

## Disclosure – Primary and Continuing

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## Agenda

Part I – Overview of Primary Disclosure under  
Federal Securities Laws

Part II – Overview of Continuing Disclosure  
under SEC Rule 15c2-12

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## Part I - Primary Disclosure

Allison Binkley



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### Overview of Primary Disclosure



- What is it? What is included?
- Why is it important?
- What laws/rules apply to it?

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### Overview of Federal Securities Regulation



- The Securities Act of 1933:
  - Regulates primary market transactions (initial sales of securities by issuers to underwriters)
- The Securities Exchange Act of 1934
  - Primarily regulates secondary market transactions
- The 34 Act created the U.S. Securities and Exchange Commission (commonly known as the SEC) to enforce federal securities laws.
  - **The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.**

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### Overview of Federal Securities Regulation



- According to the SEC, the main purpose of the 33 Act and the 34 Act can be reduced to two common-sense notions:
  - Issuers publicly offering securities for investment dollars **must tell the public the truth** about their businesses/enterprises, the securities they are selling and the risks involved in investing.
  - People who sell and trade securities – brokers, dealers and exchanges – **must treat investors fairly and honestly**, putting investors' interests first.

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### Overview of Federal Securities Regulation



- Municipal securities are generally exempt from the registration requirements of the 33 Act and governmental entities are generally exempt from the reporting requirements of the 34 Act.
- Not exempt from the anti-fraud provisions of the 33 Act and the 34 Act.
- Somewhat constrained by the "Tower Amendment" included in the 1975 amendments to the 34 Act (which created the Municipal Securities Rulemaking Board (MSRB)).
  - SEC and MSRB are prohibited from requiring issuer filings/registration prior to issuance
  - MSRB prohibited from requiring any filings by issuers with the MSRB
- Instead there is indirect regulation of municipal issuers – Rule 15c2-12.

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### Overview of Federal Securities Regulation



- Over the past several decades the municipal market has grown significantly and with that growth has come a heightened interest in the market by the SEC.
- Series of well publicized defaults (*i.e.*, NYC in the 1970's, Washington Public Power Supply System in the 1980's, Jefferson County, Alabama in the 2010's).
- In the mid-1990's, the SEC published an "Interpretive Release" as well as amendments to Rule 15c2-12 which implemented annual disclosure requirements for issuers of municipal securities.
  - Rule 15c2-12 of the 34 Act (1989, 1995, 2009, 2019)
- SEC's authority over municipal issuers is limited to enforcement of anti-fraud provisions.

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### Anti-Fraud Provisions



- Section 17(a) of the 33 Act and Section 10(b) of the 34 Act (and Rule 10b-5 under the 34 Act)
- Section 17(a) of the Securities Act of 1933:
  - Regulates primary market transactions (initial sales of securities by issuers to underwriters)
  - Section 17(a) of the 33 Act prohibits obtaining 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.**
    - A fact is material if there is a substantial likelihood that a reasonable investor would have viewed the information as "having significantly altered the 'total mix' of information available."
    - To the extent the omitted information relates to contingent future events, materiality depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of circumstances."
  - Negligence is sufficient to prove violations of Section 17(a) of the 33 Act.

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



Section 17(a) of the Securities Act of 1933:

- It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly –
  - (a) to employ any device, scheme or artifice to defraud, or
  - (b) 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 the light of the circumstances under which they were made, not misleading, or
  - (c) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

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### Section 10(b) of the 34 Act



- ▶ Section 10(b) of the Securities and Exchange Act of 1934
  - Similar to section 17(a)
  - Prohibits the use, in connection with the purchase or sale of a security of any manipulative or deceptive device
  - Requires a showing that defendants acted with "scienter" or a culpable state of mind.
    - Scienter requirement for antifraud violations may be satisfied by a showing of recklessness as well as a showing of guilty knowledge and intent. State of mind may be shown by circumstantial evidence.
    - Recklessness: "An extreme departure from the standards of ordinary care, and which represents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."

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### Rule 10(b)-5



- ▶ Rule 10b-5:
  - Prohibits the use of any instrumentality of interstate commerce, mails, or facilities of national securities exchange, in connection with the purchase or sale of any security, to:
    - (a) Employ any device, scheme or artifice to defraud;
    - (b) **Make any untrue statement of a material fact or 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
    - (c) Engage in an act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

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### What is Primary Disclosure?



