

# PRIMARY AND SECONDARY DISCLOSURE

WHAT TO KNOW AND HOW WELL DO YOU KNOW IT?

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Dinsmôre



# Today's Presenters



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## Today's Agenda

- Primary Disclosure v. Secondary Disclosure
- Disclosure Don'ts – Real World Examples
- How Well do you Know the Disclosure Rules?
  - Quiz Time!

# Primary Disclosure

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v.

# Secondary Disclosure

# History Lesson!

- Disclosure Regulations come from the Securities Act of 1933 and the Securities Exchange Act of 1934 (the "Securities Acts")
- The Securities Act of 1933 (the '33 Act)
  - Regulates primary market transactions (initial sales of securities by issuers to underwriters)
- The Securities Exchange Act of 1934 (the '34 Act)
  - Primarily regulates secondary market transactions
  - Rule 15c2-12





# History of the '33 Act

- Enacted on May 27, 1933 during the Great Depression after the stock market crash of 1929
- Requires every offer or sale of securities that uses the means and instrumentalities of interstate commerce to be registered with the SEC (unless an exemption from registration exists)
- AKA the Securities Act, the Truth in Securities Act, the Federal Securities Act



# History of the '34 Act

- Enacted June 6, 1934
- Governs the secondary trading of securities in the U.S.
- Created the U.S. Securities and Exchange Commission (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
- Rule 15c2-12 promulgated under the '34 Act



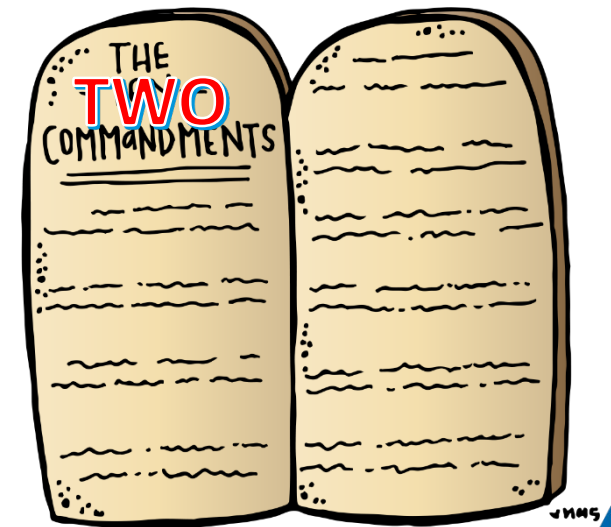
# The Guiding Principles of the Securities Acts

- **TELL THE TRUTH**

- Issuers publicly offering securities for investment must tell the public the truth about their businesses/enterprises, the securities they are selling, and the risks involved in investing

- **TREAT INVESTORS FAIRLY AND HONESTLY**

- Those who sell and trade securities – brokers, dealers and exchanges – must treat investors fairly and honestly, putting investors' interests first





# How Munis Fit in 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, but...
  - Not exempt from the anti-fraud provisions of the Securities Acts
- The “Tower Amendment” included in the 1975 amendments to the '34 Act
  - Created the Municipal Securities Rulemaking Board (MSRB)
  - Prohibits both the SEC and MSRB from directly or indirectly requiring issuers of municipal securities to file documents with the SEC and the MSRB prior to a sale
  - MSRB does not have jurisdiction to regulate issuers of municipal securities

# But Are Municipal Issuers/Obligated Persons Actually Regulated?

- Directly subject to the Anti-Fraud Provisions of the Securities Acts
- In large part, indirectly . . .
- But indirectly how???



# SEC RULE 15c2-12

- Rule 15c2-12 (the “Rule”): governs primary offering disclosure AND continuing disclosure, including submission of annual financial information and material event notices
- Primary offering of municipal securities in the principal amount of \$1 million or more, subject to exemptions
- The Rule **directly** regulates underwriters, but **indirectly** regulates issuers and obligated persons.



# Primary Forms of Regulation of “Obligated Persons”

## “Obligated Person”

- Issuer of municipal securities, or any person committed by contract or other arrangement to support payment of all, or part, of the obligations on municipal securities (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities)

## Regulation

- Directly through anti-fraud provisions of the '33 Act and the '34 Act
- Indirectly by SEC/MSRB regulation of broker-dealers, banks, and financial advisors

# Anti-Fraud Provisions



## Anti-Fraud Provisions

- Section 17(a) of the '33 Act and Section 10(b) of the '34 Act (Rule 10b-5 under the '34 Act)

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

- Regulates primary market transactions (i.e. primary disclosure)
- 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
  - ✧ What makes a fact material?



