

City of San Diego City Council

Disclosure Responsibilities under the Federal Securities Laws

John M. McNally
Hawkins Delafield & Wood LLP
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Brief Chronology

- City's disclosures to investors and rating agencies in 2002-2003, relating to pension plan liabilities, were determined by the Securities and Exchange Commission to be materially misleading in violation of the federal securities laws.
- City adopted Disclosure Ordinance in 2004 as part of Municipal Code. Disclosure Ordinance establishes the Disclosure Practices Working Group (DPWG) and directs the City Attorney to hire a Deputy City Attorney for Finance and Disclosure.
- City engaged outside law firm in March 2004 to serve as General Disclosure Counsel.

Brief Chronology (cont'd.)

- General Disclosure Counsel has conducted securities law training biannually, commencing with staff training in 2004. Training is now separately conducted for City staff, City Council, and the Mayor's Office.
- City settled with the SEC in 2006 (Administrative Proceeding; cease-and-desist order). Order concludes that “certain city officials knew or were reckless in not knowing that the Disclosures [regarding pension liabilities] were false and misleading.”
- DPWG adopts “Disclosure Controls and Procedures.”

Disclosure Responsibilities

- WHY review
- WHAT to review; and
- HOW to review

Key City Disclosures

	City's Investor Website	EMMA
Preliminary and final Official Statements	✓	✓
Comprehensive Annual Financial Reports (CAFRs)	✓	✓
Annual Reports (15c2-12)	✓	✓
Material Event Notices	—	✓
Gen Fund Cash Flow Summaries	✓	—
Rating Agency Presentations; Investor Presentations	—	—
Bond Closing documents (e.g., Tax Certificate)	—	—

SEC Jurisdiction in Municipal Securities Arena

- no securities registration
- antifraud provisions apply
- regulate municipal securities brokers and dealers (Rule 15c2-12)
- regulate municipal advisors

Disclosure Contexts

- primary
 - Preliminary and final Official Statements
- secondary
 - Rule 15c2-12 Continuing Disclosure Agreements
 - Voluntary Filings
 - Investor Information Webpage
 - Certifications relied upon by bond counsel for tax exemption purposes

Rule 15c2-12

- Rule applies to broker-dealers acting as underwriters of the City's bonds, and not to the City directly
- But City has entered into, and will be entering into, Continuing Disclosure Agreements, to allow broker-dealers to meet Rule 15c2-12
- Paragraph (b)(5) – underwriter must reasonably determine that City will provide, for the life of the bonds, “annual financial information” and notices of specified events respecting the bonds
- Concern – if City were not to comply, underwriter may not be able to reach “reasonable determination” for future bond offerings

Disclosure Standard

- Rule 10b-5
 - “unlawful for any person . . . to make any untrue statement of a material fact or to 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”

Disclosure Standard

- Material
 - “substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable [investor].”

SEC Enforcement Actions

- the governmental issuer (as entity)
- individual members of the City Council
- governmental officials and employees
- third parties (e.g., underwriters, financial advisors, bond counsel)

Litigation

- SEC
 - administrative
 - civil
 - criminal (referral to Department of Justice)
- Private Plaintiff

Rights of Action

- Rule 10b-5 of 34 Act – fraudulent intent or recklessness
- Section 17 of 33 Act (SEC only)
 - (a)(1) - fraudulent intent or recklessness
 - (a)(2); (a)(3) - negligence

Orange County Report

- “a public official may not authorize disclosure that the official knows to be false”
- “nor may a public official authorize disclosure while recklessly disregarding facts that indicate that there is a risk that the disclosure may be misleading”

Orange County Report

- *What is acting recklessly?*
 - public official has knowledge of facts bringing into question the issuer's ability to repay the securities
 - fails to take steps appropriate under the circumstances to prevent the dissemination of materially false or misleading information regarding those facts

Orange County Report

- “such steps could have included becoming familiar with the disclosure documents and questioning the issuer’s officials, employees or other agents about the disclosure of those facts.”