- Primary disclosure: made when bonds are issued or remarketed.
- Typically an "official statement" – an OS; in its preliminary form it is called a "preliminary official statement" – a POS.
- The POS is used to market bonds prior to signing a bond purchase agreement in a negotiated sale or awarding the sale of bonds through a competitive sale process.
- The POS is then finalized to become the final OS.
- A POS is permitted to exclude certain pieces of information (that get filled in after pricing in the final OS):
  - offering price(s), interest rate(s), selling compensation, aggregate principal amount, principal amount per maturity, delivery dates, any other terms or provisions required by an issuer of such securities to be specified in a competitive bid, ratings, other terms of the securities depending on such matters, and the identity of the underwriter(s).

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### Final Official Statement



- A final official statement is document or set of documents prepared by issuer that is complete and that sets forth certain information, including financial information or operating data, concerning the issuer and those entities, enterprises, funds, accounts and persons material to the offering.
  - Must include information on what must be submitted for continuing disclosure and deadline for submission
  - Must include any instances of non-compliance with continuing disclosure obligations within past 5 years
- Final Official Statement must be sent to underwriter within 7 business days after final agreement to purchase is reached (i.e., pricing and signing of bond purchase agreement)

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### Primary Disclosure Requirements



- It needs to include all material information about the bonds being offered and the means by which those bonds will be repaid.
- Everything you want investors to know and everything investors should know about the bonds being issued should be included (either directly or incorporated by reference) in the Official Statement.
- Can include the risks to an investor that relate to the purchase and repayment of a security.
- Very similar to a prospectus document of a public corporation in connection with stock or debt offerings.
- The information in the document must be both accurate and complete.
- Primary responsibility for the accuracy of this document lies with the issuer, regardless of who is preparing the document. This responsibility under the securities laws cannot be delegated to outside consultants but liability can be extended to third parties for their participation in the alleged fraud.

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### Primary Disclosure Requirements



- Sections typically include:
  - Information regarding the bonds, security and structure
- Information about the issuer:
  - Organizational, demographic information, financial
  - Economic development and/or industry and commerce
  - Pending litigation
  - Rating(s)
- Continuing disclosure requirements and past compliance
- Audited (and sometimes unaudited) financial statements
- Bond counsel opinion

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### Recent SEC Enforcement Actions



- Increased scrutiny of municipal market
- Orange County, California (January 24, 1996) after bankruptcy filing and huge losses in its investment portfolio, caused at least in part by the County Treasurer's aggressive bets on the derivative financial products, the SEC brought actions against the County, certain County officials and employees for failing to disclose the risks involved with potential investment losses.
  - The SEC issued a report advising that a public official may not authorize disclosure that the official knows to be false and may not authorize disclosure while recklessly disregarding facts.
  - **Takeaway #1 Can't disregard what you know when you review disclosure documents.**

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### Recent SEC Enforcement Actions



- San Diego, California (November 14, 2006) – SEC entered a cease and desist order against the City that settled administrative proceedings concerning the failure to disclose substantial and growing City's pension obligations.
  - Separate enforcement actions resulted in settlements with city officials including fines ranging from \$5,000 to \$25,000.
  - Remedial action taken by the City was noted very favorably by the SEC and included the development and implementation of very detailed disclosure polices and procedures for bond issuance.
- Crosby Independent School District (Texas) (2022) – Cease and desist order against school district for use of inaccurate financial statements containing material misstatements and omission in bond offering. Former CFO agreed to permanent injunction against future violations and participating in future offerings of municipal securities and civil fine of \$30,000.
- **Takeaway #2 SEC will seek financial penalties against issuer employees.**

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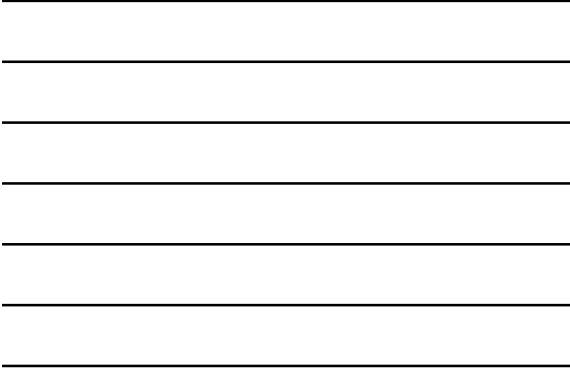
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Recent SEC Enforcement Actions