# Text of Section 17(a) of the '33 Act

- Section 17(a) of the '33 Act

✱ 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:

- to employ any device, scheme or artifice to defraud, or
- 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
- to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser

# Section 10(b) of the '34 Act

- 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”

# Rule 10(b)(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:
  - \* employ any device, scheme or artifice to defraud,
  - \* 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
  - \* engage in an act, practice or course of business which operates or would operate as a fraud or deceit upon any person

# Primary Disclosure

- Disclosures made when bonds are issued (or remarketed)
  - Done through a public offering (i.e. offering document, oftentimes referred to as a “[preliminary] official statement”)
  - The POS is used to market bonds prior to signing a bond purchase agreement (BPA) 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...
    - ✧ Which are completed in the final OS...
    - ✧ Such as pricing information

## NEW ISSUE BOOK-ENTRY ONLY

**Ratings**  
S&P AA-  
Moody's A2  
(See "RATINGS")

*In the opinion of Squire Patton Boggs (US) LLP, Bond Counsel, under existing law, interest on the Series 2021 Bonds is not excluded from gross income for federal income tax purposes, and interest on, and any profit made on the sale, exchange or other disposition of the Series 2021 Bonds is exempt from all Ohio state and local taxation, except the estate tax, the domestic insurance company tax, the dealers in intangibles tax, the tax levied on the basis of the total equity capital of financial institutions, and the net worth base of the corporate franchise tax. For a more complete discussion of the tax aspects, see **Tax Matters** herein.*



**CITY OF CLEVELAND, OHIO**  
**\$13,210,000**  
**Taxable Economic and Community**  
**Development Revenue Bonds, Series 2021 (Core City Fund)**

**Dated:** Date of Delivery

**Due:** December 1, as shown on the inside front cover page

The Series 2021 Bonds are special obligations of the City of Cleveland (the "City"), issued to (i) pay the costs of certain economic and community development projects as described herein and (ii) pay the costs of issuance of the Series 2021 Bonds. See **"AUTHORIZATION AND PURPOSE OF THE SERIES 2021 BONDS."** The Series 2021 Bonds will be initially issued only as fully registered bonds, one for each maturity, issuable under a book-entry only system, initially registered in the name of The Depository Trust Company ("DTC") or its nominee. There will be no distribution of the Series 2021 Bonds to the ultimate purchasers. The Series 2021 Bonds will be in certificated form and as such will not be transferable or exchangeable, except for transfer to another nominee of DTC or as otherwise described in this Official Statement. See **"APPENDIX B – BOOK ENTRY ONLY SYSTEM; DTC."**

The principal of, premium, if any, and interest on the Series 2021 Bonds, unless paid from other sources, are to be paid from the Nontax Revenues and the Net Project Revenues of the City identified herein. The Series 2021 Bonds will be issued and secured under the provisions of the Trust Indenture dated as of December 15, 2003, as amended by the Second Supplemental Trust Indenture, dated as of July 1, 2008, and the Third Supplemental Trust Indenture, dated as of January 1, 2010 (collectively the "Trust Indenture"), as supplemented by the Eighth Supplemental Trust Indenture, dated as of November 1, 2021, each between the City and U.S. Bank National Association, as trustee (the "Trustee"). See **"SECURITY AND SOURCES OF PAYMENT."**

*Interest on the Series 2021 Bonds is payable semiannually on each June 1 and December 1, beginning June 1, 2022. Principal and any premium will be payable to the registered owner upon presentation and surrender of the Series 2021 Bonds at the designated corporate trust office of U.S. Bank National Association, as the Trustee and Bond Registrar.*

