



NEW ENGLAND STATES
GOVERNMENT FINANCE OFFICERS ASSOCIATION

Annual Disclosures for Municipal Bonds

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Presenters



ALEXANDER SHIH
Managing Director

Public Finance / Debt Investment Banking
T 646.557.1541 // Cell & Texting 917.877.0830
alexander.shih@raymondjames.com
320 Park Avenue, 12th Floor
New York, NY 10022
www.RJPublicFinance.com



MATTHEW PAGE
Member / Chair, Public Finance

T 617.348.1825
mpage@mintz.com
One Financial Center
Boston, MA 02111
www.mintz.com/industries-practices/public-finance

What will we cover today?

- Regulatory Framework
- Types of Disclosure
- Consequences for Failure to Disclose
- Underwriter Considerations
- Best Practices

Regulatory Framework

- Rule 15c2-12 of Securities Exchange Act of 1934
- Requires that underwriters of municipal securities, before bidding, purchasing, or selling a municipal security in the primary market, must obtain and review the issuer's official statement and reasonably determine that the issuer has committed to provide continuing disclosures to investors.



Regulatory Framework (2)

- Continuing Disclosure Agreement
 - Issuer commitment to bondholders
 - Annual financial information or operating data
 - *Based on OS*
 - *Set deadline*
 - Audited financial statements, when/if available
 - Notices of 16 specified events
 - Notice of failure to provide annual information by deadline

Regulatory Framework (3)

- Antifraud provisions
 - unlawful to “employ any device, scheme, or artifice to defraud”, “obtain money or property” by using material misstatements or omissions, or to “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.” (*Section 17(a) of Securities Act of 1933*)
 - “it shall be unlawful for any person . . . (a) [t]o employ any device, scheme, or artifice to defraud, (b) [t]o make any untrue statement of a material fact or to omit to state a material fact . . . or (c) 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.” (*Rule 10b-5 of the Securities Exchange Act of 1934*)
- Materiality
 - Matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities (*Rule 10b-5*)

Disclosure Contexts

- Primary – When bonds first sold
 - Official Statement
 - *Describes bonds*
 - *Provides issuer financial and operating data material to evaluation of the offering*
 - *Describes CDA and any failure in last 5 years to comply with prior CDA*
 - Due diligence call

Disclosure Contexts (2)

- Other statements reasonably expected to reach investors
 - Investor presentations
 - Rating agency presentations
 - Remarks at conferences
- Certifications relied on by bond counsel for tax-exemption analysis

Disclosure Contexts (3)

- Secondary (Continuing) – during life of bonds
 - Annual Disclosures
 - *Late audits*
 - Event-based Disclosures, including “financial obligations”
 - *Incurrence, if material*
 - *Agreement to covenants, events of default, remedies, priority rights, or other similar terms, which affect security holders, if material*
 - *Default, acceleration, termination event, modification of terms, or other similar events, any of which reflect financial difficulties*
 - Voluntary Disclosures
 - *ESG*

Financial Obligations

- Financial Obligation means a:
 - (A) debt obligation; (B) derivative instrument entered into in connection with, or pledged as security or a source of payment for, an existing or planned debt obligation; or (C) guarantee of (A) or (B)
 - Not including municipal securities for which a final official statement has been provided consistent with Rule 15c2-12
- Discuss with counsel and financial advisor:
 - Privately placed debt
 - SRF loans
 - Lease-purchase agreements
 - Lines of credit
 - Installment purchase contracts

Consequences of failures to disclose

- SEC action
 - Well-staffed enforcement unit since 2010: “Public Finance Abuse Unit” (attorneys, financial analysts, accountants)
 - Increased focus on municipal market
 - Dodd-Frank and civil fines
 - SEC need not show loss or financial harm to investors
- Municipal Continuing Disclosure Cooperative Initiative (MCDC) in 2014
 - Underwriters and Issuers self-reported violations
 - 72 issuers from 45 states settled (no financial penalties)
 - 72 underwriters representing 96% of the underwriting volume settled (\$18 million in fines)

Underwriter Considerations

- Filing of Secondary (Continuing) Disclosure is Critical for Market Access
 - While the SEC does not regulate issuers, they do regulate the underwriter;
 - Underwriters required to review five years of disclosure filings (internally or through a third party);
 - Third party services are reviewing audits and raising questions of financial obligations that appear in audit;
 - Often these questions come the day before or day of a competitive sale, due to the nature of a tighter timeline in the competitive market.
 - Failure to respond to these questions may result in an underwriter passing on your debt
 - History of “untimely” filings may keep an underwriter from bidding on your debt

Underwriter Considerations (2)

- Early POS posting facilitates sufficient time for internal approvals;
- Electronic platforms increase market awareness;
- Additional key items likely to preclude bidding;
 - Material Litigation
 - Failure to disclose any non-compliance with 15c2-12 in your official statement
 - Pattern of Untimely Annual Audit filings
- In a negotiated sale, the due diligence process can provide an added layer of disclosure transparency;
- A working group due diligence call can provide a forum to examine offering disclosure;
- If a due diligence call is held, it is typically just prior to the release of the POS

Underwriter Considerations (3)

- On negotiated sales, the underwriter will work with the issuer, municipal advisor and bond counsel to help the issuer comply with its prior continuing disclosure obligations
- The underwriter must have a reasonable basis to believe that the issuer will be able to meet its continuing disclosure requirements going forward
- Remedies may include
 - Hiring a dissemination agent to help the issuer meet filing deadlines
 - DAC and other services can help issuers review in detail all the required disclosures and develop a plan to help the issuer remedy all the prior failures
 - Issuers must fully disclose its prior failures and provide an explanation on its processes to ensure future compliance on its offering document

Best Practices

- Disclosure controls and training
 - SEC recommends; requires in settlements
 - Minimize risk
 - Defense
- Disclosure policy
 - Disclosure coordinator
 - Outside counsel
 - Materiality standard
 - “Financial obligations” authority/review
 - Annual policy review
- Consistency as to information and deadlines

Questions?

ALEXANDER SHIH
Managing Director

Public Finance / Debt Investment Banking
T 646.557.1541 // C & Texting 917.877.0830
alexander.shih@raymondjames.com
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MATTHEW PAGE
Member / Chair, Public Finance

T 617.348.1825
mpage@mintz.com
One Financial Center
Boston, MA 02111
www.mintz.com/industries-practices/public-finance