- Anthony Michael Holland – CAO of Johnson City, Texas (2022). Holland embezzled funds from the City and to cover it up he marked up the financial statements. The financial statements were posted on EMMA to comply with continuing disclosure.
  - Takeaway #3: continuing disclosure documents are also subject to antifraud provisions.
- In the Matter of City of Harrisburg, PA
  - Cease and desist settlement for Section 10(b) and Rule 10b-5 violations
  - Public statements and info on City website including Mayor's State of the City Address, budget and fiscal reports made during a 2-year period misrepresented and omitted to state material information regarding Harrisburg's deteriorating financial condition and credit ratings downgrades.
  - During same period no continuing disclosure filings were made.
  - Takeaway #4: just because it is not posted on EMMA in continuing disclosure filings doesn't mean it's not subject to SEC scrutiny.



Recent SEC Enforcement Actions



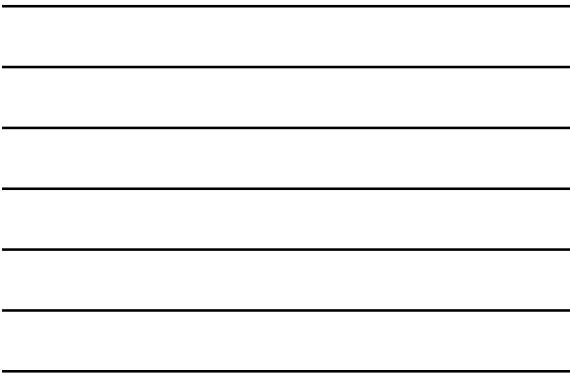
- City of Miami (SEC v City of Miami, U.S. District Court, Southern District of Florida, No. 13-22600 2016) - City and former budget director are charged with anti-fraud violations concerning year-end transfers to the City's general fund, including misstatements in ACFR and offering documents that concealed alleged improper transfers.
  - The charges also include violation of a previous cease and desist order.
  - A federal jury found both the City and former budget director liable.
  - The City paid a settlement of \$1 million. The former budget director was fined \$15,000, although the SEC sought \$450,000.
  - First federal jury trial in a municipal securities enforcement action.
  - Takeaway #5 "I fought the law and the law won."
- West Clark Community Schools (July 29, 2013) - Issuer told investors in a 2007 official statement that it was in material compliance with all previous Rule15c2-12 undertakings when it had failed to make any annual filings.
  - Takeaway #6. Be honest about past compliance with continuing disclosure.



Recent SEC Enforcement Actions - 2022



- SEC charged Rochester, New York charged the City, its former finance director and an advisory firm of misleading investors in its 2019 offering documents for bond sale on behalf of its school district. SEC alleges that offering documents contained outdated financial information and failed to disclose that district was experiencing unusual financial distress.
  - City claims don't have all of the financial information because it was school district finances.
  - SEC says officials knew the district had "an enormous and unusual" cash decline of \$63 million at the end of fiscal year 2019, partially due to increased salary spending, but they didn't investigate the extent of the overspending nor inform investors about the risks the overspending posed to the district or city's finances, the SEC alleged.
  - The SEC said that while the offering documents showed the \$63 million cash decline, readers of the documents would have needed further disclosure to understand the decline was substantially due to the district's increasing deficit and overspending. In light of the \$50 million revenue anticipation note the city sold as part of the bond offering, a more reasonable interpretation was that the decline "was due merely to a mismatch in timing of state aid revenue (and would be resolved when the aid was received)," according to the complainant.
  - Takeaway #7: if something doesn't add up, cannot ignore it.
- SEC charged town of Starlington, Louisiana, former mayor and unregistered municipal advisor with misleading investors. False financial projections were submitted to the state commission approving the bond issue.
  - Alleges that town did not inform investors that approval was based upon false projections or misuse of prior bond proceeds from sewer system to sports complex improvements.
  - Partial settlement: Cease and desist order, civil penalties, disgorgement.
  - Takeaway #8: fail to disclose prior fraud is also fraud.



