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DISCLOSURE TRENDS: DEVELOPMENTS IN PRIMARY AND SECONDARY DISCLOSURE

STAYING AHEAD OF THE CURVE

OCTOBER 11, 2023

BEGIN 

Today's Presenters



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Today's Agenda

- **Primary Disclosure v. Secondary Disclosure**
- **Hot Topics in Disclosure**
 - ESG
 - Cybersecurity
 - COVID
 - Financial Data Transparency Act
- **Disclosure Don'ts – Real World Examples**

Primary Disclosure

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



"It may seem dull to you now, Harry, but at one time, everything in that book was breaking news."

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



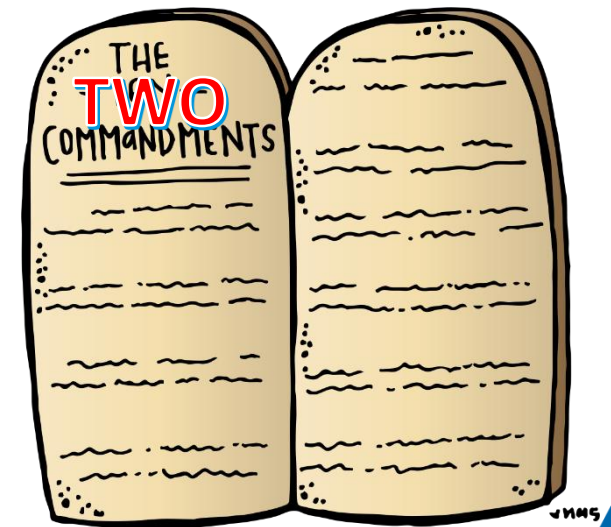
The Guiding Principles of the Securities Acts

- **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?

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

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*	

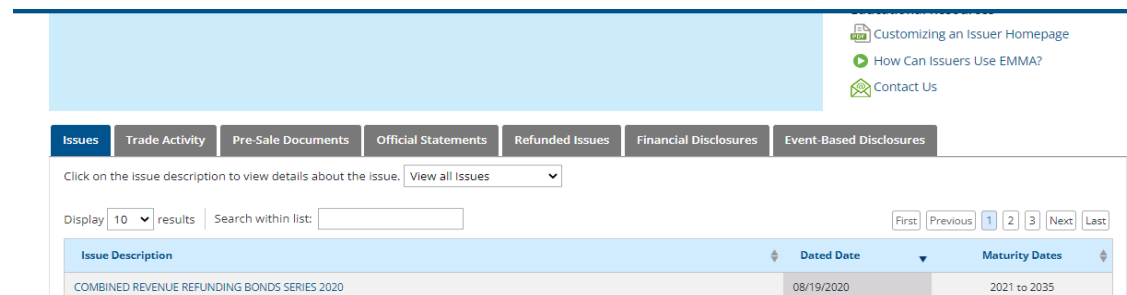
WHERE DOES IT NEED TO BE PROVIDED?

- **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



R-E-S-P – ESG!

- ESG Bonds are a growing trend in the market
- ESG = **E**nvironmental, **S**ocial and **G**overnance
- ESG muni bonds raise money to finance government projects that have a positive environmental or social impact
- The government entity issues a non-binding verbal commitment to its investors to meet certain, pre-set social or environment goals.



Disclosure for Green Bonds

- No official regulatory requirements for ESG/Green disclosure
- Remember “Two Commandments”
 - Tell the Truth
 - Treat Investors Fairly and Honestly
- If issuing ESG Bonds, information is typically included in the OS about the criteria used by the issuer to justify the ESG label on the bonds

Sample Official Statement for ICMA Sustainability Bonds and Green Bonds Found on EMMA

**RATING: S&P: “AA+”
See “RATING” herein.**

In the opinion of [Law Corp.], Bond Counsel, subject, however to certain qualifications described herein, under existing law, the interest on the Refunding Bonds is excluded from gross income for federal income tax purposes and such interest is not an item of tax preference for purposes of the federal alternative minimum tax. The interest on the 2020 Measure O Bonds is not excluded from gross income for federal income tax purposes. In the further opinion of Bond Counsel, interest on the Bonds is exempt from personal income taxes. Bond Counsel expresses no opinion regarding any other tax consequences caused by the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. See “LEGAL MATTERS – Tax Exemption.”