**THE SERIES 2021 BONDS ARE SPECIAL OBLIGATIONS OF THE CITY AND WILL NOT REPRESENT OR CONSTITUTE A GENERAL OBLIGATION DEBT OR A PLEDGE OF THE FAITH AND CREDIT OR TAXING POWER OF THE CITY, THE STATE OF OHIO OR ANY POLITICAL SUBDIVISION OR OTHER LOCAL AGENCY THEREOF. THE HOLDERS OF THE SERIES 2021 BONDS WILL NOT HAVE THE RIGHT TO HAVE EXCISES OR TAXES LEVIED BY THE CITY, THE STATE OF OHIO OR THE TAXING AUTHORITY OF ANY OTHER POLITICAL SUBDIVISION THEREOF FOR THE PAYMENT OF PRINCIPAL OF AND INTEREST ON THE SERIES 2021 BONDS.**

The Series 2021 Bonds are subject to redemption prior to maturity as described herein. See **"DESCRIPTION OF THE SERIES 2021 BONDS – Redemption Provisions."**

The Series 2021 Bonds are offered when, as and if issued by the City and accepted by the Underwriters, subject to the opinions on certain legal matters relating to their issuance of Squire Patton Boggs (US) LLP, Bond Counsel, and certain other conditions. Certain legal matters will be passed upon for the City by Barbara A. Langhenry, its Director of Law, and for the Underwriters by their counsel, Wilkerson & Associates Co., LPA. It is expected that delivery of the Series 2021 Bonds will be made on or about November 17, 2021.

**Huntington Capital Markets**

**PNC**

The date of this Official Statement is November 3, 2021, and the information speaks only as of that date.

# Secondary Disclosure

- Also known as “Continuing Disclosure”
- Disclosure that occurs after the issuance of the bonds for the purposes of the secondary market
- Governed by a Continuing Disclosure Undertaking/Continuing Disclosure Agreement (CDU/CDA)



# Continuing Disclosure Undertakings



- Persons subject to Rule 15c2-12 (Obligated Persons) must enter into an undertaking to provide continuing disclosure
  - Obligated Person = Issuer of municipal securities, or any person committed by contract or other arrangement to support payment of all, or part, of the obligations on municipal securities (other than providers of municipal bond insurance, letters of credit, or other liquidity facilities)
  - Each debt issuance subject to Rule 15c2-12 will have its own CDU/CDA
    - ✱ CAN'T ASSUME ALL CDAs FOR AN OBLIGATED PERSON ARE IDENTICAL

# What Needs to be Provided?

- Three general categories of information must be disclosed pursuant to SEC Rule 15c2-12(b)(5)(i) by the deadlines indicated below:
  1. **Audited financial statements\***
    - 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

# 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

## Continuing Disclosure Material Events

	Events	Materiality
8	Bond calls and tender offers	If <u>material</u>
9	Defeasances	Without regard to materiality
10	Release, substitution, or sale of property securing repayment of the securities	If <u>material</u>
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 <u>material</u>
14	Appointment of a successor or additional trustee or the change of name of a trustee	If <u>material</u>

## 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	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*	



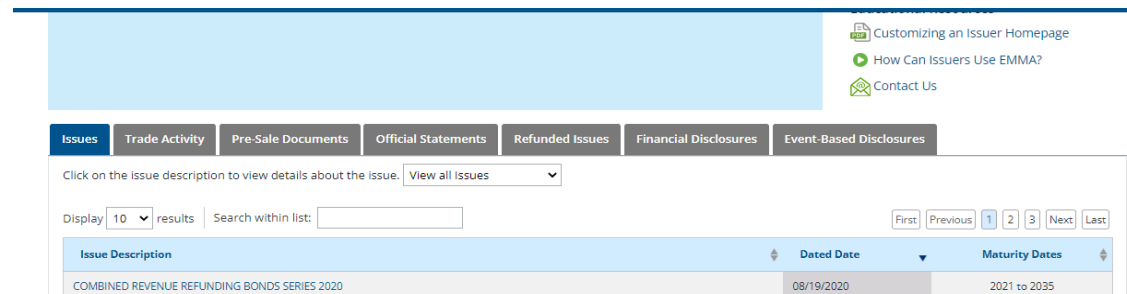
# WHERE DOES IT NEED TO BE PROVIDED?

- Continuing Disclosure filings are made on EMMA



- Serves as a national repository for, among other things:

- ✧ Municipal securities disclosure documents (POS/OS)
- ✧ Continuing disclosure
- ✧ Real-time municipal bond trade price information
- ✧ Trading activity



- 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

# Disclosure Don'ts

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# CONSEQUENCES OF FAILURE TO COMPLY WITH CONTINUING DISCLOSURE OBLIGATIONS

- 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.