### Price of Failure



- The price of failing to get disclosure right can be high.
- San Diego is reported to have spent more than \$26 million for internal investigations to determine what happened and who was responsible.
- State of New Jersey reportedly paid more than \$8 million to a law firm to assist it in developing disclosure policies and represent the State when it self-reported disclosure insufficiencies regarding pension liabilities.
- The City of Miami paid a \$1 million settlement after the jury verdict in 2016. That was in addition to the millions it had already paid out in legal fees over the previous 4 years.

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## CONTINUING DISCLOSURE



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### OVERVIEW

1. SEC Rules (SEC Rule 15c2-12)
2. Continuing Disclosure Agreements
3. Compliance Strategy/Best Practices




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## SEC Rules



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### Primary Forms of Regulation of "Obligated Persons"

- » Indirectly by SEC/MSRB regulation of broker-dealers, banks, and financial advisors
  
- » Directly through anti-fraud provisions of the Securities Act of 1933 (the "'33 Act") and the Securities Exchange Act of 1934 (the "'34 Act")



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### SEC Rules – '33 Act and '34 Act

- » '33 Act – passed with the objective of providing investors full disclosure of material facts about securities offered and sold
- » '34 Act – 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 '34 Act
      - Prohibits a knowing manipulation or deception through misrepresentation or omission of material information in connection with the purchase and sale of securities



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## SEC Rule 15c2-12

- **Rule 15c2-12:** 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
  - The Rule directly regulates only underwriters, but indirectly regulates issuers and obligated persons.



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## Continuing Disclosure Agreements



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## Continuing Disclosure Agreements

- Persons subject to Rule 15c2-12 must enter into an undertaking to provide continuing disclosure: Continuing Disclosure Agreement ("CDA")
  - Each debt issuance subject to Rule 15c2-12 will have its own Continuing Disclosure Agreement
- Three general categories of information must be disclosed pursuant to SEC Rule 15c2-12(b)(5)(i) by the deadlines indicated below:
  1. Audited financials\*
    - a. By the filing deadline stated in the CDA
  2. Selected annual financial/operating data from the Official Statement
    - a. By the filing deadline stated in the CDA
  3. Material Event Notices (rating change, late payment, etc.)
    - a. To be filed in a timely manner not in excess of ten business days after the occurrence of the event

\*if audit not available by filing date, is to be filed once it becomes available



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### Continuing Disclosure Material Events

	Events	Materiality
1	Principal and interest payment delinquencies	Without regard to materiality
2	Non-payment related defaults	If material
3	Unscheduled draws on debt service reserves reflecting financial difficulties	Without regard to materiality
4	Unscheduled draws on credit enhancements reflecting financial difficulties	Without regard to materiality
5	Substitution of credit or liquidity providers, or their failure to perform	Without regard to materiality
6	Adverse tax opinions or events affecting the tax-exempt status of the security	Adverse tax opinions, the issuance by the Internal Revenue Service 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
7	Modifications to rights of security holders	If material

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### Continuing Disclosure Material Events

	Events	Materiality
8	Bond calls and tender offers	If material
9	Defeasances	Without regard to materiality
10	Release, substitution, or sale of property securing repayment of the securities	If material
11	Rating changes	Without regard to materiality
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

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### Continuing Disclosure Material Events

	Events	Materiality
15	Incurrence of a financial obligation of the obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the obligated person, any of which affect security holders	If material
16	Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of a financial obligation of the obligated person, any of which reflect financial difficulties	Without regard to materiality
17	Failure to file continuing disclosures by deadline*	

\*Does not appear on the list of material events but required by Rule 15(c)(2)-12.