Disclosure Process

- Disclosure Ordinance (O-19320, Oct. 11, 2004)
 - established the City's Audit Committee
 - directive to establish Disclosure Controls and Procedures
- Deputy City Attorney for Finance and Disclosure

Disclosure Process

- Disclosure Practices Working Group
 - City Attorney (or designee)
 - Chief Operating Officer (or designee)
 - City Director of Debt Management
 - Chief Financial Officer
 - Deputy City Attorney for Finance and Disclosure
 - Outside General Disclosure Counsel
- Mandatory training for City staff, officials, City Council, and the Mayor
- Written certifications to the City Council by the Mayor and the City Attorney regarding all offering documents

Disclosure Process

- Written certification to the City Council from the CFO for the CAFR
- Periodic (at least annual) evaluation of Disclosure Procedures
- Annual report on Internal Controls
- Accounting – related training for financial staff

Disclosure Process

- Creation of Audit Committee
 - Committee member may attend DPWG meetings at which CAFR considered
- Adoption by DPWG of written Disclosure Controls and Procedures
 - SEC enforcement actions have recently required the adoption of written disclosure controls as a condition of settlement

DPWG Controls and Procedures

- broad definition of “Disclosure Documents”
 - See Section 3.1 of Disclosure Controls and Procedures
- audit trail for each portion of an OS
- model timelines established to review process
- document retention policy
- personal certifications to the City Council by Mayor and City Attorney

Disclosure Certifications

- Official Statements
 - Department Directors to DPWG
 - City Attorney's Office re Litigation
 - CFO to DPWG
 - City Attorney and Mayor to City Council
 - CFO to City Council
- CAFR
 - Department Directors to CFO
 - CFO to City Council

City Council Responsibility for Direct Review

- Official Statements

- CAFRs

City Council Responsibility for Oversight of Review Process

- 15c2-12 Annual filings
- Information provided to Rating Agencies
- Postings on City's Investor Information Webpage or EMMA

Direct Review - Official Statements

- Prepared by the City and provided to investors considering whether to purchase the City's bonds
- An investor needs a comprehensive presentation of all factors that could affect the ability or willingness of the City to pay the principal and interest on the bonds in full when due
- We have separately distributed the cover page and table of contents of a representative Official Statement, and please refer to that now as I highlight a few matters

Direct Review - Official Statements

- Who's involved:
 - City Council – approves OS
 - Mayor and City Attorney – certify accuracy of OS
 - DPWG – reviews and recommends approval of OS
 - Audit Committee – reviews and approves the City's CAFR
 - City staff and Management – provides the information needed to draft the disclosure
 - Third parties – e.g., financial advisors, underwriters, bond counsel, underwriters' counsel, disclosure counsel

Scope of Review (Official Statements)

- *What are relevant portions?*
 - Security and Sources of Payment for the Bonds
 - separate risk disclosure section
 - description of regulatory actions or litigation
 - sections which contain descriptions of material financial concerns

Questions to be Answered

1. What is the purpose of the bond issue?
2. What is the source of payment of the bonds?
3. What are the risks that the source of payment may be insufficient to repay the bonds?
4. Are there any events/factors (e.g., litigation, regulatory fines, pension or OPEB liability) that could pose a material risk to the City's financial position?

Questions (cont'd)

5. Do I have knowledge of any other events that would affect the deliberation of a reasonable investor?
6. Have such risks and events been brought to the attention of our staff, bond counsel and other professionals?
7. Have such risks and events been disclosed, and if not what is the rationale for the non-disclosure?

Questions (cont'd)

8. Has the City contractually agreed to provide continuing disclosure with respect to this bond issue, and if we have, who is responsible and what are the procedures for preparing and distributing this information?
9. In reviewing the “relevant portions” of the OS and CAFR, does it raise for you any “red flags” that should be brought to the attention of the financing team and/or for which I as a Councilmember would like a further explanation?

Direct Review - CAFRs

- Your responsibilities with respect to CAFRs were the subject of a Hawkins memorandum dated May 14, 2007.

City Council Responsibility for Oversight of Review Process

- With respect to 15c2-12 Annual Filings, Rating Agency Presentations, and the Postings on the Investor Information Webpage or with EMMA, in our judgment Council may assume an oversight role

Oversight Questions

1. Am I satisfied that the processes followed in preparing the disclosure document have been reasonably designed to produce accurate and reliable information?
2. Do I have a reasonable basis to have confidence in the integrity and competence of DPWG members?

Oversight Questions *(cont'd)*

3. Do I know anything that would cause me to question the accuracy of the disclosure or that would indicate that there is a risk that those disclosures may be misleading?
4. With reference to the disclosure documents, do I know of any potentially material issues or “red flags” that should be brought to the attention of management or the DPWG or for which I would like further explanation?

Summary

- Various contexts to disclosure
 - primary offerings (Official Statements)
 - disclosure provided pursuant to Continuing Disclosure Agreements
 - Voluntary filings
 - Certifications relied upon by bond counsel for tax exemption purposes

Summary

- Standards

- Materiality

- negligence, recklessness, or intent

Summary

- Steps the City has approved to implement disclosure “best practices”
 - Framework for Council Review or Approval of Disclosure Documents
 - Processes and Guidelines establish defense to any charge of negligence or recklessness
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The End