\$38,000,000 CITY ISSUER 2020 General Obligation Bonds (2018 Election Measure O: Affordable Housing) (Federally Taxable) (Sustainability Bonds)	\$7,790,000 CITY ISSUER 2020 Refunding General Obligation Bonds, Series A 2008 Election Measure FF: Neighborhood Branch Library Improvements Project) (Green Bonds)
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 The Sustainability Bond Guidelines

 The Green Bond Principles

The Future of ESG Disclosure Regulation

- The MSRB issued a Request for Information (RFI) on ESG Practices and published a summary of the responses in August 2022 (available on the MSRB's website)
- General consensus: ESG practices in the municipal market are still evolving and regulatory action is premature
- Some comments pointed to improving the EMMA (Electronic Municipal Marketplace Access) site to include specific categories on EMMA to file ESG disclosures
- MSRB is continuing to monitor emerging ESG practices as it contemplates regulation



Cybersecurity

- Cyberattacks are a growing risk for municipal issuers and often entail a significant cost
- Moody's Investors Service reported that the median cyberattack for a public administration entity costs \$1.5 million
- Roughly 100 state and local governments are victims of cyberattacks every year
- Typically seen as a Primary Disclosure Item
- Bond Buyer articles



Considerations for Cybersecurity Disclosure

- There is no rule-based requirement for municipal issuers to disclose cybersecurity incidents under Rule 15c2-12
- Issuers can choose to disclose incidents through voluntary event notices on EMMA
- Issuers can report significant cybersecurity incidents through primary disclosure in their offering documents
- Issuers can also disclose things such as cybersecurity policies and procedures and cybersecurity insurance in offering documents
- Remember the Two Commandments



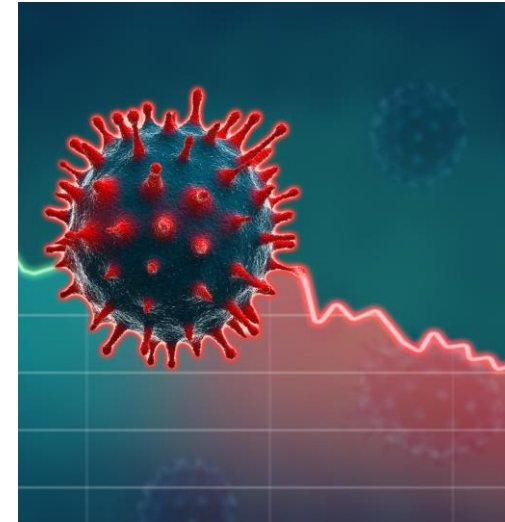
SEC's Proposed Rule 10

- In March of 2023, the SEC proposed a new rule to address cybersecurity risks for all market entities, including broker dealers and the Municipal Securities Rulemaking Board
- If implemented, the rule would require entities to establish, maintain and enforce policies and procedures for cybersecurity
- Covered entities would also be required to notify the SEC and investors if a significant cybersecurity incident occurs
- The comment period on the proposed rule has closed and it is unclear if the SEC will finalize the regulation



COVID – Can We Stop Talking about It?

- To the extent COVID-19 is affecting the issuer so as to trigger a “Material Event,” then disclosure is required
- Necessary to file a voluntary notice or to include in the official statement?
 - Will depend on each individual issuer’s population and how the issuer was affected by the pandemic



Financial Data Transparency Act

- The Financial Data Transparency Act (“FDTA”) was enacted on December 23, 2022
- Requires regulatory agencies, like the SEC, to issue new rules creating more uniformity and standard reporting practices for financial disclosure information, such as the information reported by issuers and obligated persons on EMMA
- Will require that information posted on EMMA be structured so that it is fully searchable through the use of identifier codes or tags (i.e., structured data)
- Once the rules are finalized, the FDFTA may significantly change the way information is posted to EMMA
- The FDFTA gives the SEC two years to develop and publish rules through a joint rulemaking process
- The SEC will be seeking comments from issuers and other municipal market participants



Disclosure Don'ts





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

Questions?



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