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## 2019 Amendments to Rule 15c2-12(b)(5)(i)(C)

### ➤ Event 15

- Incurrence of a financial obligation of the issuer or obligated person, if material, or agreement to covenants, events of default, remedies, priority rights, or other similar terms of a financial obligation of the issuer or obligated person, any of which affect security holders, if material

### ➤ Event 16

- Default, event of acceleration, termination event, modification of terms, or other similar events under the terms of the financial obligation of the issuer or obligated person, any of which reflect financial difficulties




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## Effect of Amendments

- As of February 27, 2019, SEC Rule 15c2-12 requires disclosure of the terms of private (bank) placements
  - Under a private placement, there is no need to enter into a Continuing Disclosure Agreement...
  - HOWEVER, the 2019 amendments to SEC Rule 15c2-12 amendments require bank placement disclosure in connection with public transactions
    - Must disclose private placements in connection with CDAs executed in public transactions
    - Effective on and after February 27, 2019 (unless a CDA requires this disclosure sooner)




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## Key Term For New Event 15 and 16

### ➤ “Financial Obligation”

- The term financial obligation means a (i) debt obligation; (ii) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (iii) guarantee of (i) or (ii). The term financial obligation shall not include municipal securities as to which a final official statement has been provided to the Municipal Securities Rulemaking Board consistent with this rule.




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### SEC "Guidance" on "Financial Obligations"

- Includes both short-term and long-term debt obligations of an obligated person under the terms of an indenture, loan agreement, lease, or similar contract regardless of the length of the repayment period of the debt obligation
- Leases that "operate as vehicles to borrow money" (i.e. financing leases) are financial obligations
  - Operating leases are not financial obligations



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### Disclosing Material Financial Obligations

- Notice of the incurrence of a "material financial obligation" should include a description of the "material" terms of the financial obligation
  - The SEC provided little guidance on its interpretation of materiality; the following examples of material terms were provided:
    - Date of incurrence, principal amount, maturity and amortization, interest rate (if fixed) or method of computation (if variable) plus any default rates, and other terms, depending on the circumstances
  - The determination is ultimately left to the obligated person
    - Best practice = consult bond counsel
    - Best practice = post full document with redactions
- Derivative instruments of the type described in the definition of financial obligation must always be disclosed on EMMA



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### EMMA

- Continuing Disclosure filings are made on EMMA
  - Electronic Municipal Market Access System
- EMMA provides details on each publicly 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
  - Ratings



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## Compliance Strategy/ Best Practices



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### CONSEQUENCES OF FAILURE TO MAKE REQUIRED DISCLOSURE

- The CDA is an enforceable obligation, and the Obligated Person may be compelled, either by the underwriter, or by any holder of the Bonds to make the disclosure reports called for.
- Rule 15(c)2-12 requires Obligated Persons to file a Notice of Failure to Comply.
- Noncompliance will appear in the Obligated Person's next Official Statement: Rule 15(c)2-12, requires that a final official statement must include a statement of any instances in the prior five years when any "obligated person for whom financial information or operating data" has been included in an Official Statement has "failed to comply in all material respects" with a prior CDA.
- May "chill the market" - bond market may feel it cannot rely on that Obligated Person to comply in the future.
- Possible action for securities fraud if, for example, investor asserts they would have bought/sold based on timely disclosure of the missing information.



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### Compliance Strategy

- > Written Policy
- > This policy should include the following information:
  - > Who is in charge? Back-up person?
  - > Maintain a file of Continuing Disclosure Agreements, review reporting requirements and reporting dates
  - > Confirm all necessary data is filed timely
  - > Annual review
  - > Monitor material events
  - > Periodic training



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## Compliance Strategy Dissemination Agent

- Should we hire a Dissemination Agent?

**Pros:** 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

**Cons:** Dissemination agents usually cannot monitor if there has been a material event

- Obligated Person must notify dissemination agent of a material event
- Obligated Persons must complete the report (most of the disclosure "work" is already done)
- Cost
- Even if a dissemination agent is hired it is ultimately the Obligated Person's obligation to confirm required filings are made on time and with complete and accurate information



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## MSRB EMMA E-mail Reminders

- The MSRB EMMA site allows users to set up e-mail 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 e-mail reminder alert can be scheduled for 60 days before required annual filings
- This reminder will occur annually unless canceled



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## COVID-19 Disclosures

- First determination: is the proposed item to be disclosed a "Material Event"?
  - If so, then MUST disclose within 10 business days of occurrence
  - If not, then no filing is required, but...
- Second determination: is there reason to file a voluntary notice?
  - May want to "get ahead" of news that will be publically disclosed
    - PR benefits
  - Promote transparency/trust among bondholders
  - Market movement towards disclosure
- Contact your bond counsel



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## Questions? and Contact Info



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