# Consequences for Issuers

- 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, SEC brought actions against County, certain County officials and employees for failing to disclose the risks involved with potential investment losses
- SEC issued 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: TELL THE TRUTH – CANNOT DISREGARD WHAT IS KNOWN WHEN REVIEWING THE DISCLOSURE DOCUMENT**

# Consequences for Issuers (Continued)

- 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
- 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: SEC MAY SEEK FINANCIAL PENALTIES AGAINST EMPLOYEES OF ISSUER**



# Consequences for Issuers (Continued)

- **Anthony Michael Holland – CAO of Johnson City, Texas (2022)**
  - Holland embezzled funds from the City and marked up the financial statements to cover it up—financial statements were posted on EMMA to comply with continuing disclosure requirements
- **In the Matter of City of Harrisburg, PA**
  - Public statements/info on City website along with budget and fiscal reports made during a 2-year period misrepresented and omitted to state material information regarding City's deteriorating financial condition and credit ratings downgrades
  - During same period, no continuing disclosure filings were posted on EMMA

**TAKEAWAY: CONTINUING DISCLOSURE DOCUMENTS ARE ALSO SUBJECT TO ANTIFRAUD PROVISIONS—EVEN IF NOT POSTED ON EMMA AS PART OF CONTINUING DISCLOSURE FILING, STILL SUBJECT TO SEC SCRUTINY**

# Consequences for Underwriters

- The SEC has charged seven firms with violating the limited offering exemption under Rule 15c2-12 over the past two years
- As discussed previously, Rule 15c2-12 requires certain disclosures to investors, but there is an exception for “limited offerings”
- To qualify for the limited offering exemption, the offering must be sold in denominations of \$100,000 or more and sold to no more than 35 investors that the underwriter *reasonably believes*.
  - (1) have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and the risks of the prospective investment, and
  - (2) are not purchasing for more than one account or with a view to distributing the securities.





## Consequences for Underwriters (Continued)



- In enforcement actions against 3 underwriters in 2022, the SEC noted that the underwriters sold securities to broker-dealers without a reasonable belief that the broker-dealers were purchasing the securities for investment and not distribution
- The underwriters did not provide the investors with copies of a preliminary or final official statement and did not confirm that a continuing disclosure undertaking had been entered into
- These enforcement actions have all come down to “reasonable belief” – meaning that the underwriters did not undertake necessary investigation or have necessary policies and procedures in place to ensure they were selling the securities to qualified investors for investment and not further distribution
- The penalties for these violations included the paying of disgorgement fees ranging from \$40,000 to \$656,000

# How Well Do You Know The Disclosure Rules?

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# Question #1

- Issuer X is offering its sewer system bonds pursuant to a POS and states in the POS that the sewage treatment plant employs 25 full-time employees when in actuality it employs 20 full-time employees. Issuer employee who provided this information for inclusion in the POS used their “best guess” as to the number of employees working at the plant when they could have looked to official records for an accurate count. Is this likely to trigger the anti-fraud rules?



# Question #2

- Issuer X decides instead to issue its sewer bonds, but rather than use an OS, local bank now offers to purchase the debt in a private sale. Is Issuer X required to enter into a CDA in connection with the sale of the debt to the local bank?



# Question #3

- Issuer Y is selling its equipment bonds publicly through an underwriter (with an OS). The principal amount of the bonds is \$950,000. Is this financing subject to the Rule (Rule 15c2-12)? Is it subject to the Securities laws and regulations?





# Questions #4-5

- Issuer Z issued bonds in the amount of \$5 million in 2023 (“2023 Bonds”), which were sold privately to a single bank purchaser (“Local Bank”). In 2024, Issuer Z failed to make one of its semi-annual principal and interest payments to Local Bank. There is no continuing disclosure agreement (“CDA”) in place with respect to the 2023 Bonds. However, Issuer Z does have another CDA in place with respect to different bonds that were sold pursuant to an OS in 2020 (“2020 Bonds”).
  - ✦ If no filings were made by Issuer Z after the issuance of the Series 2023 Bonds, would Issuer Z have complied with the Rule given that they did not have a CDA for the 2023 Bonds?
  - ✦ Is there anything that Issuer Z should have or will need to disclose with respect to the 2020 Bonds or the 2023 Bonds, and if so, when?



# Questions?

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