$20 - \$100 Million - \$250,000

Over \$100 Million - \$500,000

➤ For issuers

- Agree to cease and desist; may have no civil penalty
- Bring disclosure filings up to date and establish procedures to ensure future compliance
- Cooperate with SEC's review of any false statements related to disclosure compliance, including the parties involved in making them
- Disclose settlement with the SEC for a 5 year period in any official statements
- Possible enforcement actions

➤ **Subject to Anti-Fraud Provisions.**

- Municipal bonds are not subject to the registration and reporting requirements under the 1933 and 1934 Federal Securities Acts.
- Municipal bonds are subject to anti-fraud provisions of those Acts and Rule 10b-5.

➤ **Rule 10-5.**

- Rule 10b-5 and anti-fraud statutes require that an issuer's communications to the securities market be accurate and complete in all material respects.
- Communication cannot contain misstatements or omissions of "material" facts.

➤ **Material Fact.** A fact is material if there is a substantial likelihood a reasonable investor would consider it important in deciding whether to buy or sell bonds or the price the investor would be willing to pay or receive.

➤ **Applicability of Rule 10b-5.** Rule 10b-5 applies whenever an issuer "speaks to the market" by disclosing information to the market (bond offerings, Rule 15c2-12 continuing disclosure filings).

SPEAKING TO THE MARKET

- **Generally.** A communication is considered a disclosure to the market if the issuer reasonably expects that the information released will reach investors and the trading markets, even if not specifically prepared for that purpose.
- **Communications to the Market.** An issuer communicates information to the market in many ways. These include many communications that are not formal disclosures to the securities market:
 - Official Statements distributed in connection with bond issues
 - Rule 15c2-12 filings (both annual financial and operating data and periodic event filings)
 - Information posted on website
 - Statements from governing body members during open meetings
 - Reports presented during open meetings
 - Press releases, interviews with the press, or speeches and other public presentations
 - Widely distributed emails
 - Responses to open records requests
- **Awareness.** The number of ways in which an issuer speaks to the market illustrates why all council members/directors/trustees and officers and employees must constantly be aware of securities law principles, including that all communications must be accurate and complete in all material respects.

CONSEQUENCES OF NONCOMPLIANCE

Failure to meet the anti-fraud requirements with respect to disclosure could result in the following consequences:

➤ Potential Legal Consequences

- SEC enforcement actions, including injunctions, cease-and-desist orders (orders requiring an entity or person to refrain from certain activities immediately), and monetary penalties
- Private lawsuits
- State criminal charges for fraud
 - These actions could be with respect to the issuer entity itself or its council members/directors/trustees, officers or employees individually

➤ Potential Business Consequences

- Inability to access the public debt markets for a long period of time
- Lower bond ratings and increased borrowing costs
- Business disruption due to SEC investigations and private lawsuits
- Severe injury to business reputation

DISCLOSURE RESPONSIBILITIES

- **The Issuer's Documents.** The SEC considers disclosure documents, including offering and continuing disclosure documents, to be the issuer's documents, regardless of the preparer or provider of the information for the document.
- **Reasonable Reliance.**
 - The SEC allows issuers of municipal bonds to rely upon hired experts, lawyers and financial advisors, but such reliance cannot be reckless and must be reasonable.
 - Issuers (including governing body members and staff) cannot withhold material information and cannot completely delegate its due diligence responsibilities to others. "No one knows better than the issuer where the closets are, or what skeletons may be in the closets." (A former director of SEC Office of Municipal Securities).
 - The governing body can reasonably rely on employees but may not completely delegate due diligence responsibilities.
 - Issuers themselves (including governing body members and staff) must carefully read and review offering documents, particularly financial and operating information, prior to approval.

INCREASED SEC ENFORCEMENT

- The SEC has been increasingly scrutinizing the sufficiency and accuracy of the municipal market disclosures provided by municipal issuers
- Investigations into both primary and secondary market disclosures.
- The cases referenced below are good examples of situations in which issuers failed to disclose material facts. In all of these cases, the issuers used staff and consultants in preparing the disclosure.
 - *Greater Wenatchee Regional Events Center Public District* (Nov. 2013) – failure to disclose revisions to financial projections
 - *City of Miami, FL* (July 2013) -- misrepresentations and omissions as to annual financials and bond offering disclosures, including fund balances
 - *State of Illinois* (March 2013) and *State of New Jersey* (August 2010) -- failure to disclose pension plan underfunding
 - *West Clark Community Schools, IN* (July 2013) – misrepresentation in official statement regarding compliance with continuing disclosure undertakings
 - *City of Harrisburg, PA* (May 2013) -- misleading secondary market disclosures
 - *Massachusetts Turnpike Authority* (July 2003) -- failure to disclose project overruns in bond offering documents
 - *City of Miami, FL* (March 2003) – misrepresentations and omissions regarding financial status in official statements and in comprehensive annual financial report
 - *Dauphin County, PA* (April 2004) -- issuer failure to disclose a material facts regarding lease expirations
 - *City of San Diego* (Nov. 2000) -- failure to disclose pension plan underfunding

LESSONS LEARNED

Evidence of exercising reasonable care can help protect issuers and their officials from liability that is predicated on negligence or recklessness. General lessons learned from SEC enforcement actions include:

- Educate council members/directors/trustees and staff
- Hire skilled external auditors
- Disclose the bad with the good
- Evaluate statements/communications for anti-fraud purposes
- Reliance on staff, consultants, experts and others must be reasonable
- Adopt written policies and procedures

ADOPT AND IMPLEMENT COMPREHENSIVE POLICIES AND PROCEDURES IN DEBT POLICY OR IN SEPARATE DISCLOSURE POLICY

- Identify individual responsible for filing deadlines of continuing disclosure annual reports and event filings.
- Process for draft and review offering documents an continuing disclosure for accuracy of information.
- Depending on the issuer’s size, consider creating a “disclosure working group.”
- Identify roles of professionals
 - Financial Advisor
 - Bond Counsel
 - Disclosure Counsel

WHERE TO GO FOR INFORMATION

- Provides information required for disclosure and use of Electronic Municipal Market Access (EMMA) <http://emma.msrb.org/>
- MSRB created a State and Local Government Toolkit at <http://www.msrb.org/MSRB-For/Issuers/Issuer-Toolkit.aspx>
- GFOA Best Practices http://www.gfoa.org/index.php?option=com_content&task=view&id=1588
- BDA – Bond Dealers of America <http://www.bdamerica.org/>

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